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IN THE UNITED STATES PATENT AND TRADEMARK OFFICE
BEFORE THE TRADEMARK TRIAL AND APPEAL BOARD

Proceeding	91176027
Party	Plaintiff Apple Computer, Inc.
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Date	09/20/2010
Attachments	Notice of Reliance_09-20-10.pdf (34 pages)(1778401 bytes) Exhibit 1.pdf (88 pages)(8254262 bytes) Exhibit 2.pdf (85 pages)(8402332 bytes) Exhibit 3.pdf (123 pages)(9648292 bytes) Exhibit 4.pdf (116 pages)(6194395 bytes) Exhibit 5.pdf (98 pages)(5460206 bytes) Exhibit 6.pdf (129 pages)(9359528 bytes) Exhibit 8.pdf (100 pages)(7956642 bytes) Exhibit 7.pdf (99 pages)(7804231 bytes)

IN THE UNITED STATES PATENT AND TRADEMARK OFFICE
BEFORE THE TRADEMARK TRIAL AND APPEAL BOARD

In re Application No. 78/215,335
Filed: February 14, 2003
Published: November 7, 2006 in the Official Gazette
For: **VIDEO POD**

APPLE COMPUTER INC., Opposer vs. SECTOR LABS, LLC, Applicant.	Opposition No. 91176027 **NOTICE OF RELIANCE**

Opposer Apple Inc. ("Apple") submits of record in connection with this opposition proceeding copies of the documents set forth below. Pursuant to a stipulation between Applicant's and Opposer's counsel, internet evidence, including websites, business publications and annual reports, may be introduced into evidence through a Notice of Reliance.[1] Applicant also admitted the authenticity of the documents it produced, thereby stipulating to the admission of such documents through a Notice of Reliance.[2]

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[1] See *Safer Inc. v. OMS Investments Inc.*, 94 USPQ2d 1031, 1039 (TTAB 2010).
[2] See Applicant's Supplemental Response to Opposer's First Requests for Admission.

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
1.	Downloaded on August 27, 2010	Form 10-K – Annual Report for the fiscal year ended September 28, 2002 United States Securities and Exchange Commission http://www.sec.gov/Archives/edgar/data/320193/000104746902007674/a2096490z10-k.htm Relevant pages: 19, 20 and 48	Strength/fame of IPOD mark (sales of iPod player; Apple advertising expenditures)
2.	Downloaded on August 27, 2010	Form 10-K – Annual Report for the fiscal year ended September 27, 2003 United States Securities and Exchange Commission http://www.sec.gov/Archives/edgar/data/320193/000104746903041604./a2124888z10-k.htm Relevant pages: 18, 19 and 48	Strength/fame of IPOD mark (sales of iPod player; Apple advertising expenditures)
3.	Downloaded on August 27, 2010	Form 10-K – Annual Report for the fiscal year ended September 25, 2004 United States Securities and Exchange Commission http://www.sec.gov/Archives/edgar/data/320193/000104746904035975/a2147337z10-k.htm Relevant pages: 30, 31 and 73	Strength/fame of IPOD mark (sales of iPod player; Apple advertising expenditures)
4.	Downloaded on August 27, 2010	Form 10-K – Annual Report for the fiscal year ended September 24, 2005 United States Securities and Exchange Commission http://www.sec.gov/Archives/edgar/data/320193/000110465905058421/a05-20674_110k.htm Relevant pages: 32 and 70	Strength/fame of IPOD mark (sales of iPod player; Apple advertising expenditures)
5.	Downloaded on August 27, 2010	Form 10-K – Annual Report for the fiscal year ended September 30, 2006 United States Securities and Exchange Commission http://www.sec.gov/Archives/edgar/data/320193/000110465906084228/a06-25759_210k.htm Relevant pages: 54 and 82	Strength/fame of IPOD mark (sales of iPod player; Apple advertising expenditures)

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
6.	Downloaded on August 27, 2010	Form 10-K – Annual Report for the fiscal year ended September 29, 2007 United States Securities and Exchange Commission http://www.sec.gov/Archives/edgar/data/320193/000104746907009340/a2181030z10-k.htm Relevant pages: 44, 45 and 67	Strength/fame of IPOD mark (sales of iPod player; Apple advertising expenditures)
7.	Downloaded on August 27, 2010	Form 10-K – Annual Report for the fiscal year ended September 27, 2008 United States Securities and Exchange Commission http://www.sec.gov/Archives/edgar/data/320193/000119312508224958/d10k.htm Relevant pages: 43 and 65	Strength/fame of IPOD mark (sales of iPod player; Apple advertising expenditures)
8.	Downloaded on August 27, 2010	Form 10-K – Annual Report for the fiscal year ended September 26, 2009 United States Securities and Exchange Commission http://www.sec.gov/Archives/edgar/data/320193/000119312509214859/d10k.htm Relevant pages: 43 and 66	Strength/fame of IPOD mark (sales of iPod player; Apple advertising expenditures)
9.	August 28, 2003 (Accessed on August 27, 2010)	**Apple Launches the iTunes Music Store** (Apple press release) http://www.apple.com/pr/library/2003/apr/28musicstore.htm	Relatedness of parties' goods and services; natural zone of expansion for IPOD mark
10.	October 31, 2005 (Accessed on September 7, 2010)	**iTunes Music Store Sells One Million Videos in Less Than 20 Days** (Apple press release) http://www.apple.com/pr/library/2005/oct/31itms.html	Relatedness of parties' goods and services; natural zone of expansion for IPOD mark

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
11.	August 10, 2000 (Accessed on September 7, 2010)	**Lucasfilm and Apple Bring Star Wars: Episode II to Starwars.com and Apple.com** (Apple press release) http://www.apple.com/pr/library/2000/aug/10lucasfilms.html	Relatedness of parties' goods and services; natural zone of expansion for IPOD mark
12.	January 9, 2007 (Accessed on September 3, 2010)	**Apple TV Coming to Your Living Room** (Apple press release) http://www.apple.com/pr/library/2007/01/09appletv.html	Relatedness of parties' goods and services; natural zone of expansion for IPOD mark
13.	September 3, 2010	**The all-new Apple TV** http://www.apple.com/appletv/	Relatedness of parties' goods and services; natural zone of expansion for IPOD mark
14.	October 31, 2001 (Accessed on August 27, 2010)	**Apple Presents iPod** (Apple press release) Ultra-Portable MP3 Music Player Puts 1,000 Songs in Your Pocket http://www.apple.com/pr/library/2001/oct/23ipod.html	Apple's priority of use of mark; strength/fame of IPOD mark (Apple's promotion of iPod player)
15.	April 27, 2004	Certified status and title copy of Trademark Registration No. 2,835,698 – **IPOD**	Ownership and validity of IPOD trademark; priority of use; relatedness of goods and services; natural zone of expansion
16.	May 9, 2006	Certified status and title copy of Trademark Registration No. 3,089,360 – **IPOD**	Ownership and validity of IPOD trademark; priority of use; relatedness of goods and services; natural zone of expansion

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
17.	November 20, 2007	Certified status and title copy of Trademark Registration 3,341,191– **IPOD**	Ownership and validity of IPOD trademark; priority of use; relatedness of goods and services; natural zone of expansion
18.	July 20, 2010	Certified status and title copy of Trademark Registration 3,823,241– **IPOD**	Ownership and validity of IPOD trademark; priority of use; relatedness of goods and services; natural zone of expansion
19.	September 2, 2008	Certified status and title copy of Trademark Registration 3,497,047– **IPOD**	Ownership and validity of IPOD trademark; priority of use; relatedness of goods and services; natural zone of expansion
20.	January 26, 2010	Certified status and title copy of Trademark Registration 3,741,470– **iPod**	Ownership and validity of IPOD trademark; priority of use; relatedness of goods and services; natural zone of expansion
21.	October 14, 2008	Certified status and title copy of Trademark Registration 3,517,722 – **IPOD CLASSIC**	Ownership and validity of IPOD trademark; priority of use; relatedness of goods and services; natural zone of expansion

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
22.	August 19, 2008	Certified status and title copy of Trademark Registration 3,489,972 – **IPOD TOUCH**	Ownership and validity of IPOD trademark; priority of use; relatedness of goods and services; natural zone of expansion
23.	January 2, 2007	Certified status and title copy of Trademark Registration 3,192,683 – **IPOD NANO**	Ownership and validity of IPOD trademark; priority of use; relatedness of goods and services; natural zone of expansion
24.	November 20, 2007	Certified status and title copy of Trademark Registration 3,341,286 – **MADE FOR IPOD & design**	Ownership and validity of IPOD trademark; priority of use; relatedness of goods and services; natural zone of expansion
25.	June 24, 2008	Certified status and title copy of Trademark Registration 3,453,564 – **IPOD SHUFFLE**	Ownership and validity of IPOD trademark; priority of use; relatedness of goods and services; natural zone of expansion
26.	September 7, 2010	Certified status and title copy of Trademark Registration 3,845,303 – **POD**	Ownership and validity of trademark; relatedness of goods and services
27.	June 12, 2007	Reg. No. 3,250,408 for TOSHIBA & design	Natural zone of expansion
28.	October 14, 2008	Reg. No. 3,516,591 for UDRW	Natural zone of expansion
29.	June 26, 2007	Reg. No. 3,256,537 for DOMA	Natural zone of expansion
30.	May 27, 2008	Reg. No. 3,438,063 for LIFEPOINT & design	Natural zone of expansion
31.	December 26, 2006	Reg. No. 3,189,906 for EXAD & design	Natural zone of expansion
32.	January 2, 2007	Reg. No. 3,190,921 for QOOL	Natural zone of expansion

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
33.	March 31, 2009	Reg. No. 3,598,575 for SDHC & design	Natural zone of expansion
34.	March 17, 2009	Reg. No. 3,591,427 for EMOMUSIC	Natural zone of expansion
35.	February 10, 2009	Reg. No. 3,572,850 for EMOREC	Natural zone of expansion
36.	November 25, 2008	Reg. No. 3,537,215 for SISVEL	Natural zone of expansion
37.	October 23, 2007	Reg. No. 3,318,435 for PORTIX	Natural zone of expansion
38.	May 6, 2008	Reg. No. 3,423,070 for FIFA & design	Natural zone of expansion
39.	October 3, 2006	Reg. No. 3,151,152 for ARKAMYS	Natural zone of expansion
40.	December 19, 2006	Reg. No. 3,187,570 for IMMERSE U	Natural zone of expansion
41.	January 2, 2007	Reg. No. 3,194,363 for ASONO	Natural zone of expansion
42.	October 9, 2007	Reg. No. 3,307,400 for SELIO & design	Natural zone of expansion
43.	March 6, 2007	Reg. No. 3,215,023 for DELL & design	Natural zone of expansion
44.	November 29, 2005	Reg. No. 3,021,042 for POLAROID & design	Natural zone of expansion
45.	March 11, 2008	Reg. No. 3,394,790 for TEKNIM & design	Natural zone of expansion
46.	July 13, 2006	MacNewsWorld **Stylish iCessories for Pod People** by Megan H. Chan http://www.macnewsworld.com/story/51739.html Relevant page: 1	Use of POD to refer to Apple iPod player
47.	January 30, 2006	**Opinion – Pod People: The iPod Backlash** http://blogcritics.org/archives/2006/01/30/121345.php by: Pete Blackwell Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
48.	October 31, 2005	**Pod People** by Jerry Pournelle http://www.byte.com/documents/s=9502/byt1130788842972/1031_pournelle.html Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
49.	August 30, 2006	**Musical Perceptions: Pod People** http://musicalperceptions.blogspot.com/2006/08/pod-people.html Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
50.	October 20, 2005	**Turn on, tune in, drop out – today's motto** by Steven Winn http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2005/10/20/DDGLFFADOF1.DTL&hw=ipod+pod&sn=007&sc=603 Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
51.	February 2005	Beverage Industry, v 96, n 2, p 6 Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
52.	August 4, 2006	Campaign, p. 21 **Diary: IPod doctors struggle to restore taste to Burnett**	Similarity of marks; use of POD to refer to Apple iPod player
53.	April 5, 2006	Business Wire **Magpie Outfits are Pod Couture for the iPod; Protective iPod Covers from Magpie are Fun, Functional – and No Two Are Alike**	Similarity of marks; use of POD to refer to Apple iPod player
54.	December 5, 2004	CBS News **Invasion of the (i)Pod People** http://www.cbsnews.com/stories/2004/12/05/sunday/main659126.shtml Relevant pages: 1 and 2	Similarity of marks; use of POD to refer to Apple iPod player

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
55.	February 9, 2004	Village Voice **The Essay – Pod People** **This Valentine's Day, the fastest way to the heart may be through the earbuds** by Izzy Grinspan http://www.villagevoice.com/news/0406,essay,50893,1.html Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
56.	June 2005	Edutopia **Pod People – Teachers find cool new uses for Apple's ubiquitous music player** By Cheri Lucas http://edutopia.org/magazine/ed1article.php?id=Art_1280&issue=jun_05 Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
57.	February 4, 2004	San Francisco Bay Guardian **What-why-where Pod** **When it comes to music and the Internet, the iPod has stolen the show – but no one agrees on what to do for an encore.** by J. H. Tompkins http://www.sfbg.com/38/19/cover_noise_ipod.html Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
58.	December 22, 2004	City Pages, Vol. 25, Issue 1255 by Jim Walsh **What are those little white boxes with wires telling us to do? Christmas of the Pod People** by Jim Walsh http://www.citypages.com/databank/25/1255/article12797.asp; Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
59.	Downloaded August 22, 2006	**I want My Pod TV** http://www.dlo.com/products/homedoc_dxProd.ipl?command=showpage&cart=11553160122340369 Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
60.	July 27, 2005	Ecoustics **Russound Integrates iPods into Multiroom Audio Systems** http://news.ecoustics.com/bbs/messages/10381/150988.html Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
61.	August 5, 2006	Gizmodo **Show Us Your 'Pod Quick Update** http://www.gizmodocom/gadgets/ipod/show-is-your-pod-quick-update-192210.ptp	Similarity of marks; use of POD to refer to Apple iPod player
62.	July 28, 2005	**iPod Friendly – Broadcast Music Throughout the Home** http://www.digitaltechnews.com/news/2005/07/index.html Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
63.	July 27, 2005	Business Wire **Your iPod – Take it or Leave it; Now iPod owners can connect their Apple portable music players to Russound multiroom audio systems** http://www.findarticles.com/p/articles/ml_mOEIN/is_2005_July_27/al.ni4821065	Similarity of marks; use of POD to refer to Apple iPod player

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
64.	May, 2005	Macworld, 22, 5, 18(1) **Apple updates iPod line, drops prices: a pod for everyone** by Peter Cohen; Jim Dalrymple Relevant pages: 1 and 2	Similarity of marks; use of POD to refer to Apple iPod player
65.	August, 2003	Macworld, 20, 8, 23(1) **Speaking at the future** by Christopher Breen	Similarity of marks; use of POD to refer to Apple iPod player
66.	April, 2002	Macworld, 19, 4, 62(7) **Become an iExpert: master apple's digital hub, from iPhoto to the iPod** by Jonathan Seff; Jason Snell Relevant page: 3	Similarity of marks; use of POD to refer to Apple iPod player
67.	February, 2002	Asian Business, v38n2, p. 64 **Working up a storm** by Steven Lewis Relevant page: 2	Similarity of marks; use of POD to refer to Apple iPod player
68.	July 14, 2005	InternetWeek **BadFruit For Pod People; With iPod mania sweeping the nation, someone or something has taken the fanaticism to a new level by releasing their own software program that supports "podcasting" for iTunes**	Similarity of marks; use of POD to refer to Apple iPod player

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
69.	December 27, 2005	CNN News **Eva Longoria Has Brush with the Law; Standards Changing for G-Rated Films; Thieves Target iPod Users; Primetime Smackdown as Shows to Fight it Out – Part 1** by Brooke Anderson; Jason Carroll; Sibila Vargas, Don Lothian, Brian Todd Relevant page: 3	Similarity of marks; use of POD to refer to Apple iPod player
70.	July 25, 2005	CNN News **Man Convicted for Cameron Diaz Nude Photo Scam; Clay Aiken Answers Questions About Charity; iPod Nation: Why Are They So Popular? – Part 2** by A.J. Hammer; Karyn Bryant; Sophia Choi; Paula Zahn; Sibila Vargas Relevant page: 6	Similarity of marks; use of POD to refer to Apple iPod player
71.	July 22, 2005	CNN News **Jury Finds for Polanski in Libel Case; Fashion Editor Fired for Blogging; Courteney Cox Arguette Opens Up About Her Baby Blues – Part 2** by A.J. Hammer; Brooke Anderson; David Haffenreffer; Thomas Roberts Relevant page: 7	Similarity of marks; use of POD to refer to Apple iPod player
72.	November 4, 2005	San Jose Mercury News **iPod, therefore iSpend** by Mike Cassidy	Similarity of marks; use of POD to refer to Apple iPod player
73.	May 2006	Revolution pp 82 **If you want to take up residence on my iPod, keep it real** by Richard Calvert	Similarity of marks; use of POD to refer to Apple iPod player

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
74.	June 2005	Mortgage Technology, v 12, n 4, p 6 **Marketing to the Pod Generation: Gen Yers hate the dark. Those companies that refuse to cough up the information they want will see them head straight for the competitor** Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
75.	July 11, 2006	Newsday **For Pod people, i-cessories** by Megan H. Chan	Similarity of marks; use of POD to refer to Apple iPod player
76.	December, 2005	EContent 28, 12, 7(1) **Take it from me (terrorists shot)** by Michelle Manafy Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
77.	November 7, 2005	Mediaweek, 15, 40, 17(1) **The Pod and i. (iPod is the new age instrument)** by Lewis Grossberger	Similarity of marks; use of POD to refer to Apple iPod player
78.	June 27, 2005	Fortune, v151, n13, p43(1) **It's iPod's revolution: We just live in it** by Andy Serwer	Similarity of marks; use of POD to refer to Apple iPod player
79.	July 29, 2002	The Nation **New Products: Pen power** Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
80.	August 27, 2004	Newswire **Apple mulls iPod mini cameras for UK store**	Similarity of marks; use of POD to refer to Apple iPod player
81.	December 24, 2004	Evening Mail **Gadgets score with players**	Similarity of marks; use of POD to refer to Apple iPod player

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
82.	March 6, 2005	Mail on Sunday **Wired** by Rob Waugh Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
83.	August 22, 2005	**One year-old iPod, still in its box.1.3million songs. One scared 420,000 iPods are lying unused because their owners can't fathom how** by Simon Davis; David Smyth Evening Standard Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
84.	April 17, 2005	**The Spotter** Sunday Star Times, A ed, p12	Similarity of marks; use of POD to refer to Apple iPod player
85.	February 2, 2006	Independent **The Ten Best: iPod accessories** by Mark Harris Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
86.	October 25, 2005	Business Wire **iMiva™ Released! – Now Your iPod® Can Do More; iMiva Software Extends the Fun and Usefulness of iPods for Millions of PC Users** Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
87.	May 16, 2006	Network World **FBI special agent recounts outsourcing horror story; also warns of the dangers of mobile computing security lapses** by Bob Brown Relevant page: 3	Similarity of marks; use of POD to refer to Apple iPod player

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
88.	January 2, 2006	Computerworld, v40nl, pp. 42 **What to do: 2006** by Frank Hayes Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
89.	January 2006	Kiplinger's Personal Finance, v 60nl, pp. 94-96 **In the iPOD Zone** by Sean O'Neill	Similarity of marks; use of POD to refer to Apple iPod player
90.	November 8, 2004	Newsweek U.S. Edition **The Pods Just Keep on Coming – Most significant is the relationship Apple has forged with one of the elite figures of rock and roll** by Steven Levy Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
91.	May 12, 2004	The Courier-Journal **Rockin' the Pod** by Joshua Hammann Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
92.	February 11, 2004	The Village Voice, vol. 49, issue 6 **POD PEOPLE** by Izzy Grinspan Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
93.	August 21, 2002	The Village Voice, vol. 49, issue 6 **PCs in a 'Pod** by Brendan I Koerner Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
94.	January 1, 2005	The News Journal **Pimp my Pod** by Ryan Cormier Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
95.	October 16, 2003	The New York Times **Accessories; Finishing touches For The 'Pod** by Ivan Berger	Similarity of marks; use of POD to refer to Apple iPod player
96.	September 15, 2007	The Courier-Journal **Gizmo; Products, Trends and Technology; Gear Up, Pod pal** Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
97.	July 3, 2006	Forbes, vol. 178, issue 1 **What's on TV? Ask the Pod People** by Scott Woolley	Similarity of marks; use of POD to refer to Apple iPod player
98.	March 7, 2005	Newsweek, U.S. Edition **Technology: Price Dip for Pods** by Steven Levy	Similarity of marks; use of POD to refer to Apple iPod player
99.	May 29, 2005	San Francisco Chronicle **Time to come out of your pod** by John Flinn http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2005/05/29/TRG1QCSL6M1.DTL&hw=ipod+pod&sn=006&sc=669 Relevant page: 1	Similarity of marks; use of POD to refer to Apple iPod player
100.	October, 2004	Macworld, v21, n10, p 58-62 **Rock and Scroll** by Jonathan Seff; Peter Cohen Relevant page: 3	Similarity of marks; use of POD to refer to Apple iPod player
101.		Volkswagen advertisement	Similarity of marks; use of POD to refer to Apple iPod player

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
102.	September 9, 2008 (Accessed on October 2, 2008)	**Apple Introduces New iPod nano** **Fourth Generation iPod nano Features Apple's New Genius Technology** (Apple press release) http://www.apple.com/pr/library/2008/09/09nano.html	Strength/fame of IPOD mark (Apple's promotion of iPod player)
103.	September 9, 2008 (Accessed on October 2, 2008)	**Apple Introduces New iPod touch** **The Funniest iPod Ever – Perfect for Music, Movies & Games** (Apple press release) http://www.apple.com/pr/library/2008/09/09touch.html	Strength/fame of IPOD mark (Apple's promotion of iPod player); similarity of products
104.	February 19, 2008 (Accessed on October 2, 2008)	**iPod shuffle Now Just $49** **New 2GB Model Priced at $69** (Apple press release) http://www.apple.com/pr/library/2008/02/19shuffle.html	Strength/fame of IPOD mark (Apple's promotion of iPod player)
105.	February 5, 2008 (Accessed on October 2, 2008)	**Apple Introduces New iPhone & iPod touch Models** (Apple press release) http://www.apple.com/pr/library/2008/02/05iphoneipodtouch.html	Strength/fame of IPOD mark (Apple's promotion of iPod player)
106.	January 22, 2008 (Accessed on October 2, 2008)	**Apple Adds Pink to the iPod nano Lineup** (Apple press release) http://www.apple.com/pr/library/2008/01/22nano.html	Strength/fame of IPOD mark (Apple's promotion of iPod player)
107.	September 5, 2007 (Accessed on October 2, 2008)	**Apple Introduces All New iPod nano** **World's Most Popular Music Player Now Plays Video** (Apple press release) http://www.apple.com/pr/library/2007/09/05nano.html	Strength/fame of IPOD mark (Apple's promotion of iPod player); similarity of products
108.	September 5, 2007 (Accessed on October 2, 2008)	**Apple Introduces New iPod classic** **New 160GB Model Holds Up to 40,000 Songs** (Apple press release) http://www.apple.com/pr/library/2007/09/05classic.html	Strength/fame of IPOD mark (Apple's promotion of iPod player)

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
109.	September 5, 2007 (Accessed on October 2, 2008)	**Apple Unveils iPod touch Revolutionary Multi-touch Interface & Built-in Wi-Fi Wireless Networking** (Apple press release) http://www.apple.com/pr/library/2007/09/05touch.html	Strength/fame of IPOD mark (Apple's promotion of iPod player)
110.	April 9, 2007 (Accessed on October 2, 2008)	**100 Million iPods Sold** (Apple press release) http://www.apple.com/pr/library/2007/04/09ipod.html	Strength/fame of IPOD mark (Apple's promotion of iPod player)
111.	January 30, 2007 (Accessed on October 2, 2008)	**iPod shuffle Now Available in Five Brilliant Colors** (Apple press release) http://www.apple.com/pr/library/2007/01/30shuffle.html	Strength/fame of IPOD mark (Apple's promotion of iPod player)
112.	November 3, 2006 (Accessed on October 2, 2008)	**Apple Announces New 8GB Model of iPod nano (PRODUCT) RED Special Edition** (Apple press release) http://www.apple.com/pr/library/2006/nov/03nano.html	Strength/fame of IPOD mark (Apple's promotion of iPod player)
113.	October 31, 2006 (Accessed on October 2, 2008)	**Apple's New iPod shuffle Available Worldwide This Friday Most Wearable iPod Ever** (Apple press release) http://www.apple.com/pr/library/2006/oct/31shuffle.html	Strength/fame of IPOD mark (Apple's promotion of iPod player)
114.	October 13, 2006 (Accessed on October 2, 2008)	**Apple Announces iPod nano (PRODUCT) RED Special Edition Portion of Proceeds Contributed to the Global Fund to Fight AIDS** (Apple press release) http://www.apple.com/pr/library/2006/oct/13red.html	Strength/fame of IPOD mark (Apple's promotion of iPod player)
115.	May 23, 2006 (Accessed on October 2, 2008)	**Nike and Apple Team Up to Launch Nike+iPod Global Collaboration Brings the Worlds of Sports & Music Together Like Never Before** (Apple press release) http://www.apple.com/pr/library/2006/may/23nike.html	Strength/fame of IPOD mark (Apple's promotion of iPod player)

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
116.	September 7, 2005 (Accessed on October 2, 2008)	**Apple Introduces iPod nano** (Apple press release) http://www.apple.com/pr/library/2005/sep/07ipodnano.html	Strength/fame of IPOD mark (Apple's promotion of iPod player)
117.		Competitrack advertising analysis document, regarding **Pop and Tunes in your pocket** commercial aired on MTV on March 16, 2006	Strength/fame of IPOD mark (advertising for iPod player)
118.		Competitrack advertising analysis document, regarding **Sparks** commercial aired on ESPN on January 26, 2006	Strength/fame of IPOD mark (Apple's promotion of iPod player)
119.	November 6, 2001 (retrieved from archive.org on August 27, 2010)	http://www.apple.com/ipod/ on November 6, 2001	Strength/fame of IPOD mark (Apple's promotion of iPod player); channels of trade; priority of use
120.	June 12, 2004 (retrieved from archive.org on August 27, 2010)	http://www.apple.com/ipod/ on June 12, 2004	Strength/fame of IPOD mark (Apple's promotion of iPod player); channels of trade
121.	August 27, 2010	http://www.apple.com/ipodclassic/	Strength/fame of IPOD mark (Apple's promotion of iPod player); channels of trade
122.	August 30, 2010	Apple iPod at CircuitCity.com http:/www.circuitcity.com/applications/category/category_tlc.asp?CatId=2539&srkey=ipod	Channels of trade
123.	August 30, 2010	iPod: iPod Touch, iPod Nano, iPod Shuffle, iPod Classic – Best Buy http://www.bestbuy.com/site/olstemplatemapper.jsp?_dyncharset=ISO-8859-1&_dynSessConf=-2...	Channels of trade

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
124.	August 30, 2010	Search results for ipod – Walmart http://www.walmart.com/search/search-ng.do?search_query=ipod&ic=48_0&clicked_tab_value=...	Channels of trade
125.	August 30, 2010	ipod: Target Search Results http://www.target.com/s?keywords=ipod&searchNodeID=1038576%7C...	Channels of trade
126.	August 30, 2010	Amazon.com: Apple, New iPods http://www.amazon.com/gp/search/ref=sr_nr_p_n_condition-type_0?rh=...	Channels of trade
127.	August 30, 2010	Introducing e.Spot at Macy's http:/www1.macys.com/campaign/om/espot.jsp?keyword=ipod	Channels of trade
128.	August 30, 2010	Pods from Apple at Sears.com http://www.sears.com/shc/s/s_10153_12605_Computers%20&%20Elect...	Channels of trade
129.	August 30, 2010	Apple ipod from Kmart.com http://www.kmart.com/shc/s/search_10151_10104?keyword=apple+ipo...	Channels of trade
130.	August 27, 2010	Apple – iPod – Compare iPod models and find the right one for you. **Which iPod Are You?** http://www.apple.com/ipod/compare-ipod-models/	Relatedness of goods and services; natural zone of expansion
131.	October 26, 2004 (Accessed on August 27, 2010)	**Apple Introduces iPod Photo** (Apple press release) **Your Entire Music & Photo Library in Your Pocket** http://www.apple.com/pr/library/2004/oct/26ipodphoto.html	Relatedness of goods and services; natural zone of expansion

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
132.	October 12, 2005 (Accessed on August 27, 2010)	**Apple Unveils the New iPod** (Apple press release) **Fifth Generation iPod Now Plays Music, Photos & Video** http://www.apple.com/pr/library/2005/oct/12ipod.html	Relatedness of goods and services; natural zone of expansion
133.	October 16, 2005 (Accessed on archive.org on August 27, 2010)	http://www.apple.com/ipod/ipod.html on October 16, 2005	Relatedness of goods and services; natural zone of expansion
134.	June 3, 2007 (Accessed on archive.org on August 27, 2010)	http:// www.apple.com/ipod/ipod.html on June 3, 2007	Relatedness of goods and services; natural zone of expansion
135.	August 27, 2010	**MFi Program – Apple Developer** http://developer.apple.com/programs/mfi/	Relatedness of goods and services; natural zone of expansion
136.	January 12, 2009	Apple Store website http://store.apple.com/us/browse/home/shop_ipod?mco=MTE3MDk	Relatedness of goods and services; natural zone of expansion
137.	August 27, 2010	Apple Store website http://store.apple.com/us/browse/home/shop_ipod/ipod_accessories/speakers?mco=MTM3NTAyNTI	Relatedness of goods and services; natural zone of expansion
138.	August 27, 2010	**Optoma Pico PK-101 Pocket Projector for iPhone/iPod** http://store.apple.com/us/product/TV748ZM/A?fnode=MTY1NDA3NA&mco=MTA4NzQ3Njc#overview	Relatedness of goods and services; natural zone of expansion

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
139.	January 8, 2007	**Viewsonic Super Sizes Digital Content with World's First Fully-Featured, High Definition, DLP® Projector with Integrated iPod Dock** http://www.viewsonic.com/...ews/viewsonic-super-sizes-digital-content-with-worlds-first-fullyfeatured-high-definition-dlp174-projector-with-integrated-ipod-dock.htm	Relatedness of goods and services; natural zone of expansion
140.	August 27, 2010	**Microvision SHOWWX™ Laser Pico Projector: Overview** http://www.microvision.com/showwx/overview.html	Relatedness of goods and services; natural zone of expansion
141.		Apple IPOD print advertising summary (2001-2006)	Strength/fame of IPOD mark (advertising for iPod player)
142.	September 7, 2010	Apple Retail Store – Store List http://www.apple.com/retail/storelist/	Channels of trade; geographic extent of use
143.	February 2, 2004	Business Week **Show Time** by Peter Burrows	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
144.	May 12, 2003	Fortune **Songs in the Key of Steve Jobs may have created the first great legal online music service. That's got the record biz singing his praises** by Devin Leonard http://money.cnn.com/magazines/fortune/fortune_archive/2003/05/12/342289/index.htm	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
145.	July 26, 2004	Newsweek **iPod Nation** by Steven Levy	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
146.		Digital Domain **After 20 Years, Finally Capitalizing on Cool** by Randall Stross	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
147.	October 25, 2001	L.A. Times **Apple's iPod: More Music for More Money** **The sleek $400 player uses a high-capacity hard drive instead of memory chips** by Jon Healey	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
148.	October 29, 2001	San Francisco Chronicle (CA) **Apple's iPod Has Its Charms** by Henry Norr	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
149.	November 1, 2001	The Wall Street Journal **Apple Brings Its Flair For Smart Designs To Digital Music Player** By Walter S. Mossberg	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
150.	November 8, 2001	Philadelphia Inquirer (PA) **Apple iPod has everything but a belt clip** by Jon Fortt	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
151.	November 15, 2001	New York Post **iPod is Tops ... But is it Worth $399?** by Mary Huhn	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
152.	November 29, 2001	Los Angeles Times **Mac Focus – Visions of Toasters and iPods Dance in Their Heads** by Jim Heid	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
153.	December 9, 2001	South Florida Sun-Sentinel **iPod by Apple Computer Inc.** by James Coates	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
154.	December 17, 2001	Star Tribune (Minneapolis, MN) **THE ipod! The technology in a new little device no bigger than a deck of cards promises to dramatically change the way we listen to music. And, oh yeah, it's from Apple.** by K. J. Peterson	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
155.	March 15, 2002	Oregonian (Portland, OR) **Living Smart Home Tech Hardware iPod Music Player** by Wayne Thompson	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
156.	July 17, 2002	Newsday (USA) **Apple Opens Windows to iPod / Makes popular music player Microsoft-compatible** by Monty Phan	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
157.	July 25, 2002	The Wall Street Journal **iPod Does Windows, So Now All Music Fans Can Use Top Player** by Walter S. Mossberg	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
158.	July 29, 2002	San Francisco Chronicle **Review iPod's on the Prize – Apple's Portable Jukebox is the Class of the Field** by Benny Evangelista	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
159.	August 18, 2002	New York Times **Boite; 2 iPods and a Microphone** by Julia Chaplin	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
160.	October 31, 2002	Chicago Tribune **On Target with iPod** Edited by Cara DiPasquale and Kris Karnopp	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
161.	September 6, 2002	The News-Press (Fort Myers, FL) **Apple serves up a hit with iPod**	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
162.	January 12, 2003	Philadelphia Inquirer **The ear-opening possibilities of the iPod** by Tom Moon	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
163.	January 17, 2003	Philadelphia Inquirer **Mix master iPod makes music of juxtapositions** by Tom Moon	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
164.	December 22, 2003	Advertising Age **The Book of 10s: 10 Most Successful Product Launches: From iPod to 'Lord of the Rings'**	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
165.	January 5, 2004	USA Today **Ads for iPods offer big music gift in small package** by Theresa Howard	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
166.	February 23, 2004	Fortune **2 Role Changing Roils Tech; Convergence, long a discredited buzzword, finally lives up to its hype, Apple, HP, and Dell won't look the same** by Fred Vogelstein	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
167.	March 2004	Macworld (Center of Attention) **iPod mini, iLife '04 Expand Apple's Digital Hub** By Philip Michaels, Jonathan Seff, Jason Snell, Kelly Lunsford	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
168.	August 2, 2004	Newsweek **iPod World** By Steven Levy, Brad Stone, Sonia Kolesnikov-Jessop, Tara Pepper, Dana Thomas, Kay Itoi	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
169.	October 1, 2004	Macworld **Rock and scroll: the new Click Wheel iPod rules the digital music world** By Jonathan Seff	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
170.	December 27, 2004	San Francisco Chronicle **Hot Stories of 2004 - 2005 Stories To Watch - The iPod Generation - Portable Digital Audio Player Becomes the Apple of Techno-Centric Eyes** By Benny Evangelista	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
171.	January 12, 2005	USA Today **Apple strikes while the iPod is hot** By Jefferson Graham	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
172.	February 1, 2005	USA Today **The iPod phenomenon touches on economics, culture, even education** By Marco R. della Cava	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
173.	February 21, 2005	Fortune **How Big Can Apple Get?** By Brent Schlender	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
174.	June 27, 2005	Fortune **It's iPod's revolution: We just live in it** By Andy Serwer	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
175.	July 13, 2005	Newsday (Bloomberg News) **Sizzling iPods bolster Apple**	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
176.	October 24, 2005	Time Magazine **How Apple Does It** By Lev Grossman	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
177.	January 2006	Kiplinger's Personal Finance **iPod Perfect For Power Players;** **iPod nano made for marathon music sessions;** **iPod to the max** By Sean O'Neill	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
178.	October 23, 2006	Newsweek **The Power of iPod** [book excerpt] By Steven Levy	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
179.	February 5, 2007	The Denver Post (denverpost.com) **iPods: They're not just for tunes anymore** By Kim Komando http://www.denverpost.com/technology/ci_5157393	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
180.	June 26, 2008	The New York Times **Q & A: New iPod, New AV Cable** By J.D. Biersdorfer	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
181.	February 7, 2008	PCWorld **Apple's iPod Dominates Amazon** By Jonny Evans http://www.pcworld.com/printable/article/id,142221/printable.html	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
182.	January 12, 2009	International Herald Tribune **Your iPod, my Polaroid** By Elsa Dorfman	Strength/fame of IPOD mark (unsolicited third party article featuring the iPod player)
183.	January 5, 2010 (Accessed on September 7, 2010)	Vitrue.com **iPhone Tops Again in Second Annual Rankings of the Most Social Brands from Vitrue - Auto, Media, Game Consoles & Sports Dominate the Rankings** http://vitrue/press-room/2010-press-releases/41-2010/311-iphone-tops-again-in-second-annual-rankings-of-the-most-social-brands-from-virtue	Strength/fame of IPOD mark (#34 in list)

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
184.	January 29, 2009 (Accessed on September 7, 2010)	Vitrue.com **The Vitrue 100 - Top Social Brands of 2008** http://vitrue.com/blog/2009/01/29/the-vitrue-100-top-social-brands-of-2008/	Strength/fame of IPOD mark (#7 in list)
185.	January 15, 2008 (Accessed on June 22, 2009)	comScore, Inc. - mmetrics.com - press release **comScore Media Metrix Releases Top 50 U.S. Web Rankings for December** http://www.mmetrics.com/Press_Events/Press_Releases/2008/01/Top_50_US_Web_Sites/ …	Strength/fame of IPOD mark (traffic to Apple website)
186.	December 16, 2008 (Accessed on June 22, 2009)	comScore, Inc. - mmetrics.com - press release **comScore Media Metrix Ranks Top 50 U.S. Web Properties for November 2008** http://www.mmetrics.com/Press_Events/2008/12/Top_50_US_Internal_Sites/(language)/eng-US	Strength/fame of IPOD mark (traffic to Apple website)
187.	May 14, 2009	comScore, Inc. - press release **comScore Media Metrix Ranks Top 50 U.S. Web Properties For April 2009**	Strength/fame of IPOD mark (traffic to Apple website)
188.	August 27, 2010	Alexa.com **Apple.com Worldwide Traffic Rank/Daily Reach** http://www.alexa.com/siteinfo/apple.com#	Strength/fame of IPOD mark (traffic to Apple website)
189.	August 23, 2010	Free Merriam-Webster Dictionary **"Pod" Definition** http://www.merriam-webster.com/dictionary/pod	Descriptiveness of Applicant's mark
190.	January 16, 2002 (Accessed on September 9, 2008)	**Apple Reports First Quarter Profit of $38 Million** (press release) http://www.apple.com/pr/library/2002/01/16results.html	Strength/fame of IPOD mark (sales of iPod player)

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
191.	July 21, 2008 (Accessed on September 9, 2008)	**Apple Reports Record Third Quarter Results** (press release) http://www.apple.com/pr/library/2008/07/21results.html	Strength/fame of IPOD mark (sales of iPod player)
192.	April 23, 2008 (Accessed on September 9, 2008)	**Apple Reports Record Second Quarter Results** (press release) http://www.apple.com/pr/library/2008/04/23results.html	Strength/fame of IPOD mark (sales of iPod player)
193.	January 22, 2008 (Accessed on September 9, 2008)	**Apple Reports First Quarter Results** (press release) http://www.apple.com/pr/library/2008/01/22results.html	Strength/fame of IPOD mark (sales of iPod player)
194.	January 13, 2004	Email from Hoffman Hibbett (hoffman@sectorlabs.com) to Daniel Kokin (daniel@sectorlabs)	Channels of trade
195.	January 19, 2004	Email from Hoffman Hibbett (hoffman@sectorlabs.com) to Daniel Kokin (daniel@sectorlabs)	Channels of trade; intended consumers
196.	January 23, 2004	Email from Natalia Daniel (ndaniel@seideladvertising.com) to Daniel Kokin (daniel@sectorlabs)	Relatedness of goods; intent in selecting mark
197.	May 3, 2007	Email from John Chaisson (jmchaisson@gmail.com) to Daniel Kokin (daniel@sectorlabs)	Relatedness of goods; intent in selecting mark
198.	August 7, 2002	Email from RainaKumra (rainasun@yahoo.com) to Damir Perge (damir@futuredex.com) and Daniel Kokin (daniel@sectorlabs)	Relatedness of goods
199.	December 15, 2003	Email from Hoffman Hibbett (hoffman@sectorlabs.com) to Crystal Hsu (crystalhsu@microtek.com.tw) and J.D. Wang (jd.wang@microtek.com.tw)	Channels of trade; intended consumers
200.	January 23, 2004	Response to Office Action Application Serial No. 78215335	Descriptiveness of Applicant's mark (disclaimer of "video")

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
201.	October 27, 2008	Sector Labs, Inc./Products Featured Product/Under Development http://www.sectorlabs.com/products/index.htm	Relatedness of goods
202.		Sector Labs PowerPoint presentation – CORNERSTONES Imagination Innovation Invention (Presentation V9.ppt)	Descriptiveness of Applicant's mark; relatedness of goods; intended customers; channels of trade; marketing plans
203.	January 25, 2005	Sector Labs Executive Summary Version 40 (ExecutiveSummaryV40-2005.doc)	Descriptiveness of Applicant's mark; relatedness of goods; intended customers; channels of trade
204.		Sector Labs Video Pod brochure (brochure page v6 copy.pdf)	Descriptiveness of Applicant's mark; relatedness of goods; intended customers
205.	September 24, 2007	Opposer's First Set of Requests for Admission to Applicant	
206.	April 15, 2008	Applicant's Answers to First Set of Requests for Admission	Relatedness of goods and services; intent in selecting mark; fame of IPOD mark; descriptiveness
207.	August 1, 2010	Applicant's Supplemental Response to Opposer's First Requests for Admission	Authenticity of produced documents
208.	September 24, 2007	Opposer's First Set of Interrogatories To Applicant	

EXHIBIT	PUBLICATION DATE	PUBLICATION NAME – ARTICLE TITLE	RELEVANCE
209.	April 15, 2008	Answers to Opposer's First Set of Interrogatories	Channels of trade; descriptiveness;
210.	July 7, 2008	Applicant's First Set of Supplemental Answers to Opposer's First Set of Interrogatories	Descriptiveness
211.	August 27, 2010	TTABVUE Summary of opposition proceedings based on IPOD mark	Dilution (substantially exclusive use of iPod mark and Apple's trademark enforcement efforts)
212.	August 27, 2010	Guidelines for Using Apple Trademarks and Copyrights http://www.apple.com/legal/trademark/guidelinesfor3rdparties.html	Dilution (Apple's trademark enforcement efforts)
213.	August 27, 2010	TESS Search	Substantially exclusive use of iPod mark in Cl. 9

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Dated: September 20, 2010

Respectfully submitted,

TOWNSEND AND TOWNSEND AND CREW LLP

By: ______________________________

Margaret C. McHugh
Marie C. Seibel
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Attorney Docket No.: 020750-068800US
Opposition No. 91176027

CERTIFICATE OF SERVICE

I hereby certify that on September 20, 2010 I served the foregoing **NOTICE OF RELIANCE** on counsel for Applicant by depositing a true copy thereof with the United States Postal Service as first class mail, postage prepaid, at San Francisco, California, enclosed in a sealed envelope addressed as follows:

Ana I. Christian, Esq.
Law Offices of Ana I. Christian
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San Francisco, CA 94121
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Masha M. Martinenko

Masha M. Martinenko

62878608 v2

EXHIBIT 1

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QuickLinks -- Click here to rapidly navigate through this document

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended September 28, 2002

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____________ to _____________

Commission file number 0-10030

APPLE COMPUTER, INC.
(Exact name of Registrant as specified in its charter)

CALIFORNIA (State or other jurisdiction of incorporation or organization)	**942404110** (I.R.S. Employer Identification No.)
1 Infinite Loop **Cupertino, California** (Address of principal executive offices)	**95014** (Zip Code)

Registrant's telephone number, including area code: **(408) 996-1010**

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, no par value
Common Share Purchase Rights
(Titles of classes)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities

Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference to Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes ☒ No ☐

The aggregate market value of voting stock held by nonaffiliates of the Registrant was approximately $4,925,788,282 as of December 6, 2002, based upon the closing price on the NASDAQ National Market reported for such date. Shares of Common Stock held by each executive officer and director and by each person who beneficially owns more than 5% of the outstanding Common Stock have been excluded in that such persons may under certain circumstances be deemed to be affiliates. This determination of executive officer or affiliate status is not necessarily a conclusive determination for other purposes.

359,135,584 shares of Common Stock Issued and Outstanding as of December 6, 2002

PART I

The Business section and other parts of this Annual Report on Form 10-K ("Form 10-K") contain forward-looking statements that involve risks and uncertainties. The Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Factors That May Affect Future Results and Financial Condition" under Part II, Item 7 of this Form 10-K.

Item 1. Business

Company Background

Apple Computer, Inc. ("Apple" or the "Company") was incorporated under the laws of the State of California on January 3, 1977. The Company designs, manufactures and markets personal computers and related personal computing solutions for sale primarily to education, creative, consumer, and business customers. Substantially all of the Company's net sales over the last five years have been derived from the sale of its Apple® Macintosh® line of personal computers and related software and peripherals. The Company's fiscal year ends on the last Saturday of September. Unless otherwise stated, all information presented in this Form 10-K is based on the Company's fiscal calendar.

Business Strategy

Digital Hub

Apple is committed to bringing the best possible personal computing experience to students, educators, creative professionals, businesses and consumers around the world through its innovative hardware, software, and Internet offerings. The Company believes that personal computing has entered a new era in which the personal computer functions for both professionals and consumers as the digital hub for advanced new digital devices such as digital music players, personal digital assistants, cellular phones, digital still and movie cameras, CD and DVD players, and other electronic devices. The attributes of the personal computer, including its ability to run complex applications, possess a high quality user interface, contain large and relatively inexpensive storage, and easily connect to the Internet in multiple ways and at varying speeds, can individually add value to these devices and interconnect them as well. Apple is the only company in the personal computer industry that designs and manufactures the entire personal computer—from the hardware and operating system to sophisticated applications. Apple ties it all together with its innovative industrial design, intuitive ease-of-use, and built-in networking, graphics, and multimedia capabilities. Thus, the Company is uniquely positioned to offer digital hub products and solutions.

Apple develops products and technologies that adhere to many industry standards in order to provide an optimized user experience through interoperability. Apple has played a role in the development, enhancement, promotion, and/or use of numerous of these industry standards, many of which are discussed below.

Retail

Since inception of its retail initiative in 2001, the Company has opened 51 retail stores in the United States. The Company has located its stores at quality high traffic locations in shopping malls and urban shopping districts. Before the end of the first quarter of 2003, the Company estimates that over 30% of the U.S. population will live within 15 miles of one of its stores. In addition to its own hardware and software products, the Company's retail stores carry in inventory a variety of third-party hardware and software products.

One of the main goals of the retail initiative is to bring new customers to the Company and expand its installed base through sales to both first time computer buyers and those switching from other computing platforms. By operating its own stores, the Company is able to better control the customer retail experience. The stores are designed to enhance the presentation and marketing of personal computing

products. The stores employ experienced and knowledgeable personnel, provide post sale advice and support, offer a wide selection of third-party products selected to complement the Company's own products, host training and marketing presentations, and provide certain hardware support services. Additionally, the stores provide a forum in which the Company is able to present entire computing solutions to users in areas such as digital photography, digital video, music, children's software, and home computing. Recent survey results available to the Company indicate that approximately 40% of customers buying systems in its stores do not currently own a Macintosh.

Education

For more than 25 years, the Company has focused on educational uses of technology. The Company believes that effective integration of technology into classroom instruction can result in higher levels of student achievement, especially when used to support collaboration, information access, and the expression and representation of student thought and ideas. The Company's commitment to education encompasses a range of products and services designed to help schools maximize their investments in technology. This commitment is manifest in many of the Company's products and services, including hardware that meets the needs of education customers, video editing solutions, wireless networking capabilities, student information systems, and high-quality curriculum and professional development solutions.

Creative Professionals

Creative professionals constitute one of the Company's most important markets for both hardware and software products. This market is also important to many third-party developers who provide Macintosh-compatible hardware and software solutions. Creative customers utilize the Company's products for a variety of creative activities including digital video and film production and editing; digital video and film special effects, compositing, and titling; digital still photography; graphic design, publishing, and print production; music performance and production; audio production and sound design; and web design, development, and administration.

The Company designs its high-end hardware solutions, including servers and desktop and portable Macintosh systems, to incorporate the power, expandability, and features desired by creative professionals. Additionally, the Company's client operating system, Mac OS® X, incorporates powerful graphics and audio technologies and features developer tools to optimize system and application performance when running powerful creative solutions provided by the Company or by third-party developers. The Company also offers various software solutions to meet the needs of its creative customers, many of which are described below.

Business Organization

The Company manages its business primarily on a geographic basis. The Company's geographic operating segments include the Americas, Europe, Japan, and Asia Pacific. The Americas segment includes both North and South America, except for the Company's Retail segment which operates Apple-owned retail stores in the United States. The Europe segment includes European countries as well as the Middle East and Africa. The Japan segment includes only Japan, while the Asia Pacific segment includes Australia and Asia except for Japan. Each geographic operating segment provides similar hardware and software products and similar services. Non-geographic operating segments include the Company's subsidiary, FileMaker, Inc. and the Company's Retail segment. Further information regarding the Company's operating segments may be found in Part II, Item 7 of this Form 10-K under the heading "Segment Operating Performance," and in Part II, Item 8 on this Form 10-K in the Notes to Consolidated Financial Statements at Note 11, "Segment Information and Geographic Data."

Hardware Products

The Company offers a range of personal computing products including desktop and notebook personal computers, related devices and peripherals, networking and connectivity products, and various third-party hardware products. All of the Company's Macintosh products utilize PowerPC® RISC-based microprocessors. The Company's entire line of Macintosh systems, excluding servers, features the Company's suite of software for digital photography, music, and movies. Further information regarding the Company's products may be found in Part II, Item 7 of this Form 10-K under the heading "Factors That May Affect Future Results and Financial Condition."

*Power Mac®*G4

The Power Mac line of desktop personal computers is targeted at business and professional users and is designed to meet the speed, expansion and networking needs of the most demanding Macintosh user. The current Power Mac line features dual PowerPC G4 processors in all models, a new high-performance architecture, and on certain models Apple's SuperDrive™, a combination CD-RW/DVD-R drive that can burn DVDs that can be played in most consumer DVD players.

Xserve™

During the third quarter of 2002, the Company introduced and shipped Xserve™, a 1U rack-mount server designed for simple set up and remote management. Xserve was designed for I/O intensive applications such as digital video, high-resolution digital imagery, and large databases. Xserve delivers high-speed networking, 15 gigaflops of computational power, and almost a half terabyte of hot-plug storage. Server Admin, a new services monitoring and remote management tool, allows administrators to easily set up and manage all key Mac OS X Server network services remotely. Server Monitor, a new hardware monitoring tool, allows system administrators to remotely monitor one or many servers. The Company offers a choice of services and support programs including 4-hour onsite response, 24x7 technical support, AppleCare® Service Parts Kits and AppleCare Professional SupportLine and Tools program.

PowerBook®

The PowerBook family of portable computers is designed to meet the mobile computing needs of professionals and advanced consumer users. The Company's current PowerBook line, the Titanium PowerBook G4, was introduced in January 2001. The Titanium PowerBook is a full-featured notebook computer that incorporates PowerPC G4 processors, thin film transistor ("TFT") wide-screen active-matrix displays, integrated wireless capabilities, advanced networking and graphics capabilities, and on the latest version, a model with a built-in slot-loading SuperDrive. The Titanium PowerBook G4 is 1-inch thick, weighs as little as 5.4 pounds and is encased in a pure-grade titanium body.

iMac®

The iMac line of desktop computers is targeted at education and consumer markets. The original iMac features innovative industrial design with a built-in 15-inch shadow-mask cathode ray tube ("CRT") display, easy Internet access, fan-less operation, and a PowerPC G3 processor, making it suitable for a wide range of education and consumer applications. The Company offers its original CRT iMac design at a suggested retail price under $1,000.

In January 2002, the Company introduced the new iMac featuring an innovative industrial design that incorporates an adjustable 15-inch TFT active-matrix flat panel display and an ultra-compact base. New iMac models with 15-inch displays are available in three base configurations and feature PowerPC G4 processors, advanced graphics capabilities, and a SuperDrive on one model for playing and burning custom CDs and DVDs. In July 2002, the Company introduced an updated version of its new iMac that features a 17-inch TFT active-matrix flat panel display, a high-end PowerPC G4 processor, and a SuperDrive.

eMac™

In April 2002, the Company introduced the eMac™, a new Macintosh desktop system designed for the Company's education customers. The eMac was made available to consumers in June 2002. The eMac features a PowerPC G4 processor, a high resolution 17-inch flat CRT display, a SuperDrive option, and preserves the all-in-one compact design of the original iMac favored by many of the Company's education and consumer customers.

iBook®

Designed for the portable computing needs of education and consumer users, the current iBook design was introduced in May of 2001. Current iBook models feature 12.1-inch or 14.1-inch TFT active-matrix displays, include integrated wireless capabilities, utilize PowerPC G3 processors, offer a choice of optical drive configurations, weigh as little as 4.9 pounds, and have a long battery life. iBooks are currently available in a configuration with a suggested retail price under $1,000.

iPod™

Introduced in October 2001, the original iPod portable digital music player utilized a 5GB hard disk drive allowing it to hold up to 1,000 CD-quality songs in a 6.5 ounce design. The iPod features an intuitive user interface on a 2-inch liquid crystal display, automatic synchronization with a music collection on a Macintosh system via Apple's iTunes® digital music software, a high-speed FireWire® connection for power and data transfer and up to 10 hours of battery life. iPods also provide access to contact and calendar information downloaded from other applications on a Macintosh system. By enhancing the overall functionality and integration of the digital music player and by expanding the usefulness of digital music and other information stored on a computer, the iPod represents an important and natural extension of Apple's digital hub strategy. In March 2002, the Company added a 10GB model to its iPod line, and in July 2002, the Company added a 20GB model and announced that all iPod models would be made available in Windows-compatible versions. The newer 10GB and 20GB iPod models come with carrying cases, wired remotes, and feature a solid-state touch wheel control.

Peripheral Products

The Company sells certain associated Apple-branded computer hardware peripherals, including a range of high quality flat panel TFT active-matrix digital color displays. The Company also sells a variety of third-party Macintosh-compatible hardware products directly to end users through both its retail and online stores, including computer printers and printing supplies, storage devices, computer memory, digital video and still cameras, personal digital assistants, digital music players and related accessories, and various other computing products and supplies.

Software Products and Computer Technologies

Operating System and Server Software

During 2001, the Company introduced the first customer release of its new client operating system, Mac OS® X, and its first significant upgrade, Mac OS X version 10.1. At its introduction, Mac OS X offered advanced functionality built on an open-source UNIX-based foundation and incorporated the most fundamental changes in both core technology and user interface design made by the Company to the Mac OS in a single upgrade since the original introduction of the Macintosh in 1984. Mac OS X features memory protection, pre-emptive multi-tasking, and symmetric multiprocessing. Mac OS X includes Apple's Quartz™ 2D graphics engine (based on the Internet-standard Portable Document Format) for enhanced graphics and broad font support, OpenGL for enhanced 3D graphics and gaming, and Apple's new user interface named "Aqua®," which combines superior ease-of-use with new functionality. In January 2002, the Company made Mac OS X the default operating system on all new Macintosh systems. Mac OS X allows users to run Mac OS 9 applications natively in the Classic compatibility environment in

Mac OS X. The Company also develops and distributes extensions to the Macintosh system software including utilities, languages, and developer tools.

In August 2002, the Company released Mac OS X version 10.2 (code named "Jaguar"), the current release of Mac OS X. Jaguar includes a new Mail application designed to manage junk mail; iChat™, an AIM-compatible instant messenger; a system-wide Address Book; Inkwell™ handwriting recognition; improved Universal Access; an enhanced Finder; an updated version of QuickTime®, the Company's multimedia software for playing, interacting with or viewing video, audio, and graphics files; and an updated version of Sherlock®, the Company's advanced Internet search engine. Jaguar also features accelerated graphics performance, increased compatibility with Windows networks, and a UNIX-based foundation with enhancements including FreeBSD 4.4 and GCC 3.1-based developer tools.

Mac OS X server software was initially introduced in May 2001. The current version of Mac OS X Server, Mac OS X Server version 10.2 (code named "Jaguar Server") was released in August 2002. Jaguar Server is a UNIX-based operating system designed for superior performance and reliability. It delivers high-performance services for Internet and web serving, filing, printing, and networking services needed to manage a network of Mac, UNIX, and Windows clients. Based on the Mach 3.0 microkernel and the BSD 4.4 operating system, Jaguar Server is a modern UNIX-based server built on open standards. It provides performance and stability through full pre-emptive multi-tasking, symmetric multiprocessing, protected memory, advanced virtual memory, software RAID support, and support for networking and security standards. Jaguar Server also includes Apple's Open Directory architecture for centralized management of network resources using LDAPv3 directory services and a suite of built-in, standards-based Internet services like an optimized Apache web server for high-performance hosting of secure dynamic web sites and QuickTime Streaming Server and QuickTime Broadcaster for streaming live events over the Internet. Jaguar Server also comes with a flexible mail server that supports POP and secure IMAP, as well as WebMail for browser-based email access.

Further information regarding the introduction of and updates to Mac OS X and Mac OS X Server may be found in Part II, Item 7 of this Form 10-K under the heading "Factors That May Affect Future Results and Financial Condition."

Professional Application Software

Final Cut Pro® 3 is a video authoring application designed to meet the demanding needs of the professional video editing environment by combining in a single software package professional-quality video editing and compositing, real-time effects, professional color correction tools and an innovative interface that seamlessly integrates editing, compositing and effects tools for an efficient and powerful media creation workflow. Final Cut Pro is especially popular among broadcast professionals because it allows them to increase their programming output at a fraction of the cost of traditional editing systems. Post production facilities use Final Cut Pro for the production of a wide range of projects including feature-length films, primetime television shows, news broadcasts, documentaries, trailers and commercials. Final Cut Pro was honored by the Academy of Television Arts and Sciences with a 2002 Primetime Emmy Engineering Award for its impact on the television industry.

Shake® is the Company's industry-leading compositing and visual effects software designed for large format film and video productions. Shake features a fast rendering engine, an extensive and mature compositing toolset, two industry-standard keyers, a complete suite of color correction tools, tracking/stabilization capabilities, integrated procedural paint, rotoscoping tools, and support for leading plug-in vendors. Shake has been used in the production of over a hundred motion pictures including the past five winners of the Academy Award for Best Visual Effects. Introduced during the fourth quarter of 2002, Shake 2.5 was the first Mac OS X native version of the software and added an improved image input, a disk-based proxy system, and the ability to limit the rendering process to a portion of an image for quicker processing.

Introduced in 2002, Cinema Tools for Final Cut Pro™ is a new software package that enhances Final Cut Pro 3's 24 frames-per-second (fps) editing capabilities with support for film cut lists and 24-frame edit decision lists (EDLs) for high-definition (HD) video. The 24-frame EDL support allows off-line HD projects to be finished using significantly more affordable Final Cut Pro®-based HD finishing systems. Cinema Tools for Final Cut Pro is a robust solution for filmmakers who shoot and finish with 35mm or 16mm film, but want to take advantage of the cost and time benefits of digital editing on a Final Cut Pro system. Cinema Tools converts "telecined" content to its native 24-frame rate for editing, then generates a 24-fps cut list for negative conform. With its support for 24-fps EDL import/export, Cinema Tools for Final Cut Pro provides video professionals with not only an affordable path to online HD finishing, but also the EDL conversion capabilities required to create high-definition 24P universal masters used to efficiently meet the needs of varying international distribution formats.

DVD Studio Pro® 1.5 lets professional users encode video, conduct complex authoring tasks and preview finished product in real-time and allows users to burn DVDs using SuperDrive-equipped Macintosh systems. It handles the MPEG encoding, menu creation, asset organization, linking, and output formatting that are required to produce DVD-Video disks. DVD Studio Pro 1.5 has been optimized for Mac OS X and features enhanced integration with Final Cut Pro.

The Company was honored in 2002 by the National Academy of Recording Arts and Sciences with a Technical GRAMMY Award for its outstanding technical contributions to the music industry and recording field. This was the first Technical GRAMMY ever awarded to a personal computer company. From the original Macintosh, the first personal computer to include built-in audio capabilities, Apple has helped change the way music is written, recorded, mixed and enjoyed. The Company acquired Emagic, a leading provider of professional software and hardware solutions for computer based music production, during the fourth quarter of 2002. Emagic's most popular product, Logic®, is actively used by musicians around the world and by professionals in music production, film scoring, and post production facilities. At the time of the acquisition, Macintosh-based products accounted for over 65% of Emagic's revenues. Emagic's Windows-based product offerings were discontinued by the Company during its first fiscal quarter of 2003.

Consumer, Education and Business Oriented Application Software

iMovie™ 2, the Company's easy-to-use consumer digital video editing software for creation of home and classroom movies, features an enhanced user interface, improved audio editing capabilities, enhanced controls for titling and transitions, and added special effects.

iMovie 2 is currently preinstalled on all of the Company's Macintosh systems. iDVD™ 2 is consumer oriented software that makes it easy to turn iMovie files, QuickTime files and digital pictures into DVDs that can be played on most consumer DVD players. iDVD 2 simplifies DVD authoring by including professionally designed themes and drag-and-drop simplicity. iDVD 2 is currently preinstalled on all Macintosh systems equipped with a SuperDrive.

The Company introduced iPhoto™ in January 2002. Designed exclusively for Mac OS X, iPhoto makes it easy to import, edit, save, share, and print digital photos, as well as organize and manage an entire digital photo collection containing thousands of photos. Users are able to view their photos in full-screen; using the slide show feature accompanied by their favorite music; automatically create custom web pages of their photos; email photos to friends and family; order professionally-processed prints and enlargements online; or easily design and order custom-printed, linen-covered hard bound photo books online. Prints, enlargements, and hard bound book production is currently only available to U.S. customers. iPhoto is currently preinstalled on all of the Company's Macintosh systems.

iTunes® is a digital music application for the Macintosh that lets users create and manage their own digital music library. iTunes organizes music using searching, browsing and playlist features. It supports both audio and MP3 CD burning, features a graphic equalizer and cross fading between songs, and supports automatic synchronization with the music stored on an iPod, Apple's portable digital music player. iTunes is currently preinstalled on all Macintosh systems. In July 2002, the Company introduced iTunes 3,

featuring Smart Playlists, which automatically and dynamically updates playlists based on simple rules set by the user, and Sound Check for consistent volume playback.

During the fourth quarter of 2002, the Company released two new applications, iCal and iSync Public Beta. iCal is a new calendar program that allows users to manage multiple calendars and share them over the Internet. iCal makes it easy for consumers, students, educators and small business users to create and manage individual or group activities on single or multiple calendars; publish these calendars on the web for viewing by colleagues, friends and family members; subscribe to automatically updated calendars via the Internet to keep up with work schedules, family events and school events; organize and track activities with To Do list management; quickly locate any event via a search tool; and take calendars to go using iSync with Bluetooth-enabled mobile phones, Palm OS devices and iPod. iSync Public Beta is a preview version of Apple's new software application that automatically synchronizes address books and calendars between Macintosh systems and the new generation of Bluetooth-enabled GPRS mobile phones, Apple's iPod and Palm OS-compatible handheld organizers. In addition, users with a .Mac™ account can use iSync to seamlessly synchronize their calendars and address books across multiple Macintosh systems connected to the Internet.

AppleWorks® 6.2 is an integrated productivity application that incorporates word processing, page layout, image manipulation, spreadsheets, databases and presentations in a single application. Intended to be an easy-to-use product for the Company's consumer and education customers, AppleWorks makes it simple to create professional-looking documents in the classroom and at home.

FileMaker Corporation, a wholly owned subsidiary of the Company, develops, publishes, and distributes desktop-based database management application software for Mac OS and Windows-based systems. FileMaker's FileMaker® Pro database software and related products offer strong relational databases and advanced desktop-to-web publishing capabilities.

Internet Software, Integration, and Services

Apple's Internet strategy is focused on delivering seamless integration with and access to the Internet throughout the Company's product lines. The Company's Internet products and technologies adhere to many industry standards in order to provide an optimized user experience through interoperability. An easy Internet Setup Assistant is included with the Mac OS.

QuickTime®, the Company's multimedia software for Macintosh and Windows platforms, features streaming of live and stored video and audio over the Internet and playback of high-quality audio and video on computers. QuickTime Player is an easy-to-use application for playing, interacting with or viewing video, audio, QuickTime VR 3D images, or graphics files. More than 125 million copies of QuickTime Player were downloaded via the Internet during the last year. Tens of thousands of software applications and content CDs feature QuickTime, and more than 150 models of digital cameras from most major brands use QuickTime to capture and display their images.

The current version of QuickTime, QuickTime 6, was released in July of 2002 and features support for the open-standard MPEG 4 format. QuickTime 6 includes the new Instant-On Streaming feature that eliminates buffer delays and provides users with the ability to quickly and easily scrub through streaming media content to locate and instantly view specific sections. In addition, QuickTime 6 running on Mac OS X now supports JPEG 2000, the next generation JPEG standard that allows users to capture still images in a higher quality and smaller file size than ever before. QuickTime 6 also includes Advanced Audio Coding (AAC), the standard MPEG-4 audio format. AAC is the next generation professional-quality audio format that delivers superior sound quality with reduced file sizes.

QuickTime Pro is a suite of software that allows creation and editing of Internet-ready audio and video files and allows a user to add special effects and other features to QuickTime movies.

QuickTime Streaming Server software is the underlying server technology that powers QuickTime's ability to stream live and stored video and audio over the Internet. QuickTime Streaming Server is based on an open sourced, standards-based Real-Time Transport Protocol/Real-Time Streaming Protocol (RTP/RTSP) engine. The current version, QuickTime Streaming Server 4, extends support for standards by adding support for both MPEG 4 and MP3. While QuickTime Streaming Server is designed for Mac OS X Server, it is also available as an open source server. Because QuickTime Streaming Server is an open source technology it can be ported to other platforms, and versions are available for Linux, Solaris and Windows NT/2000.

QuickTime Broadcaster is the Company's live encoding software that allows users to quickly and easily produce professional-quality live events for online delivery. The combination of QuickTime Broadcaster, QuickTime Streaming Server 4 and QuickTime 6 provides the industry's first end-to-end MPEG-4-based Internet broadcasting system, which allows users to reach not only the large and growing base of installed QuickTime Players, but also any ISO-compliant MPEG-4 player.

WebObjects®, the Company's Java-based application server for web publishing and enterprise application development, offers a complete solution for rapid development and deployment of web applications. WebObjects features sophisticated graphical development tools, comprehensive prebuilt and reusable components, integration with numerous data sources, and robust deployment tools.

Introduced with Mac OS X Jaguar, Sherlock® 3 is the Company's advanced Internet search engine. Sherlock 3 functions for users as an Internet service tool that retrieves and displays a personalized view of some of the most practical and useful information available on the Internet, such as stock news, general headlines, movie previews, locations and show times, yellow pages listings, eBay auction activity and more. Sherlock displays each of these 'channels' in its own arrangement of columns and panes. When used for Internet searches, Sherlock utilizes multiple search engines to provide search results ranked by relevance, name, or web site.

In July 2002, the Company launched .Mac™, a new suite of Internet services that for an annual fee provides Macintosh users with powerful Internet tools. .Mac features email service with IMAP, POP or web-based access, 100MB of Internet storage, and hosting for personalized homepages and shared digital photo albums. Also included with .Mac is McAfee's Virex anti-virus software and Backup, a personal back-up solution that allows users to archive data to their Internet storage, CD, or DVD.

Wireless Connectivity and Networking

AirPort® is the Company's wireless networking technology that allows users to create a computer network and connect to the Internet without cables, additional phone lines, or complicated networking hardware. Based on the IEEE 802.11b wireless standard and Wi-Fi certified, AirPort allows high-speed wireless communications within a radius of approximately 150 feet from an AirPort base station. AirPort includes security features like firewall protection and 128-bit encryption to protect user data. With the addition of an AirPort networking card, all of the Company's desktop and portable Macintosh systems have built-in support for AirPort wireless networking, including built-in antennas and an AirPort card slot.

During 2002, the Company released its Bluetooth technology for Mac OS X. Bluetooth is an emerging industry standard for wirelessly connecting computers and peripherals that supports transmission of data at up to 1 Mbps within a range of approximately 30 feet. The Company's Bluetooth technology for Mac OS X lets customers wirelessly share files between Macintosh systems, synchronize and share contact information with Palm-OS based PDAs, and access the Internet through Bluetooth-enabled cell phones. A Bluetooth USB adaptor can Bluetooth-enable any USB-based Macintosh computer running in Mac OS X version 10.1.4 or higher. Bluetooth software is built into Max OS X Jaguar.

Introduced in the fourth quarter of 2002, the Company's new Rendezvous™ networking technology is based on open Internet Engineering Task Force (IETF) Standard Protocols such as IP, ARP and DNS. Rendezvous uses industry standard networking protocols and zero configuration technology to

automatically discover and connect devices over any IP network, including Ethernet or 802.11-based wireless networks like the Company's AirPort product. Major developers such as Canon, Epson, Hewlett-Packard, Lexmark, Philips, Sybase, World Book and

Xerox have announced support for Rendezvous in a broad range of products including network printers, consumer electronics, enterprise database management and educational applications. In September 2002, the Company announced that it was "open sourcing" the code for Rendezvous. By making the source code freely available, the Company allows developers to use Rendezvous technology in their network-enabled devices or software applications. The Rendezvous source code includes software to support UNIX, Linux, and Windows- based systems and devices. Rendezvous support is built into Mac OS X Jaguar.

Apple Remote Desktop™ for Mac OS X software enables users, teachers and administrators to remotely manage other Macintosh systems anywhere on a local network, AirPort wireless network or across the Internet. With Apple Remote Desktop, teachers can view students' computer screens, perform group demonstrations and help individuals with real-time screen-sharing, text chat and the "request attention" command. System administrators can provide remote assistance, get comprehensive system profiles, reconfigure system settings and quickly and easily distribute software applications across hundreds of computers—all from one central location over both Ethernet and AirPort wireless networks. Apple Remote Desktop supports multiple levels of administrator access, each with its own password, providing a secure way for teachers or department-level administrators to assist users while restricting privileges for deleting items or changing system settings.

The Company invented FireWire® technology, also referred to as IEEE 1394, which is a high-speed serial input/output technology for connecting digital devices such as digital camcorders and cameras to desktop and portable computers. With its high data-transfer speed and "hot plug-and-play" capability, FireWire has become an established cross-platform industry standard for both consumers and professionals and is the data interface of choice for today's digital video and audio devices, as well as external hard drives and other high-speed peripherals. Industry data indicates that FireWire will be included on more than 64 million personal computers and nearly 100 million digital devices by the end of calendar 2002. The Company received a 2001 Primetime Emmy Engineering Award for FireWire's impact on the television industry. FireWire is currently included on all Macintosh systems and is the data transfer technology utilized by iPod.

Third-Party Software Products

Thousands of third-party software titles and solutions are available for the Macintosh platform. The Company sells a variety of these third-party software products directly to end users through both its retail and online stores. Additional information regarding the Company's relationship with and dependence upon third-party software developers, including Microsoft Corporation, may be found in Part II, Item 7 of this Form 10-K under the heading "Factors That May Affect Future Results and Financial Condition."

Product Support and Services

AppleCare® offers a range of support options for Apple customers. These options include assistance that is built into software products, printed and electronic product manuals, online support including comprehensive product information as well as technical assistance, and the AppleCare Protection Plan. The AppleCare Protection Plan is a fee-based service that typically includes three years of phone support and hardware repairs, dedicated web-based support resources, and user diagnostic tools.

Apple Training offers comprehensive system administration and development training on Apple technologies, together with certification programs that test customers' skills and verify their technical proficiency. Apple Professional Services offers a range of custom, personalized technical services, including Internet consulting and setup, installation and integration services. The Company also offers specialized loan programs including loans for consumers, students, and educators. Apple also provides leasing

solutions for its education institution customers and its business and professional customers. The Company uses several third-party lenders to originate and carry these loans and leases.

Specialized Education Products and Services

The Company offers a variety of unique services and products to its education customers, including a separate online store for education customers offering special education price lists and promotions; special financing programs for K-12 and higher education students, faculty, and staff; a special edition of its productivity software suite, AppleWorks, that is cross platform for both Macintosh and Windows computers; the iBook Wireless Mobile Lab that allows teachers and students to share iBook computers, a printer, and a wireless network/Internet connection stored on a cart for mobility between classrooms; and three special Digital Media Studio solutions designed for education, including one that is integrated into a mobile cart. Additionally, Apple Professional Services offers a range of technical services to education customers.

In 2001, Apple acquired PowerSchool Inc., a privately held provider of web-based student information systems for K-12 schools and school districts. PowerSchool® software products give school administrators and teachers the ability to easily and cost-effectively manage student records and give parents real-time access to track their children's performance via the Internet. PowerSchool offers the option of remote hosting with an application service provider model.

Markets and Distribution

The Company's customers are primarily in the education, creative, consumer, and business markets. Certain customers are attracted to Macintosh computers for a variety of reasons, including the reduced amount of training resulting from the Macintosh computer's intuitive ease of use, advanced graphics capabilities, industrial design features of the Company's hardware products, and ability of Macintosh computers to network and communicate with other computer systems and environments. Apple personal computers were first introduced to education customers in the late 1970s. Over 21% of the Company's net sales in 2002 were to education customers in the United States, including sales to elementary and secondary schools and college and university customers. Further information relating to the U.S. education market and the Company's position in that market may be found in Part II, Item 7 of this Form 10-K under the heading "Factors That May Affect Future Results and Financial Condition."

The Company distributes its products through wholesalers, resellers, national and regional retailers and cataloguers. During 2000 a single distributor, Ingram Micro Inc., accounted for approximately 11.5% of net sales. No other customer accounted for more than 10% of net sales during 2000, and no individual customer accounted for more than 10% of net sales in 2002 or 2001. The Company also sells many of its products and resells certain third-party products in most of its major markets directly to consumers, education customers, businesses, and certain resellers through its retail stores in the United States, or through one of its online stores around the world. Net sales attributable to the Company's online stores totaled approximately $2.4 billion and $2.0 billion for fiscal years 2002 and 2001, respectively.

Competition

The Company is confronted by aggressive competition in all areas of its business. The market for the design, manufacture, and sale of personal computers and related software and peripheral products is highly competitive. This market continues to be characterized by rapid technological advances in both hardware and software development, which have substantially increased the capabilities and applications of these products, and have resulted in the frequent introduction of new products and significant price, feature, and performance competition. Over the past several years price competition in the market for personal computers has been particularly intense. The Company's competitors who sell Windows-based personal computers have aggressively cut prices and lowered their product margins to gain or maintain market share in response to weakness in demand for personal computing products. The Company's results

of operations and financial condition have been, and in the future may continue to be, adversely affected by these and other industry wide pricing pressures and downward pressures on gross margins.

The principal competitive factors in the market for personal computers include relative price/performance, product quality and reliability, design innovation, availability of software, product features, marketing and distribution capability, service and support, availability of hardware peripherals, and corporate reputation. Further, as the personal computer industry and its customers place more reliance on the Internet, an increasing number of Internet devices that are smaller, simpler, and less expensive than traditional personal computers may compete for market share with the Company's existing products.

The Company is currently taking and will continue to take steps to respond to the competitive pressures being placed on its personal computer sales as a result of innovations in the Windows platform. The Company's future operating results and financial condition are substantially dependent on its ability to continue to develop improvements to the Macintosh platform in order to maintain perceived functional and design advantages over competing platforms.

Further information relating to the competitive conditions of the personal computing industry and the Company's competitive position in that market place may be found in Part II, Item 7 of this Form 10-K under the heading "Factors That May Affect Future Results and Financial Condition."

Raw Materials

Although most components essential to the Company's business are generally available from multiple sources, certain key components (including microprocessors and application-specific integrated circuits ("ASICs")) are currently obtained by the Company from single or limited sources. Some other key components, while currently available to the Company from multiple sources, are at times subject to industry wide availability constraints and pricing pressures. In addition, the Company uses some components that are not common to the rest of the personal computer industry, and new products introduced by the Company often initially utilize custom components obtained from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. If the supply of a key or single-sourced component to the Company were to be delayed or curtailed or in the event a key manufacturing vendor delays shipments of completed products to the Company, the Company's ability to ship related products in desired quantities and in a timely manner could be adversely affected. The Company's business and financial performance could also be adversely affected depending on the time required to obtain sufficient quantities from the original source, or to identify and obtain sufficient quantities from an alternative source. Continued availability of these components may be affected if producers were to decide to concentrate on the production of common components instead of components customized to meet the Company's requirements. The Company attempts to mitigate these potential risks by working closely with these and other key suppliers on product introduction plans, strategic inventories, coordinated product introductions, and internal and external manufacturing schedules and levels. Consistent with industry practice, the Company acquires components through a combination of formal purchase orders, supplier contracts, and open orders based on projected demand information. These formal and informal commitments typically cover the Company's requirements for periods ranging from 30 to 130 days.

The Company believes there are several component suppliers and manufacturing vendors whose loss to the Company could have a material adverse effect upon the Company's business and financial position. At this time, such vendors include Agere Systems, Inc., Ambit Microsystems Corporation, ATI Technologies, Inc., Elite Computer Systems Co., Inc., Hon Hai Precision Industry Co., Ltd., IBM Corporation, Inventec Appliances Corporation, LG. Phillips Co., Ltd., Matsushita, Mitsubishi Electric Corporation, Motorola, Inc., Nvidia Corp., Quanta Computer, Inc., Samsung Electronics, Solectron Corporation, and Toshiba Corporation.

Further discussion relating to availability and supply of components and product may be found in Part II, Item 7 of this Form 10-K under the heading "Factors That May Affect Future Results and Financial Condition," and in Part II, Item 8 of this Form 10-K in the Notes to Consolidated Financial Statements at Note 10 under the subheading "Concentrations in the Available Sources of Supply of Materials and Product."

Research and Development

Because the personal computer industry is characterized by rapid technological advances, the Company's ability to compete successfully is heavily dependent upon its ability to ensure a continuing and timely flow of competitive products and technology to the marketplace. The Company continues to develop new products and technologies and to enhance existing products in the areas of hardware and peripherals, system software, applications software, networking and communications software and solutions, and the Internet. The Company's research and development expenditures, before any charges for purchased in-process research and development, totaled $446 million, $430 million, and $380 million in 2002, 2001, and 2000, respectively.

Patents, Trademarks, Copyrights and Licenses

The Company currently holds rights to patents and copyrights relating to certain aspects of its computer systems, peripheral systems, and software. In addition, the Company has registered, and/or has applied to register, trademarks and service marks in the United States and a number of foreign countries for "Apple," the Apple silhouette logo, the Apple color logo, "Macintosh," and numerous other product trademarks and service marks. In 1986, the Company acquired ownership of the trademark "Macintosh" for use in connection with computer products. Although the Company believes the ownership of such patents, copyrights, trademarks and service marks is an important factor in its business and that its success does depend in part on the ownership thereof, the Company relies primarily on the innovative skills, technical competence, and marketing abilities of its personnel.

Many of the Company's products are designed to include intellectual property obtained from third parties. While it may be necessary in the future to seek or renew licenses relating to various aspects of its products and business methods, the Company believes that based upon past experience and industry practice, such licenses generally could be obtained on commercially reasonable terms. Because of technological changes in the computer industry, current extensive patent coverage, and the rapid rate of issuance of new patents, it is possible certain components of the Company's products and business methods may unknowingly infringe existing patents of others. The Company has from time to time been notified that it may be infringing certain patents or other intellectual property rights of others.

Information regarding claims and litigation involving the Company related to alleged patent infringement and risks related to the Company's reliance on third-party intellectual property is set forth in Part I, Item 3 of this Form 10-K, and in Part II, Item 7 of this Form 10-K under the heading "Factors That May Affect Future Results and Financial Condition."

Foreign and Domestic Operations and Geographic Data

The United States represents the Company's largest geographic marketplace. Approximately 57% of the Company's net sales in fiscal 2002 came from sales to customers inside the United States. Final assembly of products sold by the Company is conducted in the Company's manufacturing facilities in Sacramento, California, and Cork, Ireland, and by external vendors in Fullerton, California, Taiwan, Korea, the People's Republic of China, and the Czech Republic. Margins on sales of Apple products in foreign countries, and on sales of products that include components obtained from foreign suppliers, can be adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including tariffs and antidumping penalties.

Information regarding financial data by geographic segment is set forth in Part II, Item 8 of this Form 10-K in the Notes to Consolidated Financial Statements at Note 11, "Segment Information and Geographic Data." Additional information regarding the risks associated with international operations is set forth in Part II, Item 7 of this Form 10-K under the heading "Factors That May Affect Future Results and Financial Condition."

Seasonal Business

Although the Company does not consider its business to be highly seasonal, it has historically experienced increased net sales in its first and fourth fiscal quarters, compared to other quarters in its fiscal year, due to seasonal demand related to the holiday season and the school year. However, over the past two years the Company has not experienced these seasonal fluctuations in net sales due to the negative impact of current economic conditions on the overall demand for the Company's products. Past performance should not be considered a reliable indicator of the Company's future net sales or financial performance.

Warranty

The Company offers a limited parts and labor warranty on its hardware products. The warranty period is typically one year from the date of purchase by the end user. The Company also offers a 90-day warranty for Apple software and for Apple service parts used to repair Apple hardware products. In addition, consumers may purchase extended service coverage on most Apple hardware products in all of the Company's major markets.

Backlog

In the Company's experience, the actual amount of product backlog at any particular time is not a meaningful indication of its future business prospects. In particular, backlog often increases in anticipation of or immediately following new product introductions because of over ordering by dealers anticipating shortages. Backlog often is reduced once dealers and customers believe they can obtain sufficient supply. Because of the foregoing, backlog should not be considered a reliable indicator of the Company's ability to achieve any particular level of revenue or financial performance.

Environmental Laws

Compliance with federal, state, local, and foreign laws enacted for the protection of the environment has to date had no material effect upon the Company's capital expenditures, earnings, or competitive position. Although the Company does not anticipate any material adverse effects in the future based on the nature of its operations and the subject of these laws, there is no assurance that such existing laws or future laws will not have a material adverse effect on the Company.

The parliament of the European Union is working to finalize the Waste Electrical and Electronic Equipment Directive (the Directive). The Directive makes manufacturers of electrical goods, including personal computers, financially responsible for the collection, recycling, and safe disposal of past and future products. The Directive must now be approved and implemented by individual European Union governments by 2005. The Company's potential liability resulting from the Directive related to past sales of its products and expenses associated with future sales of its product may be substantial. However, because it is likely that specific laws, regulations, and enforcement policies will vary significantly between individual European member states, it is not currently possible to estimate the Company's existing liability or future expenses resulting from the Directive. As the European Union and its individual member states clarify specific requirements and policies with respect to the Directive, the Company will continue to assess its potential financial impact. Similar legislation may be enacted in other geographies, including federal and state legislation in the United States, the cumulative impact of which could be significant.

Employees

As of September 28, 2002, Apple and its subsidiaries worldwide had 10,211 employees and an additional 2,030 temporary employees and contractors.

Item 2. Properties

The Company's headquarters are located in Cupertino, California. The Company has manufacturing facilities in Sacramento, California, Cork, Ireland, and Singapore. As of September 28, 2002, the Company leased approximately 2.7 million square feet of space, primarily in the United States, and to a lesser extent, in Europe, Japan, and the Asia Pacific region. Leased space in the United States includes 395,000 square feet of retail space. Leases are generally for terms of 5 to 10 years, and usually provide renewal options for terms of 3 to 5 additional years.

The Company owns its manufacturing facilities in Cork, Ireland, and Singapore, which total approximately 617,000 square feet. The Company also owns a 752,000 square-foot facility in Sacramento, California, which is used as a manufacturing, warehousing and distribution center. The Sacramento and Cork facilities also house customer support call centers. In addition, the Company owns 930,000 square feet of facilities located in Cupertino, California, used for research and development and corporate functions. Outside the United States, the Company owns additional facilities totaling approximately 106,000 square feet.

The Company believes its existing facilities and equipment are well maintained and in good operating condition. The Company has invested in internal capacity and strategic relationships with outside manufacturing vendors, and therefore believes it has adequate manufacturing capacity for the foreseeable future. The Company continues to make investments in capital equipment as needed to meet anticipated demand for its products.

Information regarding critical business operations that are located near major earthquake faults is set forth in Part II, Item 7 of this Form 10-K under the heading "Factors That May Affect Future Results and Financial Condition."

Item 3. Legal Proceedings

The Company is subject to certain legal proceedings and claims, including those described below, which have arisen in the ordinary course of business and have not been fully adjudicated. Information regarding the risks and potential financial impact of these legal matters is set forth in Part II, Item 7 of this Form 10-K under the heading "Factors That May Affect Future Results and Financial Condition," and in Part II, Item 8 of this Form 10-K in the Notes to Consolidated Financial Statements at Note 10 under the subheading "Commitments and Contingencies."

Articulate Systems, Inc. v. Apple Computer, Inc.

Plaintiff Articulate filed this action in March 1996 in the United States District Court in Massachusetts claiming patent infringement relating to voice recognition technology. Plaintiff seeks unspecified damages and other relief. The Company has answered the complaint, denying all allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims requesting declaratory judgment for non-infringement, unenforceability and invalidity. The case was stayed for several months pending resolution of four summary judgment motions filed by the Company, all of which were denied by the Court. Through a series of corporate transactions the assets belonging to Plaintiff were acquired by a subsidiary, Lernout & Hauspie Speech Products N.V. ("L&H"). L&H filed for bankruptcy in November 2000 and is being liquidated as part of the bankruptcy. The case is currently stayed pending the resolution of the liquidation.

Bancroft v. Apple Computer, Inc.

Plaintiff Bancroft filed this purported class action on January 30, 2002 in Los Angeles Superior Court on behalf of a potentially nationwide class of purchasers of certain Power Macintosh G3 computers. Plaintiff alleges violation of the Consumer Legal Remedies Act ("CLRA") arising from allegedly poor performance while running the Company's Mac OS X operating system, specifically relating to 2D hardware acceleration, QuickTime movie hardware acceleration, 3D graphics performance and DVD movie playback. Plaintiff seeks actual damages, injunctive relief, restitution, punitive damages, attorneys' fees and other relief. The Company has answered the complaint, denying all allegations and alleging numerous affirmative defenses. The parties participated in mediation in October 2002 without resolution. The parties are in discovery.

BIAX Corporation v. Apple Computer, Inc.

Plaintiff BIAX filed this action on September 5, 2001 in the United States District Court in Delaware claiming patent infringement relating to dual processor technology. IBM and Motorola were added as defendants in an amended complaint. Plaintiff seeks unspecified damages and other relief. The Company has answered the complaint, denying all allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims requesting a declaratory judgment for non-infringement, unenforceability and invalidity. The parties are in discovery.

Dynacore Holdings Corp. v. Apple Computer, Inc.

Plaintiff Dynacore filed this action on June 6, 2001 in United States District Court for the Southern District of New York against the Company and thirteen other defendants claiming patent infringement relating to IEEE 1394 technology, also known as FireWire. Plaintiff claims that any computer system or other electronic product that uses or complies with the IEEE 1394 standard violates the patent. Plaintiff seeks unspecified damages and other relief. The Company has answered the complaint, denying all allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims requesting declaratory judgment for non-infringement and invalidity. Defendants are seeking to amend the pleading to assert a counterclaim for inequitable conduct against Dynacore. The case was stayed pending the Federal Circuit's decision in *Datapoint Corp. v. Standard Microsystems Corp.*, a related case in which plaintiff claimed that its patent was infringed by products complying with the fast Ethernet standard. In February 2002, the Federal Circuit affirmed the judgment of non-infringement in Datapoint, and the District Court lifted the stay in this action. The defendants filed a joint motion for summary judgment based upon the decision in Datapoint. The Court heard the motion on October 4, 2002 and has not yet issued its ruling.

Elonex IP Holdings Ltd., EIP Licensing, B.V. v. Apple Computer, Inc.

Plaintiffs filed this action on February 12, 2001 in the United States District Court in Delaware claiming patent infringement relating to a low power consumption monitor standby system. Plaintiffs filed numerous identical lawsuits against other computer monitor manufacturers and computer systems manufacturers. Plaintiffs seek unspecified damages and other relief. The Company answered the complaint, denying all allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims requesting declaratory judgment for non-infringement, unenforceability and invalidity of the patents at issue. The parties reached a settlement in July 2002. Settlement of this matter did not have a material effect on the Company's financial position or results of operations.

FTC Inquiry–Prado v. Apple Computer, Inc. (and related actions)

In October 1997, Apple began charging all U.S. non-education customers for live telephone technical support beyond 90 days after purchase of Apple products. In late 1997, the Federal Trade Commission (FTC) commenced an investigation into customer complaints that Apple's change in technical support practices was either unfair or contrary to earlier representations to certain customers. Four purported class action lawsuits were filed against Apple related to this change. During the fourth quarter of 1999, the

regional and national offices of the FTC approved a settlement with the Company, and a settlement was approved by the Court in three of the class action suits. In November 1999, two appeals were filed objecting to the settlement. The California Court of Appeal upheld the settlement, and the California Supreme Court denied review of the Court of Appeal's decision. No further appeals were taken and the Company is administering the settlement. Settlement of this matter did not have a material effect on the Company's financial position or results of operations.

Hawaii Structural Iron Workers and Pension Trust Fund v. Apple Computer, Inc. and Steven P. Jobs; Young v. Apple Computer, Inc. et al; Hsu v. Apple Computer Inc. et al

Beginning on September 27, 2001, three shareholder class action lawsuits were filed in the United States District Court for the Northern District of California against the Company and its Chief Executive Officer. These lawsuits are substantially identical, and purport to bring suit on behalf of persons who purchased the Company's publicly traded common stock between July 19, 2000, and September 28, 2000. The complaints allege violations of the 1934 Securities Exchange Act and seek unspecified compensatory damages and other relief. The Company believes these claims are without merit and intends to defend them vigorously. The Company filed a motion to dismiss on June 4, 2002, which was heard by the Court on September 13, 2002. On December 11, 2002, the Court granted the Company's motion to dismiss for failure to state a cause of action, with leave to plaintiffs to amend their complaint within thirty days.

Pierce et al. v. Apple Computer, Inc.

Plaintiff Pierce filed this action on June 15, 2000 in Santa Clara County Superior Court. This case was a purported nationwide consumer class action brought on behalf of purchasers of the Company's AirPort Card and AirPort Base Station ("AirPort System"). Plaintiffs alleged that the Company engaged in false advertising and unfair business practices (among other causes of action) by advertising that the AirPort System is Internet-ready and failing to disclose that the AirPort System is incompatible with certain Internet service providers, primarily America Online. The Company answered the complaint, denying all allegations and alleging numerous affirmative defenses. The parties reached a settlement that received final approval by the Court on October 8, 2002. The Company is administering the settlement. Settlement of this matter did not have a material effect on the Company's financial position or results of operations.

Pitney Bowes Inc. v. Apple Computer, Inc.

Plaintiff Pitney Bowes filed this patent infringement action on June 18, 2001 in the United States District Court in Connecticut alleging patent infringement relating to laser printer technology. Plaintiff has filed similar lawsuits against other companies. Plaintiff seeks unspecified damages and other relief. The Company has answered the complaint, denying all allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims requesting a declaratory judgment for non-infringement, unenforceability and invalidity of the patents at issue. The Connecticut Court transferred this case to the Eastern District of Kentucky on February 1, 2002 and consolidated the case with two other lawsuits, a declaratory judgment action filed by Xerox and Pitney Bowes' patent infringement case against Epson. The case is set for trial on June 8, 2004.

Sternberg v. Apple Computer, Inc. and Gordon et al. v. Apple Computer, Inc.

Plaintiff Sternberg filed this action against the Company on March 17, 2000 in the Santa Clara County Superior Court. The case was a purported nationwide consumer class action brought on behalf of purchasers of iMac DV and iMac DV SE computers. Plaintiff alleged that Apple engaged in false advertising, unfair competition and breach of warranty, among other causes of action, by marketing and selling a DVD player with iMac DV and iMac DV SE computers where the playback was unacceptable. A companion case, *Gordon et al. v. Apple Computer, Inc.* was filed by largely the same plaintiffs on June 14, 2000. This case was essentially the same as Sternberg but with respect to a different computer model—the Power Macintosh G4. The Company answered both complaints, denying all allegations and alleging numerous affirmative defenses. The parties reached a settlement in August 2001 that received final

approval by the Court on February 25, 2002. The Company is administering the settlement. Settlement of this matter did not have a material effect on the Company's financial position or results of operations.

UNOVA, Inc. v. Apple Computer, Inc., et al.

Plaintiff UNOVA filed this patent infringement action against the Company and six other defendants on May 8, 2002 in the Central District of California for infringement of eight UNOVA patents related to "Smart Battery Management". Plaintiff alleges that the Company's portable computers manufactured since 1996 infringe these eight patents. Plaintiff has filed similar lawsuits against other companies in addition to the co-defendants in this case. Plaintiff seeks unspecified damages and other relief. The Company has answered the complaint, denying all allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims requesting a declaratory judgment for non-infringement, invalidity and unenforceability.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of the Company's fiscal year ended September 28, 2002.

PART II

Item 5. Market for the Registrant's Common Equity and Related Shareholder Matters

The Company's common stock is traded on the over-the-counter market and is quoted on the Nasdaq National Market under the symbol AAPL, on the Tokyo Stock Exchange under the symbol APPLE, and on the Frankfurt Stock Exchange under the symbol APCD. As of December 6, 2002, there were 28,310 shareholders of record.

On June 21, 2000, the Company effected a two-for-one stock split in the form of a Common Stock dividend to shareholders of record as of May 19, 2000. All share price and per share data and numbers of Common shares have been retroactively adjusted to reflect the stock split. The Company did not pay cash dividends in either fiscal 2002 or 2001. The Company anticipates that, for the foreseeable future, it will retain any earnings for use in the operation of its business. The price range per share of common stock presented below represents the highest and lowest closing prices for the Company's common stock on the Nasdaq National Market during each quarter.

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Fiscal 2002 price range per common share	$ 18.74-$13.99	$ 26.11-$16.55	$ 25.45-$20.78	$ 23.76-$14.98
Fiscal 2001 price range per common share	$ 25.22-$14.68	$ 27.12-$18.75	$ 23.75-$14.44	$ 26.75-$13.63

Item 6. Selected Financial Data

The following selected financial information has been derived from the audited consolidated financial statements. The information set forth below is not necessarily indicative of results of future operations, and should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and related notes thereto included in Item 8 of this Form 10-K in order to fully understand factors that may affect the comparability of the information presented below.

Five fiscal years ended September 28, 2002 (In millions, except share and per share amounts)	2002	2001	2000	1999	1998
Net sales	$ 5,742	$ 5,363	$ 7,983	$ 6,134	$ 5,941
Net income (loss)	$ 65	$ (25)	$ 786	$ 601	$ 309
Earnings (loss) per common share:					
Basic	$ 0.18	$ (0.07)	$ 2.42	$ 2.10	$ 1.17
Diluted	$ 0.18	$ (0.07)	$ 2.18	$ 1.81	$ 1.05
Cash dividends declared per common share	$ —	$ —	$ —	$ —	$ —
Shares used in computing earnings (loss) per share (in thousands):					
Basic	355,022	345,613	324,568	286,314	263,948
Diluted	361,785	345,613	360,324	348,328	335,834
Cash, cash equivalents, and short-term investments	$ 4,337	$ 4,336	$ 4,027	$ 3,226	$ 2,300
Total assets	$ 6,298	$ 6,021	$ 6,803	$ 5,161	$ 4,289
Long-term debt	$ 316	$ 317	$ 300	$ 300	$ 954
Total liabilities	$ 2,203	$ 2,101	$ 2,696	$ 2,057	$ 2,647
Shareholders' equity	$ 4,095	$ 3,920	$ 4,107	$ 3,104	$ 1,642

A net loss before taxes related to the Company's non-current debt and equity investments of $42 million was recognized in 2002. Net gains before taxes related to the Company's non-current debt and equity investments of $75 million, $367 million, $230 million, and $40 million were recognized in 2001, 2000, 1999, and 1998, respectively. In 2002, the Company acquired Emagic resulting in a charge of approximately

$1 million for acquired in-process technologies with no alternative future use. The Company recognized a similar charge of $11 million in 2001 related to its acquisition of PowerSchool. Net charges related to Company restructuring actions of $30 million, $8 million, and $27 million were recognized in 2002, 2000, and 1999, respectively. During 2000, the Company recognized the cost of a special executive bonus for the Company's Chief Executive Officer for past services in the form of an aircraft with a total cost to the Company of approximately $90 million. In 2002, of the original $90 million accrual, $2 million remained unspent and was reversed.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This section and other parts of this Form 10-K contain forward-looking statements that involve risks and uncertainties. The Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Factors That May Affect Future Results and Financial Condition" below. The following discussion should be read in conjunction with the consolidated financial statements and notes thereto included in Item 8 of this Form 10-K. All information presented herein is based on the Company's fiscal calendar.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with generally accepted accounting principles and the Company's discussion and analysis of its financial condition and results of operations requires the Company's management to make judgments, assumptions and estimates that affect the amounts reported in its consolidated financial statements and accompanying notes. Note 1 of the Notes to Consolidated Financial Statements in Item 8 of this Form 10-K describe the significant accounting policies and methods used in the preparation of the Company's consolidated financial statements. Management bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates.

Management believes the following to be critical accounting policies. That is, they are both important to the portrayal of the Company's financial condition and results, and they require management to make judgments and estimates about matters that are inherently uncertain.

Revenue Recognition

The Company recognizes revenue pursuant to applicable accounting standards, including Statement of Position (SOP) No. 97-2, *Software Revenue Recognition*, as amended, and Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements*. SAB 101, as amended, summarizes certain of the SEC's views in applying generally accepted accounting principles to revenue recognition in financial statements and provides guidance on revenue recognition issues in the absence of authoritative literature addressing a specific arrangement or a specific industry.

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectibility is probable. Product is considered delivered to the customer once it has been shipped, and title and risk of loss have been transferred. Revenue on multiple element sales arrangements is allocated to various elements based on vendor specific objective evidence of the fair value of each element of the transaction and is recognized as each element is delivered.

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end user rebates and other sales programs and volume-based incentives. Future market conditions and product transitions may require the Company to increase customer incentive programs and incur incremental price protection obligations that could result in incremental reductions of revenue at the time such programs are offered. Additionally, certain customer

incentive programs require management to estimate the number of customers who will actually redeem the incentive based on historical experience and the specific terms and conditions of particular incentive programs. If a greater than estimated proportion of customers redeem such incentives, the Company would be required to record additional reductions to revenue.

Allowance for Doubtful Accounts

The Company distributes its products through third-party computer resellers and directly to certain education, consumer, and commercial customers. The Company generally does not require collateral from its customers. However, when possible, the Company does attempt to limit credit risk on trade receivables through the use of flooring arrangements for selected customers with third-party financing companies and credit insurance for certain customers in Europe, Asia, and Latin America. However, considerable trade receivables that are not covered by collateral, flooring arrangements, or credit insurance are outstanding with the Company's distribution and retail channel partners.

The allowance for doubtful accounts is based on management's assessment of the collectibility of specific customer accounts and includes consideration of the credit worthiness and financial condition of those specific customers. The Company records an allowance to reduce the specific receivables to the amount that is reasonably believed to be collectible. The Company also records an allowance for all other trade receivables based on multiple factors including historical experience with bad debts, the general economic environment, the financial condition of the Company's distribution channels, and the aging of such receivables. If there is a deterioration of a major customer's financial condition, if the Company becomes aware of additional information related to the credit worthiness of a major customer, or if future actual default rates on trade receivables in general differ from those currently anticipated, the Company may have to adjust its allowance for doubtful accounts, which would affect earnings in the period the adjustments are made.

Inventory Valuation and Inventory Purchase Commitments

The Company must order components for its products and build inventory in advance of product shipments. The Company records a write-down for inventories of components and products, including third-party products held for resale, which have become obsolete or are in excess of anticipated demand or net realizable value. The Company performs a detailed review of inventory each period that considers multiple factors including demand forecasts, product lifecycle status, product development plans, and component cost trends. The personal computer industry is subject to a rapid and unpredictable pace of product and component obsolescence. If future demand or market conditions for the Company's products are less favorable than forecasted or if unforeseen technological changes negatively impact the utility of component inventory, the Company may be required to record additional write-downs which would negatively affect gross margins in the period when the write-downs are made.

The Company accrues necessary reserves for cancellation fees related to component orders that have been canceled. Consistent with industry practice, the Company acquires components through a combination of formal purchase orders, supplier contracts, and open orders based on projected demand information. These formal and informal commitments typically cover the Company's requirements for periods ranging from 30 to 130 days. If there is an abrupt and substantial decline in demand for one or more of the Company's products or an unanticipated change in technological requirements for any of the Company's products, the Company may be required to record additional reserves for cancellation fees, negatively affecting gross margins in the period when the cancellation fees are identified.

Valuation of Long-Lived Assets Including Acquired Intangibles

The Company reviews property, plant, and equipment and certain identifiable intangible assets for impairment whenever events or changes in circumstances indicate the carrying amount of such an asset may not be recoverable. Recoverability of these assets is measured by comparison of their carrying amount to future undiscounted cash flows the assets are expected to generate. If such assets are considered to be

impaired, the impairment to be recognized in earnings equals the amount by which the carrying value of the assets exceeds their fair market value. Although the Company has recognized no material impairment adjustments related to its property, plant, and equipment or identifiable intangibles during the past three fiscal years, except those made in conjunction with restructuring actions, deterioration in the Company's business in a geographic region or business segment in the future, including deterioration in the performance of individual retail stores, could lead to such impairment adjustments in the future periods in which such business issues are identified.

As of September 28, 2002, the Company had $85 million in goodwill. The Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets*, in the first quarter of fiscal 2002. As a result, the Company no longer amortizes goodwill but instead performs a review of goodwill for impairment annually, or earlier if indicators of potential impairment exist. The review of goodwill for potential impairment is highly subjective and requires that: (1) goodwill be allocated to various business units of the Company's business to which it relates; (2) the Company estimate the fair value of those business units to which the goodwill relates; and (3) the Company determine the book value of those business units. If the estimated fair value of business units with allocated goodwill is determined to be less than their book value, the Company is required to estimate the fair value of all identifiable assets and liabilities of those business units in a manner similar to a purchase price allocation for an acquired business. This requires independent valuation of certain internally developed and unrecognized assets including in-process research and development and developed technology. Once this process is complete, the amount of goodwill impairment, if any, can be determined.

Based on the Company's estimates as of September 28, 2002, there was no impairment of goodwill. However, changes in various circumstances including changes in the Company's market capitalization, changes in the Company's forecasts, and changes in the Company's internal business structure could cause one or more of the Company's business units to be valued differently thereby causing an impairment of goodwill. Additionally, in response to changes in the personal computer industry and changes in global or regional economic conditions, the Company may strategically realign its resources and consider restructuring, disposing of, or otherwise exiting businesses, which could result in an impairment of property, plant, and equipment, identifiable intangibles, or goodwill.

Valuation of Non-Current Debt and Equity Investments

As of September 28, 2002, the Company held investments in certain debt and equity securities with a combined carrying value of $39 million. These investments, which are reflected in the consolidated balance sheets as non-current debt and equity investments, have been categorized as available-for-sale requiring that they be carried at fair value with unrealized gains and losses, net of taxes, reported in equity as a component of accumulated other comprehensive income. The Company recognizes an impairment charge to earnings when it is judged an investment has experienced a decline in value that is other-than-temporary. The Company has recognized material impairment charges related to its non-current debt and equity investments in two quarters during the last two fiscal years. Various factors are considered in determining whether a decline in value is other-than-temporary, including the length of time and extent to which the investment's market value has been less than its cost basis, the financial condition and near-term prospects of the issuer, and the Company's intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

The Company's non-current debt and equity investments are in public companies whose security prices are subject to significant volatility. The Company recognized a pre-tax impairment loss of $50 million related to two of these investments in the fourth quarter of 2002. As a result, as of September 28, 2002, the Company had no significant unrealized gains or losses recorded against the carrying value of its non-current debt and equity investments. Should the fair value of these investments fall below the Company's current cost bases and/or the financial condition or prospects of either company deteriorate, the Company may determine in a future period that such a decline in fair value is other-than-temporary,

requiring an impairment loss be recognized in the period such a determination is made. Additional information regarding these investments and potential charges related to their impairment may be found below under the caption "Factors That May Affect Future Results and Financial Condition."

Net Sales

Net sales and Macintosh unit sales for geographic segments and by product follow (net sales in millions and Macintosh unit sales in thousands):

	2002	Change	2001	Change	2000
Americas net sales	$ 3,088	3 %	$ 2,996	(30)%	$ 4,298
Europe net sales	1,251	0 %	1,249	(31)%	1,817
Japan net sales	710	0 %	713	(47)%	1,345
Retail net sales	283	—	19	—	—
Other segments net sales	410	6 %	386	(26)%	523
Total net sales	$ 5,742	7 %	$ 5,363	(33)%	$ 7,983
Americas Macintosh unit sales	1,728	(2)%	1,768	(29)%	2,507
Europe Macintosh unit sales	722	(4)%	754	(32)%	1,110
Japan Macintosh unit sales	386	(2)%	394	(46)%	730
Retail Macintosh unit sales	92	—	7	—	—
Other segments Macintosh unit sales	173	5 %	164	(22)%	211
Total Macintosh unit sales	3,101	0 %	3,087	(32)%	4,558
Power Macintosh net sales (a)	$ 1,380	(17)%	$ 1,664	(39)%	$ 2,747
PowerBook net sales	831	2 %	813	(14)%	948
iMac net sales	1,448	30 %	1,117	(53)%	2,381
iBook net sales	875	8 %	809	0 %	809
Software, Service, and Other net sales	1,208	26 %	960	(13)%	1,098
Total net sales	$ 5,742	7 %	$ 5,363	(33)%	$ 7,983
Power Macintosh unit sales (a)	766	(18)%	937	(35)%	1,436

PowerBook unit sales	357	3 %	346	(10)%	383
iMac unit sales	1,301	8 %	1,208	(45)%	2,194
iBook unit sales	677	14 %	596	9 %	545
Total Macintosh unit sales	3,101	0 %	3,087	(32)%	4,558
Net sales per Macintosh unit sold (b)	$ 1,462		$ 1,426		$ 1,510

(a) Includes server sales and amounts previously reported as Power Macintosh G4 Cube.

(b) Based on net sales associated with Macintosh units and total Macintosh units sold.

Net sales increased $379 million or 7% during 2002 compared to 2001, while Macintosh unit sales were relatively flat year-over-year at approximately 3.1 million units. On a geographic basis, performance in the domestic market was relatively strong, especially when considering the performance of the Company's Retail segment which currently operates exclusively in the United States. However, the European and Japanese markets remained sluggish throughout 2002. The Company's net sales in 2002 were positively influenced by a number of factors.

First, net sales from software, service, and other sources rose $248 million or 26% in 2002 versus 2001. This increase was driven by several factors including a 28% increase in combined third-party and Apple-

branded software sales; $143 million in net sales of iPod, the Company's portable digital music player that was introduced in the first half of 2002; a 9% increase in the sale of computer accessories; and a 14% increase in service revenue caused primarily by increased revenue associated with extended maintenance and support contracts. The growth in software revenue was primarily the result of increased sales of third-party software in the Company's retail and online stores and expansion in recent years in the number of Apple-branded software titles.

Second, overall unit sales of Macintosh portable systems grew by 92,000 units or 10% in 2002 reflecting a general trend in the personal computer market away from desktop systems towards portable systems. During 2002, portable Macintosh systems represented 33% of total systems sales versus 31% in 2001 and 20% in 2000. Growth in this area has been most pronounced for iBook, the Company's education and consumer oriented portable Macintosh system. iBook unit sales increased 14% in 2002 and 9% in 2001.

Third, the Company's Retail segment grew from 8 stores at the end of 2001 to 40 stores at the end of 2002. The Retail segment's net sales grew from $19 million in 2001 to $283 million in 2002. While the Retail segment may cannibalize some net sales from the Company's preexisting sales channels in the U.S., the Company does believe that a substantial portion of the Retail segment's net sales are incremental to the Company's total net sales. See additional comments below related to the Retail segment under the heading "Segment Operating Performance."

Fourth, the Company's average unit pricing remained relatively stable during 2002 as a result of various changes in overall unit mix offset by somewhat lower pricing year-over-year on comparative Macintosh systems. Net sales per Macintosh unit sold during 2002 of $1,462 per unit reflects the shift in mix towards relatively higher-priced portable Macintosh systems and reflects the impact on net sales of the relatively higher-priced new iMac design introduced during 2002. The impact of these changes in mix were offset by the decline in unit sales of relatively higher-priced Power Macintosh systems and by lower pricing on comparative Macintosh systems during 2002 for most of the Company's Macintosh product lines in response to industry pricing pressure.

Fifth, any comparison of net sales in 2002 versus 2001 must consider the effect of unusually low net sales during the first quarter of 2001. As discussed below, this was attributable to several factors at the beginning of 2001, including continuing deterioration in worldwide demand for personal computers, rebate programs and price cuts instituted by the Company during that quarter that cost the Company approximately $138 million, and a plan implemented by the Company during the first quarter of 2001 to reduce substantially the level of inventory in its distribution channels that resulted in a decline in channel inventory of approximately 300,000 units during that quarter. Net sales during the first quarter of 2001 are discussed in more detail below.

Offsetting the favorable factors discussed above, the Company's net sales in 2002 were negatively impacted by several notable factors. First, unit sales of Power Macintosh systems fell 18% during 2002 as compared to 2001. This followed a 35% decline in Power

Macintosh unit sales in 2001 from 2000. The Company continues to believe that weak economic conditions over the past several years are having a pronounced negative impact on its professional and creative customers and that many of these customers continue to delay upgrades of their Power Macintosh systems due to the Company's ongoing transition to Mac OS X, its new operating system, and in anticipation of certain software vendors transitioning their Macintosh applications to run natively in Mac OS X. Further, the Company did not experience the anticipated increase in Power Macintosh sales that it expected following the introduction of Adobe's PhotoShop 7 during 2002. Additionally, many professional users may have postponed upgrading their systems until after the introduction of Mac OS X Jaguar released in the fourth quarter of 2002. Others may have delayed upgrading until after the availability of other professionally oriented software applications for Mac OS X such as QuarkXpress.

Second, despite the overall increase in net sales during 2002 in the Americas, the Company continues to see weakness in its U.S. education channel. Total net sales in this channel fell 15% in 2002 and 4% in 2001. These declines are consistent with industry data that shows the Company losing market share in the U.S. education market in each of the last two fiscal years. The Company believes this weakness has been caused by multiple factors, including increased price competition in this price sensitive market from the Company's competitors who sell Windows-based personal computers. Additionally, some of the Company's education customers appear to be delaying technology purchases due to concerns about the overall impact of the weaker economy on their available funding. The Company continues to take steps to address weakness in the U.S. education channel. However, it is difficult to anticipate how this trend will affect fiscal 2003 and to anticipate when and if this trend will reverse.

Third, the personal computer industry in general and the Company specifically continue to see relatively soft demand for its products. Despite an overall increase in unit sales of consumer oriented Macintosh systems during 2002, consumer sales remain far below levels experienced in 2000 and earlier. Worsening global economic conditions over the past three years exacerbated by the economic and political uncertainties caused by terrorist activities and the associated international responses have clearly had a pronounced negative effect on the overall demand for the Company's products in virtually all of its markets. Further, growth in the overall personal computer industry has been slowed due to the high market penetration of personal computers and a lengthening of consumer, creative, and business personal computer upgrade cycles. In short, the Company believes that expansion in the overall market for personal computers has for the most part stalled and that growth awaits a combination of economic recovery and technological advancements.

Net sales decreased $2.6 billion or 33% during 2001 compared to 2000, while Macintosh unit sales fell 32% from 2000. Demand for all of the Company's products in all of the Company's geographic operating segments was negatively impacted throughout 2001 by unfavorable global economic conditions. On a year-over-year basis, net sales and Macintosh unit sales were down in all of the Company's geographic operating segments, and net sales and unit sales by product were down for each Macintosh product category except iBook. In addition to general economic conditions, two other primary factors contributed to the decline in net sales during 2001. First, as discussed below, the Company executed a plan during the first three quarters of 2001 to reduce substantially the level of inventory in its distribution channels. As a result of these efforts, the Company's Macintosh channel inventory fell by approximately 450,000 units during the first nine months of 2001. Second, the Company believes that many of its professional users were delaying upgrades of their Power Macintosh systems due to the Company's ongoing transition to Mac OS X, its new operating system, and in anticipation of software vendors transitioning their Mac applications to run natively in Mac OS X.

Several positive factors combined to partially mitigate the overall decline in net sales during 2001. The net sales per Macintosh unit sold remained relatively strong during 2001 after adjusting for the $138 million impact to net sales of the rebate programs and price cuts instituted by the Company during the first quarter of 2001, falling only about 2.5% from 2000. The relatively strong per unit sales in 2001 reflects somewhat lower year-over-year pricing on comparative systems, offset by a shift in overall sales mix toward higher-priced portable systems. Also, the Company experienced very little shift in the mix of overall combined unit sales of relatively lower-priced consumer and education Macintosh systems, iMac and iBook, and their higher-priced professionally oriented equivalents. Combined unit sales of iMac and iBook systems accounted for 58% of total Macintosh unit sales in 2001 and 60% in 2000. Second, combined unit sales of portable systems, iBook and PowerBook, actually rose 2% during 2001 despite the negative economic climate and the overall decline in unit sales. Not only does this increase in portable system sales reflect a general industry shift toward portable systems, it is also specifically attributable to the strong demand for redesigned iBooks introduced during the third quarter of 2001 and for the Titanium PowerBook G4 which was introduced during the second quarter of 2001. Third, a small decline in net sales

in the U.S. education market during 2001 compared to 2000 was partially mitigated by a 7% increase in U.S. education unit sales during 2001.

First quarter 2001 net sales decreased 57% to $1.007 billion compared to the same quarter in 2000 and decreased 46% from the fourth quarter of 2000. Both the year-over-year and sequential declines in net sales during the first quarter of 2001 were attributable to several factors, including continued deterioration in worldwide demand for personal computers and rebate programs and price cuts instituted by the Company during the quarter that cost the Company approximately $138 million. In addition, the Company implemented a plan during the first quarter to reduce substantially the level of inventory in its distribution channels from the amounts at the end of fiscal 2000 to lower levels by the end of the first quarter of 2001. The Company ended fiscal 2000 with substantially more inventory in its distribution channels than planned due to the lower than expected sell-through of the Company's products during the fourth quarter of that year. The Company reduced Macintosh channel inventory during the first quarter by approximately 300,000 units. These factors contributed to the 52% year-over-year decline during the first quarter in total Macintosh unit sales that were experienced across the Company's entire product line. These factors also reduced the net sales per Macintosh unit sold (a function of total net sales associated with Macintosh units and total Macintosh CPU unit sales) during the first quarter of 2001 to $1,476, a decline of approximately 12% from the same period in 2000.

Segment Operating Performance

The Company manages its business primarily on a geographic basis. The Company's reportable operating segments include the Americas, Europe, Japan, and Retail. The Americas segment includes both North and South America, except for the Company's Retail segment. The European segment includes European countries as well as the Middle East and Africa. The Japan segment includes only Japan. The Retail segment operates Apple-owned retail stores in the United States. Each reportable geographic operating segment provides similar hardware and software products and similar services. Further information regarding the Company's operating segments may be found in Part II, Item 8 on this Form 10-K in the Notes to Consolidated Financial Statements at Note 11, "Segment Information and Geographic Data."

Americas

Net sales for the Americas segment increased 3% or $92 million in 2002. As discussed above, the Americas segment was negatively affected by a decline in U.S. education sales in 2002 of $215 million. The Americas segment also experienced a 17% decline in Power Macintosh unit sales. However, outside of the U.S. education channel, unit sales of consumer desktop and portable systems rebounded from the substantial declines experienced in 2001, rising a combined 31% in 2002. Sales of software, peripherals, and accessories were also up in the Americas during 2002. Growth in unit sales of consumer oriented systems during 2002 in the Americas is somewhat attributable to the significantly depressed level of net sales experienced in the first quarter of 2001 discussed above. However, growth in the Americas was somewhat negatively affected, particularly with respect to consumer-oriented systems, by the significant growth of the Company's Retail segment in the U.S. More than 70% of the Retail segment's Macintosh unit sales during 2002 were for iMacs and iBooks.

The Americas segment's 2001 net sales and unit sales declined 30% and 29%, respectively, from 2000. The operating performance of the Americas segment for 2001 reflects the Company's overall performance characterized by significant declines in year-over-year quarterly net sales and units sales, particularly during the first quarter and particularly in consumer channels, with sequential increases in unit sales and net sales during each of the last three quarters of 2001. Net sales in the Americas segment during 2001 were also negatively affected by the Company's overall reduction in channel inventories during the year. Consumer sales in the Americas were particularly hard hit by current economic conditions. Outside of the U.S. education channel, unit sales of the Company's consumer oriented iMac fell 64% in 2001. The effect of falling consumer demand in the Americas segment was partially offset by strong U.S. education sales. The Company's unit sales in U.S. education markets rose 7% in 2001 driven by the acceptance of the

Company's new portable products, particularly the iBook, and reflect a general shift in demand in the U.S. education market towards portable versus desktop systems. Portable systems accounted for 28% of total unit sales in the Company's U.S. education market in 2001 compared to 18% during 2000.

During 2002 and 2001, the Americas segment represented approximately 54% and 56%, respectively, of the Company's total net sales and represented approximately 56% and 57%, respectively, of total Macintosh unit sales.

Europe

Economic conditions in Europe remained weak throughout 2002, and the overall demand for the Company's products in that region remained flat during 2002 versus 2001. Unit sales in Europe for 2002 reflect relatively stronger demand for consumer-oriented products, particularly iBook whose unit sales increased 27% in 2002, offset by declines in Power Macintosh unit sales.

Net sales in Europe fell $568 million or 31% during 2001 compared to 2000, while Europe's unit sales fell 32%. Europe's results reflect the worsening economic climate in Europe in the latter half of 2001 and reductions in channel inventories as experienced in the

Company's other geographic operating segments. Combined unit sales of the Company's consumer oriented products in Europe were particularly impacted during 2001, falling 40% from 2000.

Japan

Net sales in Japan remained flat during 2002 versus 2001, with a slight decline in unit sales of 2%. Consistent with the Company's other geographic operating segments, during 2002 Japan showed growth in unit sales of consumer systems and a decline in unit sales of Power Macintosh systems. Japan's iMac unit sales increased 85% in 2002. However, in the case of Japan the increase in iMac unit shipments in 2002 versus 2001 was primarily the result of the unusually depressed level of net sales experienced by the Company in the first quarter of 2001 discussed above. Additionally, net sales in Japan on a sequential and year-over-year comparative basis generally worsened as 2002 progressed reflecting particularly poor economic conditions that currently exist in Japan.

Net sales and unit sales in Japan fell 47% and 46%, respectively, in 2001 versus 2000. Although unit sales and net sales in Japan have generally trended upwards as 2001 progressed, the Japan segment has been particularly affected by current unfavorable economic conditions. Reflecting the continuing harsh consumer climate in Japan, the Japan segment's combined unit sales of iMacs and iBooks during 2001 were down 58% from 2000, and professionally oriented systems unit sales fell 30%.

Retail

By the end of September 2002, the Company had 40 retail stores operating in the United States, 32 of which were opened during fiscal 2002. The Company has opened 11 additional stores during the first quarter of 2003. During 2002, approximately 39% of the Retail segment's net sales came from the sale of Apple-branded and third-party peripherals and software. This compares to 21% for the Company as a whole. With an average of 35 stores open, the Retail segment achieved average annualized revenue per store during the fourth quarter of approximately $12 million and had approximately 2.25 million visitors. The Retail segment reported a loss for all of 2002 of $22 million, and a loss for the fourth quarter of 2002 of $3 million.

Expansion of the Retail segment has required and will continue to require a substantial investment in fixed assets and related infrastructure, operating lease commitments, personnel, and other operating expenses. Capital expenditures associated with the Retail segment totaled $106 million in 2002 and $92 million in 2001. As of September 28, 2002, the Retail segment had 807 employees and had outstanding operating lease commitments associated with retail store space and related facilities of $209 million. The Company would incur substantial costs should it choose to terminate its Retail segment or close individual stores. Such costs could adversely affect the Company's results of operations and financial condition. Investment

in a new business model such as the Retail segment is inherently risky, particularly in light of the significant investment involved, the current economic climate, and the fixed nature of a substantial portion of the Retail segment's operating expenses. Results for this segment are dependent upon a number of risks and uncertainties, some of which are discussed below under the heading "Factors That May Affect Future Results and Financial Condition."

Backlog

In the Company's experience, the actual amount of product backlog at any particular time is not a meaningful indication of its future business prospects. In particular, backlog often increases in anticipation of or immediately following new product introductions because of over-ordering by dealers anticipating shortages. Backlog often is reduced once dealers and customers believe they can obtain sufficient supply. Because of the foregoing, backlog cannot be considered a reliable indicator of the Company's ability to achieve any particular level of revenue or financial performance. Further information regarding the Company's backlog may be found below under the heading "Factors That May Affect Future Results and Financial Condition."

Gross Margin

Gross margin for the three fiscal years ended September 28, 2002 are as follows (in millions, except gross margin percentages):

	2002	2001	2000
Net sales	$ 5,742	$ 5,363	$ 7,983
Cost of sales	4,139	4,128	5,817
Gross margin	$ 1,603	$ 1,235	$ 2,166

Gross margin percentage	28%	23%	27%

Gross margin increased to 28% of net sales in 2002 from 23% in 2001. As discussed below, gross margin in 2001 was unusually low resulting from negative gross margin of 2% experienced in the first quarter of 2001. As a percentage of net sales, the Company's quarterly gross margins declined during fiscal 2002 from 31% in the first quarter down to 26% in the fourth quarter. This decline resulted from several factors including a rise in component costs as the year progressed and aggressive pricing by the Company across its products lines instituted as a result of continued pricing pressures in the personal computer industry. The Company anticipates that its gross margin and the gross margin of the overall personal computer industry will remain under pressure throughout fiscal 2003 in light of weak economic conditions, flat demand for personal computers in general, and the resulting pressure on prices.

The foregoing statements regarding anticipated gross margin in 2003 and the general demand for personal computers during 2003 are forward-looking. Gross margin could differ from anticipated levels because of several factors, including certain of those set forth below in the subsection entitled "Factors That May Affect Future Results and Financial Condition." There can be no assurance that current gross margins will be maintained, targeted gross margin levels will be achieved, or current margins on existing individual products will be maintained. In general, gross margins and margins on individual products will remain under significant downward pressure due to a variety of factors, including continued industry wide global pricing pressures, increased competition, compressed product life cycles, potential increases in the cost and availability of raw material and outside manufacturing services, and potential changes to the Company's product mix, including higher unit sales of consumer products with lower average selling prices and lower gross margins. In response to these downward pressures, the Company expects it will continue to take pricing actions with respect to its products. Gross margins could also be affected by the Company's ability to effectively manage quality problems and warranty costs and to stimulate demand for certain of its products. The Company's operating strategy and pricing take into account anticipated changes in foreign

currency exchange rates over time; however, the Company's results of operations can be significantly affected in the short-term by fluctuations in exchange rates.

The Company orders components for its products and builds inventory in advance of product shipments. Because the Company's markets are volatile and subject to rapid technology and price changes, there is a risk the Company will forecast incorrectly and produce or order from third parties excess or insufficient inventories of particular products or components. The Company's operating results and financial condition have been in the past and may in the future be materially adversely affected by the Company's ability to manage its inventory levels and outstanding purchase commitments and to respond to short-term shifts in customer demand patterns.

Gross margin declined to 23% of net sales in 2001 from 27% in 2000. This decline resulted primarily from gross margin of negative 2% experienced during the first quarter of 2001 compared to 26% gross margin for the same quarter in 2000. In addition to lower than normal net sales, first quarter 2001 margins were negatively impacted by the rebate programs and price cuts discussed above that decreased revenue by approximately $138 million. Additionally, actual and forecasted declines in net sales caused the Company to recognize during the first quarter of 2001 approximately $122 million of charges associated with purchase order cancellations and loss commitments for component purchases. Without these charges, gross margin for the first quarter of 2001 would have been approximately 21%, and gross margin for all of 2001 would have been approximately 27%. As a percentage of net sales, the Company's gross margin increased each quarter as 2001 progressed reaching 30% during the fourth quarter. This pattern reflects the favorable impact during 2001 of declining component costs, especially for DRAM, hard drives, and flat panel screens.

Operating Expenses

Operating expenses for the three fiscal years ended September 28, 2002 are as follows (in millions, except for percentages):

	2002	2001	2000
Research and development	$ 446	$ 430	$ 380
Percentage of net sales	8%	8%	5%
Selling, general, and administrative expenses	$ 1,111	$ 1,138	$ 1,166
Percentage of net sales	19%	21%	15%

Research and Development (R&D)

The Company recognizes that focused investments in R&D are critical to its future growth and competitive position in the marketplace and are directly related to timely development of new and enhanced products that are central to the Company's core business strategy.

R&D expense increased 4% or $16 million to $446 million in 2002 as compared to 2001. This followed a $50 million or 13% increase in 2001 as compared to 2000. The overall increase in R&D expense over the last two years relates primarily to increased R&D headcount and support for new product development activities. R&D spending in 2002 also included capitalized software development costs of approximately $13.3 million associated with the development of Mac OS X Jaguar and approximately $6 million associated with the new PowerSchool enterprise student information system. R&D spending in 2001 also included capitalized software development costs of approximately $5.4 million associated with the development of the original version of Mac OS X. Further information related to the Company's capitalization of software development costs may be found in Part II, Item 8 of this Form 10-K at Note 1 of Notes to Consolidated Financial Statements.

Selling, General, and Administrative Expense (SG&A)

SG&A decreased $27 million or 2% during 2002 as compared to 2001. The decrease in SG&A in 2002 is primarily the result of lower discretionary spending on marketing and advertising expenses, decreased spending related to information systems, and benefits directly related to the Company's restructuring

actions in 2002 and 2001. These decreases were partially offset by higher sales expense in 2002 resulting from increased operating expenses associated with expansion of the Company's Retail segment. SG&A expenditures decreased $28 million or 2% during 2001 as compared to 2000. Declines in SG&A spending in both 2002 and 2001 reflect the Company's overall efforts to stabilize and selectively reduce recurring SG&A costs in light of lower net sales and to reduce discretionary marketing and advertising expenses. Given current economic conditions and the Company's continued strategic investments in new product development and its Retail segment, the Company is currently identifying additional opportunities to make appropriate reductions in SG&A costs.

Special Charges Included in Operating Expenses

Special charges included in operating expense for the three fiscal years ended September 28, 2002 are as follows (in millions):

	2002	2001	2000
Restructuring costs	$ 30	—	$ 8
Purchased in-process research and development	$ 1	$ 11	—
Executive bonus	$ (2)	—	$ 90

2002 Restructuring Actions

During fiscal 2002, the Company recorded total restructuring charges of $30 million related to actions intended to eliminate certain activities and better align the Company's operating expenses with existing general economic conditions and to partially offset the cost of continuing investments in new product development and investments in the Company's Retail operating segment. Once fully implemented, the Company estimates these restructuring actions will result in reduced quarterly operating expenses of approximately $10 million.

Of the $30 million restructuring charge for fiscal 2002, $6 million was incurred in the fourth quarter of 2002 related to actions designed to reduce headcount costs in Corporate operations and sales and to adjust its PowerSchool product strategy. Headcount actions, primarily in Corporate operations, sales, and PowerSchool related research and development, resulted in the elimination of approximately 180 positions worldwide at a cost of $1.8 million. The shift in product strategy at PowerSchool included discontinuing development and marketing of a PowerSchool product that resulted in the impairment of previously capitalized development costs associated with the product in the amount of $4.5 million. The remaining charge in 2002 of $24 million was incurred in the first quarter of 2002 and will ultimately result in the elimination of approximately 425 positions worldwide, 415 of which were eliminated by September 28, 2002, at a cost of $8 million. Positions were eliminated primarily in the Company's operations, information systems, and administrative functions. In addition, these restructuring actions also included significant changes in the Company's information systems strategy resulting in termination of equipment leases and cancellation of existing projects and activities. Related lease and contract cancellation charges totaled $12 million, and charges for asset impairments totaled $4 million. Of the total charge in 2002 of $30 million, substantially all had been spent by September 28, 2002, except for approximately $1 million related primarily to future payments on abandoned operating leases.

2000 Restructuring Actions

During the first quarter of 2000, the Company initiated restructuring actions resulting in recognition of an $8 million restructuring charge. This charge was comprised of $3 million for the write-off of various operating assets and $5 million for severance payments to approximately 95 employees associated with consolidation of various domestic and international sales and marketing functions. Of the $5 million accrued for severance, $2.5 million had been spent before the end of 2000, and the remainder was spent in 2001. Of the $3 million accrued for the write-off of various assets, substantially all was utilized before the end of 2000.

Purchased In-Process Research and Development (IPR&D)

During the fourth quarter of 2002, the Company acquired Emagic GmbH, a provider of professional software solutions for computer based music production, for approximately $30 million in cash; $551,000 of which was allocated to IPR&D. The amount of the purchase price allocated to IPR&D was expensed upon acquisition, because the technological feasibility of products under development had not been established and no alternative future uses existed. The IPR&D relates primarily to Emagic's Logic series technology and extensions. At the date of the acquisition, the products under development were between 43%-83% complete, and it was expected that the remaining work would be completed during the Company's fiscal 2003 at a cost of approximately $415,000. The remaining efforts include finalizing user interface design and development, and testing. The fair value of the IPR&D was determined by an independent third-party valuation using the income approach, which reflects the projected free cash flows that will be generated by the IPR&D projects and that are attributable to the acquired technology, and discounting the projected net cash flows back to their present value using a discount rate of 25%.

In May 2001, the Company acquired PowerSchool, Inc. (PowerSchool), a provider of web-based student information systems for K-12 schools and districts that enables schools to record, access, report, and manage their student data and performance in real-time, and gives parents real-time web access to track their children's progress. Of total purchase consideration of $66.1 million, $10.8 million was allocated to IPR&D and was expensed upon acquisition because the technological feasibility of products under development had not been established and no alternative future uses existed. The IPR&D relates to technologies representing processes and expertise employed to design, develop, and deploy a functioning, scalable web-based student information system for use by K-12 schools. At the date of the acquisition, the PowerSchool product under development was approximately 50% complete, and it was expected that the remaining 50% would be completed during the Company's fiscal 2002 at a cost of approximately $9.25 million. The remaining efforts, which were completed during 2002, included completion of coding, finalizing user interface design and development, and testing. The fair value of the IPR&D was determined by an independent third-party valuation using the income approach, which reflects the projected free cash flows that will be generated by the IPR&D projects and that are attributable to the acquired technology, and discounting the projected net cash flows back to their present value using a discount rate of 25%.

Executive Bonus

During the first quarter of 2000, the Company's Board of Directors approved a special executive bonus for the Company's Chief Executive Officer for past services in the form of an aircraft with a total cost to the Company of approximately $90 million, the majority of which was not tax deductible. Approximately half of the total charge was for the cost of the aircraft. The other half represents all other costs and taxes associated with the bonus. In the fourth quarter of 2002, all significant work and payments associated with the aircraft were complete. Of the original $90 million accrual, $2.4 million remained unspent at the end of fiscal 2002 and was reversed.

Other Income and Expense

Other income and expense for the three fiscal years ended September 28, 2002 are as follows (in millions):

	2002	2001	2000
Gains (losses) on non-current investments, net	$ (42)	$ 88	$ 367
Unrealized loss on convertible securities	$ —	(13)	$ —
Interest income	$ 118	$ 218	$ 210
Interest expense	(11)	(16)	(21)
Miscellaneous other income and expense	5	15	14

Interest and other income, net	$	112	$	217	$	203
Total other income and expense	$	70	$	292	$	570

Gains and Losses on Non-current Investments

Investments categorized as non-current debt and equity investments on the consolidated balance sheet are in equity and debt instruments of public companies. The Company's non-current debt and equity investments, and certain investments in private companies carried in other assets, have been categorized as available-for-sale requiring that they be carried at fair value with unrealized gains and losses, net of taxes, reported in equity as a component of accumulated other comprehensive income. However, the Company recognizes an impairment charge to earnings in the event a decline in fair value below the cost basis of one of these investments is determined to be other-than-temporary. The Company includes recognized gains and losses resulting from the sale or from other-than-temporary declines in fair value associated with these investments in other income and expense. Further information related to the Company's non-current debt and equity investments may be found in Part II, Item 8 of this Form 10-K at Note 2 of Notes to Consolidated Financial Statements.

During 2002, the Company determined that declines in the fair value of certain of these investments were other-than-temporary. As a result, the Company recognized a $44 million charge to earnings to write-down the basis of its investment in EarthLink, Inc. (EarthLink), a $6 million charge to earnings to write-down the basis of its investment in Akamai Technologies, Inc. (Akamai), and a $15 million charge to earnings to write-down the basis of its investment in a private company investment. These losses in 2002 were partially offset by the sale of 117,000 shares of EarthLink stock for net proceeds of $2 million and a gain before taxes of $223,000, the sale of 250,000 shares of Akamai stock for net proceeds of $2 million and a gain before taxes of $710,000, and the sale of approximately 4.7 million shares of ARM Holdings plc (ARM) stock for both net proceeds and a gain before taxes of $21 million.

During 2001, the Company sold a total of approximately 1 million shares of Akamai stock for net proceeds of $39 million and recorded a gain before taxes of $36 million, and sold a total of approximately 29.8 million shares of ARM stock for net proceeds of $176 million and recorded a gain before taxes of $174 million. These gains during 2001 were partially offset by a $114 million charge to earnings that reflected an other-than-temporary decline in the fair value of the Company's investment in EarthLink and an $8 million charge that reflected an other-than-temporary decline in the fair value of certain private company investments. During 2000, the Company sold a total of approximately 45.2 million shares of ARM stock for net proceeds of $372 million and a gain before taxes of $367 million.

The combined carrying value of the Company's investments in EarthLink, Akamai, and ARM as of September 28, 2002, was $39 million. The Company believes it is likely there will continue to be significant fluctuations in the fair value of these investments in the future.

Accounting for Derivatives and Cumulative Effect of Accounting Change

On October 1, 2000, the Company adopted Statement of Financial Accounting Standard (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*. SFAS No. 133 established accounting and reporting standards for derivative instruments, hedging activities, and exposure definition. Net of the related income tax effect of approximately $5 million, adoption of SFAS No. 133 resulted in a favorable cumulative-effect-type adjustment to net income of approximately $12 million for the first quarter of 2001. The $17 million gross transition adjustment was comprised of a $23 million favorable adjustment for the restatement to fair value of the derivative component of the Company's investment in Samsung Electronics Co., Ltd. (Samsung), partially offset by the unfavorable adjustments to certain foreign currency and interest rate derivatives. SFAS No. 133 also required the Company to adjust the carrying value of the derivative component of its investment in Samsung to earnings during the first quarter of 2001, the before tax effect of which was an unrealized loss of approximately $13 million.

Interest and Other Income, Net

Net interest and other income was $112 million in fiscal 2002, compared to $217 million in fiscal 2001. This $105 million or 48% decrease is primarily the result of declining investment yields on the Company's cash and short-term investments resulting from substantially lower market interest rates. The weighted average interest rate earned by the Company on its cash, cash equivalents and short-term investments fell to 2.85% in 2002 compared to 5.38% in 2001.

Net interest and other income increased $14 million or 7% to $217 million during 2001. The increase was due in part to interest income from higher cash and invested balances in 2001, partially offset by declining interest rates and investment yields, and a rebalancing of the aggregate investment portfolio to a higher proportion of lower risk and better credit investments. The weighted average interest rate earned by the Company on its cash, cash equivalents and short-term investments fell to 5.38% in 2001 compared to 6.12% in 2000.

The Company expects interest and other income, net to decline substantially in 2003 as declines in interest rates continue to impact earnings on the Company's investment portfolio. The Company's expects this decline to be most pronounced in the second half of the fiscal year. The foregoing statements are forward-looking. Interest and other income, net could differ from expected levels because of several factors, including certain of those set forth below in the subsection entitled "Factors That May Affect Future Results and Financial Condition." Additionally, actual future interest and other income, net may be significantly impacted by unforeseen changes in market interest rates, foreign currency exchange rates, and the fair value of the Company's short-term and long-term investments.

Provision for Income Taxes

The Company's effective tax rate for 2002 was 25% compared to the higher statutory rate due primarily to the research and development credit and the reversal of valuation allowances. As of September 28, 2002, the Company had deferred tax assets arising from deductible temporary differences, tax losses, and tax credits of $369 million before being offset against certain deferred tax liabilities for presentation on the Company's balance sheet. Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, will be sufficient to fully recover the remaining net deferred tax assets. As of September 28, 2002, a valuation allowance of $30 million was recorded against the deferred tax asset for the benefits of tax losses that may not be realized. The valuation allowance relates principally to the operating loss carryforwards acquired from NeXT and other acquisitions, the utilization of which is subject to certain limitations imposed by the Internal Revenue Code. The Company will continue to evaluate the realizability of the deferred tax assets quarterly by assessing the need for and amount of the valuation allowance.

The Internal Revenue Service (IRS) has completed audits of the Company's federal income tax returns through 1997. Substantially all IRS audit issues for years through 1997 have been resolved. Management believes that adequate provision has been made for any adjustments that may result from tax examinations.

Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board issued SFAS No. 143, *Accounting for Asset Retirement Obligations*, which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The standard applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the asset. SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset and this additional carrying amount is depreciated over the life of the asset. The Company is required to adopt the provisions of SFAS No. 143 for the first quarter of its fiscal 2003. Management does not expect the adoption of SFAS No. 143 to have a material impact on the Company's financial statements.

In August 2001, the Financial Accounting Standards Board issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (Statement 144), which supersedes both SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* and the accounting and reporting provisions of APB Opinion No. 30 (Opinion 30), *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, for the disposal of a segment of a business (as previously defined in that Opinion). SFAS No. 144 retains the fundamental provisions in SFAS No. 121 for recognizing and measuring impairment losses on long-lived assets held for use and long-lived assets to be disposed of by sale, while also resolving significant implementation issues associated with SFAS No. 121. For example, SFAS No. 144 provides guidance on how a long-lived asset that is used as part of a group should be evaluated for impairment, establishes criteria for when a long-lived asset is held for sale, and prescribes the accounting for a long-lived asset that will be disposed of other than by sale. SFAS No. 144 retains the basic provisions of Opinion 30 on how to present discontinued operations in the income statement but broadens that presentation to include a component of an entity (rather than a segment of a business). Unlike SFAS No. 121, an impairment assessment under SFAS No. 144 will never result in a write-down of goodwill. Rather, goodwill is evaluated for impairment under SFAS No. No. 142, *Goodwill and Other Intangible Assets.*

The Company is required to adopt the provisions of SFAS No. 144 for the first quarter of its fiscal 2003. Management does not expect the adoption of SFAS No. 144 for long-lived assets held for use to have a material impact on the Company's financial statements because the impairment assessment under SFAS No. 144 is largely unchanged from SFAS No. 121. The provisions of SFAS No. 144 for assets held for sale or other disposal generally are required to be applied prospectively after the adoption date to newly initiated disposal activities.

In June 2002, the Financial Accounting Standards Board issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 supersedes Emerging Issues Task Force Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs To Exit an Activity (Including Certain Costs Associated with a Restructuring)* and requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, as opposed to when management is committed to an exit plan. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. This Statement is effective for exit or disposal activities initiated after December 31, 2002. The provisions of SFAS No. 146 are required to be applied prospectively after the adoption date to newly initiated exit activities, and may affect the timing of recognizing future restructuring costs, as well as the amounts recognized.

Liquidity and Capital Resources

The following table presents selected financial information and statistics for each of the last three fiscal years (dollars in millions):

	2002	2001	2000
Cash, cash equivalents, and short-term investments	$ 4,337	$ 4,336	$ 4,027
Accounts receivable, net	$ 565	$ 466	$ 953
Inventory	$ 45	$ 11	$ 33
Working capital	$ 3,730	$ 3,625	$ 3,494
Days sales in accounts receivable (a)	36	29	46
Days of supply in inventory (b)	4	1	2
Annual operating cash flow	$ 89	$ 185	$ 868

(a) Based on ending net trade receivables and most recent quarterly net sales for each period.

(b) Based on ending inventory and most recent quarterly cost of sales for each period.

As of September 28, 2002, the Company had $4.337 billion in cash, cash equivalents, and short-term investments, virtually unchanged from the end of fiscal 2001. The primary sources of total cash, cash equivalents, and short-term investments in fiscal 2002 were $89 million in cash generated by operating activities and $105 million in proceeds from the exercise of employee stock options, offset by cash utilized for business and asset acquisitions of $52 million and capital expenditures of $174 million.

The Company believes its existing balances of cash, cash equivalents, and short-term investments will be sufficient to satisfy its working capital needs, capital expenditures, stock repurchase activity, outstanding commitments, and other liquidity requirements associated with its existing operations over the next 12 months.

Lease Commitments

As of September 28, 2002, the Company had total outstanding commitments on noncancelable operating leases of $464 million, $209 million of which related to the lease of retail space and related facilities. Remaining terms on the Company's existing operating leases range from 1 to 12 years. Subsequent to September 28, 2002, the Company entered into additional operating lease commitments for retail space with future lease commitments totaling $65 million for periods ranging from 5 to 10 years.

Long-Term Debt

The Company currently has long-term debt outstanding in the form of $300 million of aggregate principal amount 6.5% unsecured notes. The notes were sold at 99.925% of par, for an effective yield to maturity of 6.51%. The notes pay interest semiannually and mature on February 15, 2004.

Purchase Commitments with Contract Manufacturers and Component Suppliers

The Company utilizes several contract manufacturers to manufacture sub-assemblies for the Company's products and to perform final assembly and test of finished products. These contract manufacturers acquire components and build product based on demand information supplied by the Company, which typically covers periods ranging from 1 to 3 months. The Company also obtains individual components for its products from a wide variety of individual suppliers. Consistent with industry practice, the Company acquires components through a combination of formal purchase orders, supplier contracts, and open orders based on projected demand information. Such formal and informal purchase commitments typically cover the Company's forecasted component and manufacturing requirements for periods ranging from 30 to 130 days. As of September 28, 2002, the Company had outstanding third-party manufacturing commitments and component purchase commitments of approximately $525 million.

Capital Expenditures

Of total capital expenditures in 2002 of $174 million, $106 million was for retail store facilities and equipment related to the Company's Retail segment and $68 million was for corporate infrastructure including information systems enhancements and operating facilities enhancements and expansions. The Company currently anticipates it will utilize approximately $160 million for capital expenditures during 2003, approximately $77 million of which is expected to be utilized for further expansion of the Company's Retail segment and the remainder utilized to support normal replacement of existing capital assets and enhancements to general information technology infrastructure.

Stock Repurchase Plan

In July 1999, the Company's Board of Directors authorized a plan for the Company to repurchase up to $500 million of its common stock. This repurchase plan does not obligate the Company to acquire any specific number of shares or acquire shares over any specified period of time. During 2002 and 2001, the Company repurchased no common shares. However, during the fourth quarter of 2001, the Company entered into a forward purchase agreement to acquire 1.5 million shares of its common stock in September of 2003 at an average price of $16.64 per share for a total cost of $25.5 million. Since inception of the repurchase plan, the Company has repurchased or committed to repurchase a total of 6.55 million shares of its common stock at a cost of $217 million.

Non-Current Debt and Equity Investments

The Company has held significant investments in ARM, Samsung Electronics Co., Ltd, Akamai, and EarthLink. These investments are reflected in the consolidated balance sheets as non-current debt and equity investments and have been categorized as available-for-sale requiring that they be carried at fair value with unrealized gains and losses, net of taxes, reported in equity as a component of accumulated other comprehensive income. All realized gains on the sale of these investments have been included in other income. The combined fair value of these investments was $39 million, $128 million, and $786 million as of the end of fiscal 2002, 2001, and 2000, respectively. The Company believes it is likely there will continue to be significant fluctuations in the fair value of these investments in the future.

Further information related to the Company's non-current debt and equity investments may be found in Part II, Item 8 of this Form 10-K at Note 2 of Notes to Consolidated Financial Statements.

Factors That May Affect Future Results and Financial Condition

Because of the following factors, as well as other factors affecting the Company's operating results and financial condition, past financial performance should not be considered to be a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

General economic conditions and current economic and political uncertainty could adversely affect the Company.

The Company's operating performance depends significantly on general economic conditions. For much of the past 3 years, demand for the Company's products has been negatively impacted by worsening global economic conditions. Continued uncertainty about future economic conditions continues to make it difficult to forecast future operating results. Should global and regional economic conditions fail to improve or continue to deteriorate, demand for the Company's products could continue to be adversely affected, as could the financial health of its suppliers, distributors, and resellers.

The terrorist attacks that took place on September 11, 2001, disrupted commerce throughout the world and created many economic and political uncertainties that have had a strong negative impact on the global economy. The long-term effects of the September 11, 2001 attacks on the Company's future operating results and financial condition remain unknown. The national and international responses to terrorist attacks, the potential for future terrorist attacks and other acts of hostility, and the potential for war in the Middle East have created economic and political uncertainties that could adversely affect the Company's future operating results and financial condition.

The market for personal computers is highly competitive.

The personal computer industry is highly competitive and is characterized by aggressive pricing practices, downward pressure on gross margins, frequent introduction of new products, short product life cycles, continual improvement in product price/performance characteristics, price sensitivity on the part of consumers, and a large number of competitors. Over the past several years, price competition in the market for personal computers has been particularly intense. The Company's competitors who sell Windows-based personal computers have aggressively cut prices and lowered their product margins in order to gain or maintain market share in response to weakness in demand for personal computing products that began in the second half of calendar 2000. The Company's results of operations and financial condition have been, and in the future may continue to be, adversely affected by these and other industry-wide pricing pressures and downward pressures on gross margins.

The personal computer industry has also been characterized by rapid technological advances in software functionality, hardware performance, and features based on existing or emerging industry standards. Further, as the personal computer industry and its customers place more reliance on the Internet, an increasing number of Internet devices that are smaller and simpler than traditional personal computers may compete for market share with the Company's existing products. Several competitors of the Company have either targeted or announced their intention to target certain of the Company's key market segments, including consumer, education, professional and consumer digital video editing, and design and publishing. Additionally, several of the Company's competitors have introduced or announced plans to introduce products that mimic many of the unique design, technical features, and solutions of the Company's products. The Company has many substantial competitors, many of whom have greater financial, marketing, manufacturing, and technological resources, as well as broader product lines and larger installed customer bases than those of the Company. Additionally, there has been a trend towards consolidation in the personal computer industry that has resulted in larger and potentially stronger competitors in the Company's markets.

The Company is currently the only maker of hardware using the Mac OS. The Mac OS has a minority market share in the personal computer market, which is dominated by makers of computers utilizing Microsoft's Windows operating systems. The Company's future operating results and financial condition are substantially dependent on its ability to continue to develop improvements to the Macintosh platform in order to maintain perceived design and functional advantages over competing platforms, including Windows.

The Company has higher research and development and selling, general and administrative costs, as a percentage of revenues, than many of competitors.

The Company's ability to compete successfully and maintain attractive gross margins is heavily dependent upon its ability to ensure a continuing and timely flow of innovative and competitive products and technology to the marketplace. As a result, the Company incurs higher research and development costs as a percentage of revenue than its competitors who sell Windows-based personal computers. Many of these competitors seek to compete aggressively on price and maintain very low cost structures. Further, as a result of the expansion of the Company's Retail segment and costs associated with marketing the Company's brand including its unique operating system, the Company incurs higher selling costs as a percent of revenue than many of its competitors. If the Company is unable to continue to develop and sell innovative new products with attractive gross margins, its results of operations may be materially adversely affected by its operating cost structure.

The Company must successfully manage frequent product introductions and transitions.

Due to the highly volatile nature of the personal computer industry, which is characterized by dynamic customer demand patterns and rapid technological advances, the Company must continually introduce new products and technologies and enhance existing products in order to remain competitive. The success of new product introductions is dependent on a number of factors, including market acceptance, the Company's ability to manage the risks associated with product transitions, the availability of application software for new products, the effective management of inventory levels in line with anticipated product demand, the availability of products in appropriate quantities to meet anticipated demand, and the risk that new products may have quality or other defects in the early stages of introduction. Accordingly, the Company cannot determine in advance the ultimate effect that new products will have on its sales or results of operations.

During 2001, the Company introduced a new client operating system, Mac OS X, and delivered its first major upgrade, Mac OS X version 10.1. During 2002, the Company delivered another major upgrade, Mac OS X Jaguar. Inability of the Company to improve the performance and functionality of Mac OS X, advance customer acceptance of the new operating system and its upgrades, or obtain the continued commitment of software developers to transition existing applications to run on Mac OS X or create new applications to run on Mac OS X, may have an adverse impact on the Company's operating results and financial condition.

Because orders for components, and in some cases commitments to purchase components, must be placed in advance of customer orders, the Company faces substantial inventory risk.

The Company records a write-down for inventories of components and products that have become obsolete or are in excess of anticipated demand or net realizable value and accrues necessary reserves for cancellation fees of orders for inventories that have been canceled. Although the Company believes its inventory and related provisions are adequate, given the rapid and unpredictable pace of product obsolescence in the computer industry, no assurance can be given the Company will not incur additional inventory and related charges. In addition, such charges have had, and may again have, a material effect on the Company's financial position and results of operations.

The Company must order components for its products and build inventory in advance of product shipments. Because the Company's markets are volatile and subject to rapid technology and price changes, there is a risk the Company will forecast incorrectly and produce or order from third parties excess or insufficient inventories of particular products. Consistent with industry practice, components are normally acquired through a combination of formal purchase orders, supplier contracts, and open orders based on projected demand information. Such formal and informal purchase commitments typically cover the Company's forecasted component and manufacturing requirements for periods ranging from 30 to 130 days. The Company's operating results and financial condition have been in the past and may in the future be materially adversely affected by the Company's ability to manage its inventory levels and respond to short-term shifts in customer demand patterns.

Future operating results are dependent upon the Company's ability to obtain a sufficient supply of components, some of which are in short supply or available only from limited sources.

Although most components essential to the Company's business are generally available from multiple sources, certain key components including microprocessors and application specific integrated circuits ("ASICs") are currently obtained by the Company from single or limited sources. Some key components (including without limitation DRAM, TFT-LCD flat-panel displays, and optical and magnetic disk drives), while currently available to the Company from multiple sources, are at times subject to industry-wide availability and pricing pressures. In addition, new products introduced by the Company often initially utilize custom components obtained from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. In situations where a component or product utilizes new technologies, initial capacity constraints may exist until such time as the suppliers' yields have

matured. The Company and other producers in the personal computer industry also compete for various components with other industries that have experienced increased demand for their products. The Company uses some components that are not common to the rest of the personal computer industry including certain microprocessors and ASICs. Continued availability of these components may be affected if producers were to decide to concentrate on the production of components other than those customized to meet the Company's requirements. If the supply of a key component were to be delayed or constrained on a new or existing product, the Company's results of operations and financial condition could be adversely affected.

The Company's ability to produce and market competitive products is also dependent on the ability and desire of IBM and Motorola, the sole suppliers of the PowerPC RISC-based microprocessor for the Company's Macintosh computers, to provide the Company with a sufficient supply of microprocessors with price/performance features that compare favorably to those supplied to the Company's competitors by Intel Corporation and other developers and producers of microprocessors used by personal computers using the Windows operating systems. Further, despite its efforts to educate the marketplace to the contrary, the Company believes that many of its current and potential customers believe that the relatively slower MHz rating or clock speed of the microprocessors it utilizes in its Macintosh systems compares unfavorably to those utilized by Windows-based systems and translates to slower overall system performance. There have been instances in recent years where the inability of the Company's suppliers to provide advanced G4 and G3 microprocessors with higher clock speeds in sufficient quantity has had significant adverse effects on the Company's results of operations. The inability in the future of the Company to obtain microprocessors in sufficient quantities with competitive price/performance features could have an adverse impact on the Company's results of operations and financial condition.

The Company is dependent on manufacturing and logistics services provided by third parties, many of whom are located outside of the United States.

Many of the Company's products are manufactured in whole or in part by third-party manufacturers. In addition, the Company has outsourced much of its transportation and logistics management. While outsourcing arrangements may lower the fixed cost of operations, they also reduce the Company's direct control over production and distribution. It is uncertain what effect such diminished control will have on the quality or quantity of the products manufactured, or the flexibility of the Company to respond to changing market conditions. Moreover, although arrangements with such manufacturers may contain provisions for warranty expense reimbursement, the Company may remain at least initially responsible to the ultimate consumer for warranty service or in the event of product defects. Any unanticipated product defect or warranty liability, whether pursuant to arrangements with contract manufacturers or otherwise, could adversely affect the Company's future operating results and financial condition.

Final assembly of products sold by the Company is conducted in the Company's manufacturing facilities in Sacramento, California, and Cork, Ireland, and by external vendors in Fullerton, California, Taiwan, Korea, the People's Republic of China, and the Czech Republic. Currently, manufacture of many of the components used in the Company's products and final assembly of all of the Company's portable products including PowerBooks, iBooks, and the iPod is performed by third-party vendors in Taiwan. If for any reason manufacturing or logistics in any of these locations is disrupted by regional economic, business, environmental, political, or military conditions or events, the Company's results of operations and financial condition could be adversely affected.

The Company's products could experience quality problems that result in decreased net sales and operating profits.

The Company sells highly complex hardware and software products that may contain defects in design and manufacture. Sophisticated operating system software and applications such as the Company sells often contains "bugs" that can unexpectedly interfere with the operation of the software. Defects may also occur in components and products the Company purchases from third parties that may be beyond its control.

There can be no assurance that the Company will be able to detect and fix all defects in the hardware and software it sells. Failure to do so could result in lost revenues, loss of reputation, and significant expense to remedy.

The Company's retail initiative requires a substantial investment and commitment of resources and is subject to numerous risks and uncertainties.

Since May of 2001, the Company has opened 51 retail stores in the United States and anticipates opening more stores in calendar 2003. The Company's retail initiative has required substantial investment in equipment and leasehold improvements, information systems, inventory, and personnel. The Company has also entered into substantial operating leases commitments for retail space with lease terms ranging from 5 to 12 years. The Company would incur substantial costs should it choose to terminate this initiative or close individual stores. Such costs could adversely affect the Company's results of operations and financial condition. Additionally, a relatively high proportion of the Retail segment's costs are fixed because of depreciation on store constructions costs and lease expense. As a result, should the Retail segment experience a decline in sales for any reason, significant losses would result.

Certain of the Company's stores have been intentionally designed and built to serve as high profile venues that function as vehicles for general corporate marketing, corporate events, and brand awareness. Because of their unique design elements, locations and size, these stores require substantially more investment in equipment and leasehold improvements than the Company's typical retail stores. The Company has opened two such stores and has several others under development. Because of their location and size, these high profile stores also require the Company to enter into substantially larger operating lease commitments compared to those required for its more typical stores. Current leases on such locations have terms ranging from 5 to 10 years with total commitments per location over the lease terms ranging from $25 million to $50 million. Closure or poor performance of one of these high profile stores could have a particularly significant negative impact on the Company's results of operations and financial condition.

Many of the general risks and uncertainties the Company faces could also have an adverse impact on its Retail segment. Also, many factors unique to retail operations present risks and uncertainties, some of which are beyond the Company's control, that could adversely affect the Retail segment's future results, cause its actual results to differ from those currently expected, and/or have an adverse effect on the Company's consolidated results of operations. Potential risks and uncertainties unique to retail operations that could have an adverse impact on the Retail segment include, among other things, macro-economic factors that have a negative impact on general retail activity; inability to manage costs associated with store construction and operation; lack of consumer acceptance of the Company's retail approach; failure to attract new users to the Macintosh platform; inability to sell third-party hardware and software products at adequate margins; failure to manage relationships with existing retail channel partners; lack of experience in managing retail operations; costs associated with unanticipated fluctuations in the value of Apple-branded and third-party retail inventory; and inability to obtain quality retail locations at reasonable cost.

Unit sales of the Company's professionally oriented desktop systems have declined sharply over past two to three years negatively impacting net sales and gross margin.

Unit sales of Power Macintosh systems fell 18% during 2002 as compared to 2001 and fell 35% in 2001 from 2000. Power Macintosh unit sales have fallen as a percentage of total Macintosh unit sales from 38% in 1999 to 25% in 2002. The Company believes that weak economic conditions over the past several years are having a pronounced negative impact on its professional and creative customers who are the primary users of such systems. The Company also believes that many of these customers continue to delay upgrades of their Power Macintosh systems due to the Company's ongoing transition to Mac OS X and in anticipation of certain software vendors transitioning their professionally oriented Macintosh software applications to run natively in Mac OS X. In addition to the negative impact on net sales, declining sales of Power Macintosh systems also have a negative effect on the Company's overall gross margin because Power Macintosh systems are generally higher priced and have higher individual gross margins than the

Company's other Macintosh systems. Continued deterioration in Power Macintosh unit sales will adversely affect the Company's future net sales and gross margin. If future unit sales of Power Macintosh systems fail to partially or fully recover, it will be difficult for the Company to improve its overall profitability.

The Company faces increasing competition in the U.S. education market.

Sales in the United States to both elementary and secondary schools, as well as for college and university customers, remains a core market for Apple. Net sales in these markets fell to 21% of the Company's total net sales in 2002 from 26% in 2001. This drop reflects declines in both net sales and Macintosh unit sales in these markets of 15% and 14%, respectively, in fiscal 2002 compared to 2001. These developments are consistent with industry data showing the Company losing market share in the U.S. education market in each of the last two fiscal years. Several competitors of the Company have either targeted or announced their intention to target the education market for personal computers. Although the Company has taken certain steps to strengthen its position in the education market, there can be no assurance that the Company will be able to increase its share of the education market or maintain its existing share of that market. Failure to increase or maintain market share in the education market may have an adverse impact on the Company's operating results and financial condition.

The Company's future operating performance is dependent on the performance of distributors and other resellers of the Company's products.

The Company distributes its products through wholesalers, resellers, national and regional retailers and cataloguers, many of whom distribute products from competing manufacturers. In addition, the Company also sells many of its products and resells certain third-party products in most of its major markets directly to end users, certain education customers, and certain resellers through its online stores around the world. The Company also sells its own products and certain third-party products through its retail stores in the United States. Many of the Company's significant resellers operate on narrow product margins and have been negatively affected by current economic conditions. Considerable trade receivables that are not covered by collateral or credit insurance are outstanding with the Company's distribution and retail channel partners. The Company's business and financial results could be adversely affected if the financial condition of these resellers weakened, if resellers within consumer channels were to cease distribution of the Company's products, or if uncertainty regarding demand for the Company's products caused resellers to reduce their ordering and marketing of the Company's products.

Further information regarding risks associated with Marketing and Distribution may be found in Part I, Item 1 of this Form 10-K under the heading "Markets and Distribution," which information is hereby incorporated by reference.

The Company's business is subject to the risks of international operations.

A large portion of the Company's revenue is derived from its international operations. As a result, the Company's operating results and financial condition could be significantly affected by risks associated with international activities, including economic and labor conditions, political instability, tax laws (including U.S. taxes on foreign subsidiaries), and changes in the value of the U.S. dollar versus the local currency in which the products are sold and goods and services are purchased. Historically, the Company's primary exposure to movements in foreign currency exchange rates relate to non-dollar denominated sales in Europe, Japan, Australia, Canada, and certain parts of Asia and non-dollar denominated operating expenses incurred throughout the world. Weaknesses in foreign currencies, particularly the Japanese Yen and the Euro, can adversely impact consumer demand for the Company's products and the U.S. dollar value of the Company's foreign currency denominated sales. Conversely, strengthening in these and other foreign currencies can increase the cost to the Company of product components, negatively affecting the Company's results of operations.

Margins on sales of Apple products in foreign countries, and on sales of products that include components obtained from foreign suppliers, can be adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including tariffs and antidumping penalties.

Further information related to the Company's global market risks may be found in Part II, Item 7A of this Form 10-K under the subheading "Foreign Currency Risk" and may be found in Part II, Item 8 of this Form 10-K at Notes 1 and 2 of Notes to Consolidated Financial Statements, which information is hereby incorporated by reference.

The Company's future performance is dependent upon support from third-party software developers.

The Company believes that decisions by customers to purchase the Company's personal computers, as opposed to Windows-based systems, are often based on the availability of third-party software for particular applications such as Microsoft Office. The Company also believes the availability of third-party application software for the Company's hardware products depends in part on third-party developers' perception and analysis of the relative benefits of developing, maintaining, and upgrading such software for the Company's products versus software for the larger Windows market. This analysis is based on factors such as the perceived strength of the Company and its products, the anticipated potential revenue that may be generated, acceptance by customers of Mac OS X, and the costs of developing such software products. To the extent the Company's financial losses in prior years and the minority market share held by the Company in the personal computer market, as well as the Company's decision to end its Mac OS licensing program, have caused software developers to question the Company's prospects in the personal computer market, developers could be less inclined to develop new application software or upgrade existing software for the Company's products and more inclined to devote their resources to developing and upgrading software for the larger Windows market. In addition, past and future development by the Company of its own software applications and solutions may negatively impact the decision of software developers to develop, maintain, and upgrade similar or competitive software for the Company's products. Moreover, there can be no assurance software developers will continue to develop software for Mac OS X, the Company's new operating system, on a timely basis or at all.

In August 1997, the Company and Microsoft Corporation entered into patent cross license and technology agreements. In addition, for a period of five years through August 2002, and subject to certain limitations related to the number of Macintosh computers sold by the Company, Microsoft was required to make versions of its Microsoft Office and Internet Explorer products for the Mac OS. Although Microsoft has released Microsoft Office and Internet Explorer for Mac OS X, Microsoft is not obligated to produce future versions of its products subsequent to August 2002. While the Company believes its relationship with Microsoft has been and will continue to be beneficial to the Company and to its efforts to increase the installed base for the Mac OS, the Company does compete directly with Microsoft in a number of key areas. Accordingly, Microsoft's interest in producing application software for the Mac OS following expiration of the agreements may be influenced by Microsoft's perception of its interests as the vendor of the Windows operating system. Discontinuance of Microsoft Office and other Microsoft products for the Macintosh platform would have an adverse effect on the Company's net sales and results of operations.

The Company's business relies on access to patents and intellectual property obtained from third parties, and the Company's future results could be adversely affected if it is alleged or found to have infringed on the intellectual property rights of others.

Many of the Company's products are designed to include intellectual property obtained from third parties. While it may be necessary in the future to seek or renew licenses relating to various aspects of its products and business methods, the Company believes that based upon past experience and industry practice, such licenses generally could be obtained on commercially reasonable terms. However, there can be no assurance that the necessary licenses would be available or available on acceptable terms.

Because of technological changes in the computer industry, current extensive patent coverage, and the rapid rate of issuance of new patents, it is possible certain components of the Company's products and business methods may unknowingly infringe existing patents of others. The Company has from time to time been notified that it may be infringing certain patents or other intellectual property rights of others. Responding to such claims, regardless of their merit, can be time consuming, result in significant expenses, and cause the diversion of management and technical personnel. Several pending claims are in various stages of evaluation. The Company may consider the desirability of entering into licensing agreements in certain of these cases. However, no assurance can be given that such licenses can be obtained on acceptable terms or that litigation will not occur. In the event there is a temporary or permanent injunction entered prohibiting the Company from marketing or selling certain of its products or a successful claim of infringement against the Company requiring it to pay royalties to a third-party, the Company's future operating results and financial condition could be adversely effected. Information regarding claims and potential litigation involving the Company related to alleged patent infringement and other matters is set forth in Part I, Item 3 of this Form 10-K. In the opinion of management, the Company does not have a potential liability for damages or royalties from any current legal proceedings or claims related to the infringement of patent or other intellectual property rights of others that would have a material adverse effect on its results of operations, or financial condition. However, the results of such legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of the matters related to infringement of patent or other intellectual property rights of others described in Part I, Item 3 of this Form 10-K or should several of these matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

The Company expects its quarterly revenues and operating results to fluctuate for a variety of reasons.

The Company's profit margins vary among its products, its geographic markets, and its distribution channels. As a result, the overall profitability of the Company in any given period will depend, in part, on the product, geographic, and channel mix reflected in that period's net sales.

The typical concentration of net sales in the third month of the Company's fiscal quarters can adversely affect the Company's business and operating results.

The Company generally sells more products during the third month of each quarter than it does during either of the first two months, a pattern typical in the personal computer industry. This sales pattern can produce pressure on the Company's internal infrastructure during the third month of a quarter and may adversely impact the Company's ability to predict its financial results accurately. Developments late in a quarter, such as lower-than-anticipated demand for the Company's products, an internal systems failure, or failure of one of the Company's key logistics or components suppliers, can have significant adverse impacts on the Company and its results of operations and financial condition.

The Company's success depends largely on its ability to attract and retain key personnel.

Much of the future success of the Company depends on the continued service and availability of skilled personnel, including those in technical, marketing and staff positions. Experienced personnel in the information technology industry are in high demand and competition for their talents is intense, especially in the Silicon Valley, where the majority of the Company's employees are located. There can be no assurance that the Company will be able to successfully attract and retain the key personnel it needs. Additionally, volatility or a lack of positive performance in the Company's stock price may adversely affect its ability to retain key employees. As of September 28, 2002, a substantial majority of the Company's outstanding employee stock options were out-of-the-money.

The Company is subject to risks associated with the availability and cost of insurance.

The Company has observed rapidly changing conditions in the insurance markets relating to nearly all areas of traditional corporate insurance. Such conditions have resulted in higher premium costs, higher policy deductibles, and lower coverage limits. For some risks, because of cost and/or availability, the

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Company does not have insurance coverage. For these reasons, the Company is retaining a greater portion of its insurable risks than it has in the past at relatively greater cost.

The Company is exposed to credit risk on its accounts receivables. This risk is heightened as economic conditions worsen.

The Company distributes its products through third-party computer resellers and retailers and directly to certain educational institutions and commercial customers. A substantial majority of the Company's outstanding trade receivables are not covered by collateral or credit insurance. The Company also has non-trade receivables from certain of its manufacturing vendors resulting from the sale by the Company of raw material components to these manufacturing vendors who manufacture sub-assemblies or assemble final products for the Company. While the Company has procedures in place to monitor and limit exposure to credit risk on its trade and non-trade receivables, there can be assurance that such procedures will be effective in limiting its credit risk and avoiding losses. Additionally, if the global economy and regional economies fail to improve or continue to deteriorate, it becomes more likely that the Company will incur a material loss or losses as a result of the weakening financial condition of one or more of its customers or manufacturing vendors.

The market value of the Company's non-current debt and equity investments is subject to significant volatility.

The Company holds minority investments in several public companies with a combined fair market value of approximately $39 million as of September 28, 2002. These investments are in publicly traded companies whose share prices are subject to significant volatility. The Company has categorized its investments in these companies as available-for-sale requiring the investments be carried at fair value, with unrealized gains and losses, net of taxes, reported as a component of accumulated other comprehensive income. The Company recognizes an impairment charge to earnings when it is judged an investment has experienced a decline in value that is other-than-temporary. The Company has recognized material impairment charges related to its non-current debt and equity investments twice in the last two fiscal years.

The Company is subject to risks associated with environmental regulations.

Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations including, in some instances, the requirement that the Company provide consumers with the ability to return to the Company product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Although the Company does not anticipate any material adverse effects in the future based on the nature of its operations and the thrust of such laws, there is no assurance that such existing laws or future laws will not have a material adverse effect on the Company.

The parliament of the European Union is working on finalizing the Waste Electrical and Electronic Equipment Directive (the Directive). The Directive makes producers of electrical goods, including personal computers, financially responsible for the collection, recycling, and safe disposal of past and future products. The Directive must now be approved and implemented by individual European Union governments by June 2004, while the producers' financial obligations are scheduled to start June 2005. The Company's potential liability resulting from the Directive related to past sales of its products and expenses associated with future sales of its product may be substantial. However, because it is likely that specific laws, regulations, and enforcement policies will vary significantly between individual European member states, it is not currently possible to estimate the Company's existing liability or future expenses resulting from the Directive. As the European Union and its individual member states clarify specific requirements and policies with respect to the Directive, the Company will continue to assess its potential financial impact. Similar legislation may be enacted in other geographies, including federal and state legislation in the United States, the cumulative impact of which could be significant.

Business interruptions could adversely affect the Company's future operating results.

The Company's major business operations are subject to interruption by earthquake, fire, power shortages, terrorist attacks and other hostile acts, labor disputes, and other events beyond its control. The majority of the Company's research and development activities, its corporate headquarters, and other critical business operations, including certain major components suppliers and manufacturing vendors, are located near major seismic faults. The Company does not carry earthquake insurance for direct quake-related losses. The Company's operating results and financial condition could be materially adversely affected in the event of a major earthquake or other natural or manmade disaster.

Unanticipated changes in the Company's tax rates could affect its future results.

The Company's future effective tax rates could be favorably or unfavorably affected by unanticipated changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of the Company deferred tax assets and liabilities, or by changes in tax laws or their interpretation.

The Company's stock price may be volatile.

The Company's stock has at times experienced substantial price volatility as a result of variations between its actual and anticipated financial results and as a result of announcements by the Company and its competitors. In addition, the stock market has experienced extreme price and volume fluctuations that have affected the market price of many technology companies in ways that have been unrelated to the operating performance of these companies. These factors, as well as general economic and political conditions and investors' concerns regarding the credibility of corporate financial reporting and integrity of financial markets, may materially adversely affect the market price of the Company's common stock in the future.

Item 7A. Disclosures About Market Risk

Interest Rate and Foreign Currency Risk Management

To ensure the adequacy and effectiveness of the Company's foreign exchange and interest rate hedge positions, as well as to monitor the risks and opportunities of the non-hedge portfolios, the Company continually monitors its foreign exchange forward and option positions, and its interest rate swap and option positions both on a stand-alone basis and in conjunction with its underlying foreign currency and interest rate related exposures, respectively, from both an accounting and an economic perspective. However, given the effective horizons of the Company's risk management activities and the anticipatory nature of the exposures intended to hedge, there can be no assurance the aforementioned programs will offset more than a portion of the adverse financial impact resulting from unfavorable movements in either foreign exchange or interest rates. In addition, the timing of the accounting for recognition of gains and losses related to mark-to-market instruments for any given period may not coincide with the timing of gains and losses related to the underlying economic exposures and, therefore, may adversely affect the Company's operating results and financial position. The Company adopted Statement of Financial Accounting Standard No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as of October 1, 2000. SFAS No. 133 establishes accounting and reporting standards for derivative instruments, hedging activities, and exposure definition. Management does not believe that ongoing application of SFAS No. 133 will significantly alter the Company's hedging strategies. However, its application may increase the volatility of other income and expense and other comprehensive income.

Interest Rate Risk

While the Company is exposed to interest rate fluctuations in many of the world's leading industrialized countries, the Company's interest income and expense is most sensitive to fluctuations in the general level of U.S. interest rates. In this regard, changes in U.S. interest rates affect the interest earned on the Company's cash, cash equivalents, and short-term investments as well as costs associated with foreign currency hedges.

The Company's fixed income investment policy and strategy is to ensure the preservation of capital, meet liquidity requirements, and optimize return in light of the current credit and interest rate environment. The Company benchmarks its performance by utilizing external money managers to manage a small portion of the aggregate investment portfolio. The external managers adhere to the Company's investment policies and also provide occasional research and market information that supplements internal research used to make credit decisions in the investment process.

During 1994, the Company issued $300 million aggregate principal amount of 6.5% unsecured notes in a public offering registered with the SEC. The notes were sold at 99.925% of par, for an effective yield to maturity of 6.51%. The notes pay interest semiannually and mature on February 15, 2004.

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's investment portfolio and long-term debt obligations and related derivative financial instruments. The Company places its short-term investments in highly liquid securities issued by high credit quality issuers and, by policy, limits the amount of credit exposure to any one issuer. The Company's general policy is to limit the risk of principal loss and ensure the safety of invested funds by limiting market and credit risk. All highly liquid investments with maturities of three months or less are classified as cash equivalents; highly liquid investments with maturities greater than three months are classified as short-term investments. As of September 28, 2002, $1.087 billion of the Company's investment portfolio classified as short-term investments was invested in U.S. Agency and corporate debt securities with maturities ranging from 1 to 5 years. As of September 29, 2001, $313 million of the Company's investment portfolio classified as short-term investments was in U.S. agency securities with underlying maturities ranging from 1 to 4 years. The remainder all had underlying maturities between 3 and 12 months. Due to liquidity needs, or in anticipation of credit deterioration, or for the purpose of duration management of the Company's

investment portfolio, the Company may sell investments prior to their stated maturities. As a result of such activity, the Company recognized net gains of $7 million in 2002 and $1 million in 2001.

In order to provide a meaningful assessment of the interest rate risk associated with the Company's investment portfolio, the Company performed a sensitivity analysis to determine the impact that a change in interest rates would have on the value of the investment portfolio assuming a 100 basis point parallel shift in the yield curve. Based on investment positions as of September 28, 2002, a hypothetical 100 basis point increase in interest rates across all maturities would result in a $37.7 million decline in the fair market value of the portfolio. As of September 29, 2001, a similar 100 basis point shift in the yield curve would have resulted in a $17.8 million decline in fair value. Such losses would only be realized if the Company sold the investments prior to maturity. Except in instances noted above, the Company's policy is to hold investments to maturity.

The Company sometimes enters into interest rate derivative transactions, including interest rate swaps, collars, and floors, with financial institutions in order to better match the Company's floating-rate interest income on its cash equivalents and short-term investments with its fixed-rate interest expense on its long-term debt, and/or to diversify a portion of the Company's exposure away from fluctuations in short-term U.S. interest rates. The Company may also enter into interest rate contracts that are intended to reduce the cost of the interest rate risk management program.

During the last two years, the Company has entered into interest rate swaps with financial institutions in order to better match the Company's floating-rate interest income on its cash equivalents and short-term investments with its fixed-rate interest expense on its long-term debt, and/or to diversify a portion of the Company's exposure away from fluctuations in short-term U.S. interest rates. The interest rate swaps, which qualified as accounting hedges, generally required the Company to pay a floating interest rate based on the three- or six-month U.S. dollar LIBOR and receive a fixed rate of interest without exchanges of the underlying notional amounts. These swaps effectively converted the Company's fixed-rate 10-year debt to floating-rate debt and convert a portion of the floating rate investments to fixed rate. Due to prevailing market interest rates, during 2002 the Company entered into and then subsequently closed out debt swap positions realizing a gain of $6 million. During 2001 the Company closed out all of its then existing debt swap positions realizing a gain of $17 million. Both the gains in 2001 and 2002 were deferred, recognized in long-term debt and are being amortized to other income and expense over the remaining life of the debt. At certain times in the past, the Company has also entered into interest rate contracts that are intended to reduce the cost of the interest rate risk management program. The Company does not hold or transact in such financial instruments for purposes other than risk management.

The Company's asset swaps did not qualify for hedge accounting treatment and were recorded at fair value on the balance sheet with associated gains and losses recorded in interest and other income. Interest rate asset swaps outstanding as of September 30, 2000, had a weighted-average receive rate of 5.50% and a weighted-average pay rate of 6.66%. The unrealized loss on these assets swaps as of September 30, 2000, of $5.7 million was deferred and then recognized in income in 2001 as part of the SFAS No. 133 transition adjustment effective on October 1, 2000. The Company closed out all of its existing interest rate asset swaps during 2001 realizing a gain of $1.1 million.

Foreign Currency Risk

Overall, the Company is a net receiver of currencies other than the U.S. dollar and, as such, benefits from a weaker dollar and is adversely affected by a stronger dollar relative to major currencies worldwide. Accordingly, changes in exchange rates, and in particular a strengthening of the U.S. dollar, may negatively affect the Company's net sales and gross margins as expressed in U.S. dollars. There is also a risk that the Company will have to adjust local currency product pricing within the time frame of our hedged positions due to competitive pressures when there has been significant volatility in foreign currency exchange rates.

The Company enters into foreign currency forward and option contracts with financial institutions primarily to protect against foreign exchange risks associated with existing assets and liabilities, certain firmly committed transactions, and probable but not firmly committed transactions. Generally, the Company's practice is to hedge a majority of its existing material foreign exchange transaction exposures. However, the Company may not hedge certain foreign exchange transaction exposures due to immateriality, prohibitive economic cost of hedging particular exposures, and limited availability of appropriate of hedging instruments. The Company also enters into foreign currency forward and option contracts to offset the foreign exchange gains and losses generated by the re-measurement of certain recorded assets and liabilities denominated in non-functional currencies of its foreign subsidiaries.

In order to provide a meaningful assessment of the foreign currency risk associated with certain of the Company's foreign currency derivative positions, the Company performed a sensitivity analysis using a value-at-risk (VAR) model to assess the potential impact of fluctuations in exchange rates. The VAR model consisted of using a Monte Carlo simulation to generate 3000 random market price paths. The value-at-risk is the maximum expected loss in fair value, for a given confidence interval, to the Company's foreign exchange portfolio due to adverse movements in rates. The VAR model is not intended to represent actual losses but is used as a risk estimation and management tool. The model assumes normal market conditions. Forecasted transactions, firm commitments, and assets and liabilities denominated in foreign currencies were excluded from the model. Based on the results of the model, the Company estimates with 95% confidence a maximum one-day loss in fair value of $3.8 million as of September 28, 2002 compared to a maximum one-day loss of $6.8 million as of September 29, 2001. Because the Company uses foreign currency instruments for hedging purposes, losses incurred on those instruments are generally offset by increases in the fair value of the underlying exposures.

Actual gains and losses in the future associated with the Company's investment portfolio and derivative positions may differ materially from the sensitivity analyses performed as of September 28, 2002 due to the inherent limitations associated with predicting the changes in the timing and amount of interest rates, foreign currency exchanges rates, and the Company's actual exposures and positions.

Item 8. Financial Statements and Supplementary Data

All financial statement schedules have been omitted, since the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Consolidated Financial Statements and Notes thereto.

CONSOLIDATED BALANCE SHEETS

(In millions, except share amounts)

	September 28, 2002	September 29, 2001
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 2,252	$ 2,310
Short-term investments	2,085	2,026
Accounts receivable, less allowances of $51 and $51, respectively	565	466
Inventories	45	11
Deferred tax assets	166	169
Other current assets	275	161
Total current assets	5,388	5,143
Property, plant, and equipment, net	621	564
Non-current debt and equity investments	39	128
Acquired intangible assets	119	76
Other assets	131	110
Total assets	$ 6,298	$ 6,021
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	$ 911	$ 801
Accrued expenses	747	717
Total current liabilities	1,658	1,518
Long-term debt	316	317
Deferred tax liabilities	229	266
Total liabilities	2,203	2,101
Commitments and contingencies		

Shareholders' equity:		
Common stock, no par value; 900,000,000 shares authorized; 358,958,989 and 350,921,661 shares issued and outstanding, respectively	1,826	1,693
Acquisition-related deferred stock compensation	(7)	(11)
Retained earnings	2,325	2,260
Accumulated other comprehensive income (loss)	(49)	(22)
Total shareholders' equity	4,095	3,920
Total liabilities and shareholders' equity	$ 6,298	$ 6,021

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except share and per share amounts)

Three fiscal years ended September 28, 2002	2002	2001	2000
Net sales	$ 5,742	$ 5,363	$ 7,983
Cost of sales	4,139	4,128	5,817
Gross margin	1,603	1,235	2,166
Operating expenses:			
Research and development	446	430	380
Selling, general, and administrative	1,111	1,138	1,166
Special charges:			
Restructuring costs	30	—	8
In-process research and development	1	11	—
Executive bonus	(2)	—	90
Total operating expenses	1,586	1,579	1,644
Operating income (loss)	17	(344)	522
Other income and expense:			
Gains (losses) on non-current investments, net	(42)	88	367
Unrealized loss on convertible securities	—	(13)	—
Interest and other income, net	112	217	203
Total other income and expense	70	292	570
Income (loss) before provision for income taxes	87	(52)	1,092
Provision for (benefit from) income taxes	22	(15)	306
Income (loss) before accounting change	65	(37)	786
Cumulative effect of accounting change, net of income taxes of $5	—	12	—
Net income (loss)	$ 65	$ (25)	$ 786

Earnings (loss) per common share before accounting change:			
Basic	$ 0.18	$ (0.11)	$ 2.42
Diluted	$ 0.18	$ (0.11)	$ 2.18
Earnings (loss) per common share:			
Basic	$ 0.18	$ (0.07)	$ 2.42
Diluted	$ 0.18	$ (0.07)	$ 2.18
Shares used in computing earnings (loss) per share (in thousands):			
Basic	355,022	345,613	324,568
Diluted	361,785	345,613	360,324

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In millions, except share amounts which are in thousands)

	Preferred Stock		Common Stock		Retained	Acquisition-Related Deferred Stock	Accumulated Other Comprehensive	Total Shareholders'
	Shares	Amount	Shares	Amount	Earnings	Compensation	Income (Loss)	Equity
Balances as of September 25, 1999	150	$ 150	321,598	$ 1,349	$ 1,499	$ —	$ 106	$ 3,104
Components of comprehensive income:								
Net income					786			786
Foreign currency translation	—	—	—	—	—	—	(17)	(17)
Change in unrealized gain on available-for-sale securities, net of tax	—	—	—	—	—	—	155	155
Total comprehensive income								924
Common stock issued under stock option and purchase plans	—	—	7,632	85	—	—	—	85
Conversion of Series A preferred stock	(74)	(74)	9,000	74	—	—	—	—
Common stock repurchased	—	—	(2,553)	(116)	—	—	—	(116)
Tax benefit related to stock options	—	—	—	110	—	—	—	110
Balances as of September 30, 2000	76	$ 76	335,677	$ 1,502	$ 2,285	$ —	$ 244	$ 4,107
Components of comprehensive income (loss):								
Net income (loss)					(25)			(25)
Foreign currency translation	—	—	—	—	—	—	(3)	(3)
Change in unrealized gain on available-for-sale securities, net of tax	—	—	—	—	—	—	(267)	(267)
Change in unrealized gain on derivative investments, net of tax	—	—	—	—	—	—	4	4
Total comprehensive income (loss)								(291)
Issuance of common stock and assumption of stock options in connection with acquisition	—	—	2,403	66	—	(13)	—	53
Amortization of acquisition-related deferred stock compensation	—	—	—	—	—	2	—	2
Common stock issued under stock option and purchase plans	—	—	3,660	42	—	—		42
Conversion of Series A preferred stock	(76)	(76)	9,182	76	—	—	—	—
Tax benefit related to stock options	—	—	—	7	—	—	—	7

Balances as of September 29, 2001	—	$ —	350,922	$ 1,693	$ 2,260	$ (11)	$ (22)	$ 3,920
Components of comprehensive income (loss):								
Net income (loss)					65			65
Foreign currency translation	—	—	—	—	—	—	5	5
Change in unrealized gain on available-for-sale securities, net of tax	—	—	—	—	—	—	(17)	(17)
Change in unrealized gain on derivative investments, net of tax	—	—	—	—	—	—	(15)	(15)
Total comprehensive income (loss)								38
Amortization of acquisition-related deferred stock compensation	—	—	—	—	—	4	—	4
Common stock issued under stock option and purchase plans	—	—	8,037	105	—	—		105
Tax benefit related to stock options	—	—	—	28	—	—	—	28
Balances as of September 28, 2002	—	$ —	358,959	$ 1,826	$ 2,325	$ (7)	$ (49)	$ 4,095

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

Three fiscal years ended September 28, 2002	2002	2001	2000
Cash and cash equivalents, beginning of the year	$ 2,310	$ 1,191	$ 1,326
Operating:			
Net income (loss)	65	(25)	786
Cumulative effect of accounting change, net of taxes	—	(12)	—
Adjustments to reconcile net income to cash generated by operating activities:			
Depreciation and amortization	118	102	84
Provision for deferred income taxes	(34)	(36)	163
Loss on disposition of property, plant, and equipment	7	9	10
(Gains) losses on investments, net	35	(88)	(367)
Unrealized loss on convertible securities	—	13	—
Purchased in-process research and development	1	11	—
Changes in operating assets and liabilities:			
Accounts receivable	(99)	487	(272)
Inventories	(34)	22	(13)
Other current assets	(114)	106	(37)
Other assets	(11)	12	20
Accounts payable	110	(356)	318
Other current liabilities	45	(60)	176
Cash generated by operating activities	89	185	868
Investing:			
Purchase of short-term investments	(4,144)	(4,268)	(4,267)
Proceeds from maturities of short-term investments	2,846	4,811	3,075
Proceeds from sales of short-term investments	1,254	278	256
Purchases of long-term investments	—	(1)	(232)

Purchase of property, plant, and equipment	(174)	(232)	(142)
Proceeds from sales of equity investments	25	340	372
Cash used for business acquisitions	(52)	—	—
Other	(7)	(36)	(34)
Cash generated by (used for) investing activities	(252)	892	(972)
Financing:			
Proceeds from issuance of common stock	105	42	85
Cash used for repurchase of common stock	—	—	(116)
Cash generated by (used for) financing activities	105	42	(31)
Increase (decrease) in cash and cash equivalents	(58)	1,119	(135)
Cash and cash equivalents, end of the year	$ 2,252	$ 2,310	$ 1,191
Supplemental cash flow disclosures:			
Cash paid during the year for interest	$ 20	$ 20	$ 20
Cash paid for income taxes, net	$ 11	$ 42	$ 47
Noncash transactions:			
Issuance of common stock for conversion of Series A preferred stock	$ —	$ 76	$ 74
Issuance of common stock in connection with acquisition	$ —	$ 66	$ —

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1—Summary of Significant Accounting Policies

Apple Computer, Inc. and its subsidiaries (the Company) designs, manufactures, and markets personal computers and related personal computing and communicating solutions for sale primarily to education, creative, consumer, and business customers.

Basis of Presentation and Preparation

The accompanying consolidated financial statements include the accounts of the Company. Intercompany accounts and transactions have been eliminated. The preparation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in these consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates.

Typically, the Company's fiscal year ends on the last Saturday of September. Fiscal years 2002 and 2001 were each 52-week years. However, approximately every six years, the Company reports a 53-week fiscal year to align its fiscal quarters with calendar quarters by adding a week to its first fiscal quarter. Consequently, an additional week was added to the first quarter of fiscal 2000. All information presented herein is based on the Company's fiscal calendar.

Financial Instruments

Investments

The Company places its short-term investments in highly liquid securities issued by high credit quality issuers. All highly liquid investments with maturities of three months or less at the date of purchase are classified as cash equivalents; highly liquid investments with maturities greater than three months are classified as short-term investments. Management determines the appropriate classification of its investments in debt and marketable equity securities at the time of purchase and reevaluates such designation as of each balance sheet date. The Company's marketable debt and equity securities have been classified and accounted for as available-for-sale. These securities are carried at fair value, with the unrealized gains and losses, net of taxes, reported as a component of shareholders' equity. The cost of securities sold is based upon the specific identification method.

Derivative Financial Instruments

On October 1, 2000, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*. SFAS No. 133 establishes accounting and reporting standards for derivative instruments, hedging activities, and exposure definition. SFAS No. 133 requires that all derivatives be recognized as either assets or liabilities at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in fair value will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings. Net of the related income tax effect of approximately $5 million, adoption of SFAS No. 133 resulted in a favorable cumulative-effect-type adjustment to net income of approximately $12 million. Net of the related income tax effect of approximately $5 million, adoption of SFAS No. 133 resulted in a favorable cumulative-effect-type adjustment to other comprehensive income of approximately $12 million, all of which was reclassified to earnings during 2001. Management does not believe that ongoing application of SFAS No. 133 will significantly alter the Company's hedging strategies. However, its application may increase the volatility of other income and expense and other comprehensive income.

For derivative instruments that hedge the exposure to variability in expected future cash flows that are attributable to a particular risk and that are designated as cash flow hedges, the net gain or loss on the

derivative instrument is reported as a component of other comprehensive income in stockholders' equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. To receive hedge accounting treatment, cash flow hedges must be highly effective in achieving offsetting changes to expected future cash flows on hedged transactions. For derivative instruments that hedge the exposure to changes in the fair value of an asset or a liability or an identified portion thereof that are attributable to a particular risk and that are designated as fair value hedges, the net gain or loss on the derivative instrument as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in earnings in the current period. The net gain or loss on the effective portion of a derivative instrument that is designated as an economic hedge of the foreign currency translation exposure of the net investment in a foreign operation is reported in the same manner as a foreign currency translation adjustment. For forward contracts designated as net investment hedges, the Company excludes changes in fair value relating to changes in the forward carry component from its definition of effectiveness. Accordingly, any gains or losses related to this component are recognized in current earnings. For derivative instruments not designated as hedging instruments, changes in fair value are recognized in earnings in the current period.

For foreign currency forward contracts designated as cash flow hedges, hedge effectiveness is measured based on changes in the fair value of the contract attributable to changes in the forward exchange rate. Changes in the expected future cash flows on the forecasted hedged transaction and changes in the fair value of the forward hedge are both measured from the contract rate to the forward exchange rate associated with the forward contract's maturity date. For currency option contracts designated as cash flow hedges, hedge effectiveness is measured based on changes in total fair value of the option contract. Hedge effectiveness is assessed by comparing the present value of the cumulative change in expected cash flows on the hedged transactions determined as the sum of the probability-weighted outcomes with respect to the option strike rates with the total change in fair value of the option hedge. For interest rate swap agreements qualifying as fair value hedges, the Company assumes no ineffectiveness because these swaps meet the criteria for accounting under the short-cut method defined in SFAS No. 133.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market. If the cost of the inventories exceeds their market value, provisions are made currently for the difference between the cost and the market value.

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. Depreciation is computed by use of the declining balance and straight-line methods over the estimated useful lives of the assets, which are 30 years for buildings, from 2 to 5 years for equipment, and the shorter of lease terms or estimated useful lives for leasehold improvements. The Company capitalizes eligible costs to acquire or develop internal-use software that are incurred subsequent to the preliminary project stage. Capitalized costs related to internal-use software are amortized using the straight-line method over the estimated useful lives of the assets, which range from 3 to 5 years.

Prior to the fourth quarter of 2001, the Company had classified capitalized costs related to internal-use software on the balance sheet in other assets. Effective as of September 29, 2001, and for all other periods presented, the Company has reclassified internal-use software to property, plant, and equipment and reclassified related cash flows for the purchase or development of internal-use software from cash flow from operations to cash flow from investing activities.

Non-Current Debt and Equity Investments

Investments categorized as non-current debt and equity investments on the consolidated balance sheet are in equity and debt instruments of public companies. They are not categorized as current assets either because, given their nature, they are not readily convertible into cash or because they represent potentially longer-term investments by the Company. Further, the fair value of these investments has been subject to a high degree of volatility. The Company's non-current debt and equity investments have been categorized as available-for-sale requiring that they be carried at fair value with unrealized gains and losses, net of taxes, reported in equity as a component of accumulated other comprehensive income. However, the Company recognizes an impairment charge to earnings in the event a decline in fair value below the cost basis of one of these investments is determined to be other-than-temporary. The Company includes recognized gains and losses resulting from the sale or from other-than-temporary declines in fair value associated with these investments in other income and expense. Occasionally, the Company uses short-term equity derivatives to manage potential dispositions of non-current debt and equity investments. Any gains or losses associated with such derivatives are recognized currently in other income and expense.

Long-Lived Assets Including Goodwill and Other Acquired Intangible Assets

The Company reviews property, plant, and equipment and certain identifiable intangibles, excluding goodwill, for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of these assets is measured by comparison of its carrying amount to future undiscounted cash flows the assets are expected to generate. If property, plant, and equipment and certain identifiable intangibles are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the assets exceeds its fair market value. For the three years ended September 28, 2002, the Company has made no material adjustments to its long-lived assets except those made in connection with the restructuring actions described in Note 5.

The Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets*, in the first quarter of fiscal 2002. SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually or sooner whenever events or changes in circumstances indicate that they may be impaired. Prior to fiscal 2002, goodwill was amortized using the straight-line method over its estimated useful life. The Company completed its transitional and annual goodwill impairment tests as of October 1, 2001, and August 30, 2002, respectively, and found no impairment. The Company established reporting units based on its current reporting structure. For purposes of testing goodwill for impairment, goodwill has been allocated to these reporting units to the extent it relates to each reporting unit.

SFAS No. 142 also requires that intangible assets with definite lives be amortized over their estimated useful lives and reviewed for impairment in accordance with SFAS No. 144, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*. The Company is currently amortizing its acquired intangible assets with definite lives over periods ranging from 3 to 7 years.

Foreign Currency Translation

The Company translates the assets and liabilities of its international non-U.S. functional currency subsidiaries into U.S. dollars using exchange rates in effect at the end of each period. Revenues and expenses for these subsidiaries are translated using rates that approximate those in effect during the period. Gains and losses from these translations are credited or charged to "accumulated translation adjustment" included in "accumulated other comprehensive income (loss)" in shareholders' equity. The Company's foreign manufacturing subsidiaries and certain other international subsidiaries that use the U.S. dollar as their functional currency, remeasure monetary assets and liabilities at year-end exchange

rates, and inventories, property, and nonmonetary assets and liabilities at historical rates. Gains and losses from these translations are included in the Company's results of operations.

Revenue Recognition

Net sales consist primarily of revenue from the sale of products (hardware, software, and peripherals), consulting and implementation services, and extended warranty and support contracts. The Company recognizes revenue pursuant to applicable accounting standards, including Statement of Position (SOP) No. 97-2, *Software Revenue Recognition*, as amended. Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectibility is probable. Product is considered delivered to the customer once it has been shipped, and title and risk of loss have been transferred. For online sales to individuals, for some sales to education customers in the United States, and for certain other sales, the Company defers revenue until product is received by the customer because the Company legally retains a portion of the risk of loss on these sales during transit. For other product sales, these criteria are met by the Company at the time product is shipped. The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end user rebates and other sales programs and volume-based incentives.

Revenue for consulting and implementation services is recognized upon performance and acceptance by the customer. Revenue from extended warranty and support contracts is recognized ratably over the contract period. Amounts billed to customers in excess of revenue recognized on extended warranty and support contracts are recognized as deferred revenue until revenue recognition criteria are met.

Revenue on arrangements that include multiple elements such as hardware, software, and services is allocated to each element based on vendor specific objective evidence of the fair value of each element. Allocated revenue for each element is recognized when revenue recognition criteria have been met for each element. Vendor specific objective evidence of fair value is generally determined based on the price charged when each element is sold separately.

Shipping Costs

The Company's shipping and handling costs are included in cost of sales for all periods presented.

Warranty Expense

The Company provides currently for the estimated cost that may be incurred under product warranties at the time related revenue is recognized.

Research and Development

Research and development costs are expensed as incurred. Development costs of computer software to be sold, leased or otherwise marketed are subject to capitalization beginning when a product's technological feasibility has been established and ending when a product is available for general release to customers. In most instances, the Company's products are released soon after technological feasibility has been established. Therefore, costs incurred subsequent to achievement of technological feasibility are usually not significant, and generally all software development costs have been expensed.

During the third and fourth quarter of 2002, the Company incurred substantial development costs associated with the development of Mac OS X version 10.2 (code-named "Jaguar") subsequent to achievement of technological feasibility as evidenced by public demonstration and release of a developer beta in May 2002 and prior to release of the final version of the product in the fourth quarter. As such, the Company capitalized approximately $13.3 million of development costs associated with development of

Jaguar. Amortization of this asset began in the fourth quarter when Jaguar was shipped and is being recognized on a straight-line basis over 3 years. In addition, during 2002, the Company also began capitalizing certain costs related to development of its new PowerSchool enterprise student information system. Capitalization, which began upon achievement of technological feasibility in the first quarter, amounted to approximately $6 million during the first nine months of fiscal 2002. The final version of the enterprise student information system was released in July.

During 2001 the Company incurred substantial development costs associated with the development of the original version of Mac OS X, subsequent to release of a public beta version of the product and prior to release of the final product version. As a result, the Company capitalized approximately $5.4 million of development costs during 2001 associated with development of Mac OS X. Related amortization is computed by use of the straight-line method over the estimated useful life of the asset of 8 years.

Total amortization related to capitalized software development costs was $1.2 million and $350,000 in 2002 and 2001, respectively.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expense was $209 million, $261 million, and $281 million for 2002, 2001, and 2000, respectively.

Stock-Based Compensation

The Company measures compensation expense for its employee stock-based compensation plans using the intrinsic value method prescribed by Accounting Principles Board (APB) Opinion 25, *Accounting for Stock Issued to Employees* and has provided pro forma disclosures of the effect on net income and earnings per share as if the fair value-based method had been applied in measuring compensation expense. The Company has elected to follow APB No. 25 because, as discussed below, the alternative fair value accounting provided for under SFAS No. 123, *Accounting for Stock-Based Compensation*, requires use of option valuation models that were not developed for use in valuing employee stock options and employee stock purchase plan shares. Under APB Opinion No. 25, when the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of the grant, no compensation expense is recognized.

Pro forma information regarding net income (loss) per share is required by SFAS No. 123 and has been determined as if the Company had accounted for its employee stock options granted and employee stock purchase plan purchases subsequent to September 29, 1995, under the fair value method of that statement. The fair values for these options and stock purchases were estimated at the date of grant and beginning of the period, respectively, using a Black-Scholes option pricing model. For purposes of pro forma disclosures, the estimated fair value of the options and shares are amortized to pro forma net income over the options' vesting period and the shares' plan period.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected life of options and the Company's expected stock price volatility. Because the Company's employee stock options and employee stock purchase plan shares have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not provide a reliable measure of the fair value of the Company's employee stock options and employee stock purchase plan shares.

For purposes of the pro forma disclosures pursuant to SFAS No. 123 provided in the Company's annual reports through 2002, the expected volatility assumptions used by the Company have been based solely on historical volatility rates of the Company's common stock. The Company has made no adjustments to its expected volatility assumptions based on current market conditions, current market trends, or expected volatility implicit in market traded options on the Company's stock. The Company will continue to monitor the propriety of this approach to developing its expected volatility assumption and could determine for future periods that adjustments to historical volatility and/or use of a methodology that is based on the expected volatility implicit in market traded options on the Company's common stock are more appropriate based on the facts and circumstances existing in future periods.

Earnings Per Common Share

Basic earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the dilutive potential shares of common stock had been issued. The dilutive effect of outstanding options is reflected in diluted earnings per share by application of the treasury stock method. The dilutive effect of convertible securities is reflected using the if-converted method. Dilutive potential shares of common stock related to stock options were excluded from the calculation of diluted loss per common share for fiscal 2001 because their effect would have been antidilutive.

Stock Split

On June 21, 2000, the Company affected a two-for-one stock split in the form of a Common Stock dividend to shareholders of record as of May 19, 2000. All per share data and numbers of Common shares have been retroactively adjusted to reflect the stock split.

Comprehensive Income

Comprehensive income consists of two components, net income and other comprehensive income. Other comprehensive income refers to revenue, expenses, gains and losses that under generally accepted accounting principles are recorded as an element of shareholders' equity but are excluded from net income. The Company's other comprehensive income is comprised of foreign currency translation adjustments from those subsidiaries not using the U.S. dollar as their functional currency, from unrealized gains and losses on marketable securities categorized as available-for-sale, and from net deferred gains and losses on certain derivative instruments accounted for as cash flow hedges.

Segment Information

The Company reports segment information based on the "management" approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of the Company's reportable segments. Information about the Company's products, major customers, and geographic areas on a company-wide basis is also disclosed.

Note 2—Financial Instruments

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximate their fair value due to the short maturities of those instruments.

Cash, Cash Equivalents and Short-Term Investments

The following table summarizes the fair value of the Company's cash and available-for-sale securities held in its short-term investment portfolio, recorded as cash and cash equivalents or short-term investments as of September 28, 2002, and September 29, 2001 (in millions):

	September 28, 2002	September 29, 2001
Cash	$ 161	$ 138
U.S. Treasury and Agency securities	47	—
U.S. corporate securities	1,952	1,998
Foreign securities	92	174
Total cash equivalents	2,091	2,172
U.S. Treasury and Agency securities	681	1,042
U.S. corporate securities	988	692
Foreign securities	416	292
Total short-term investments	2,085	2,026
Total cash, cash equivalents, and short-term investments	$ 4,337	$ 4,336

The Company's U.S. corporate securities include commercial paper, loan participations, certificates of deposit, time deposits and corporate debt securities. Foreign securities include foreign commercial paper, loan participation, certificates of deposit and time deposits with foreign institutions, most of which are denominated in U.S. dollars. Net unrealized gains on the Company's investment portfolio, primarily related to investments with stated maturities greater than 1 year, were $20 million as of September 28, 2002 and $11 million as of September 29, 2001. The Company occasionally sells short-term investments prior to their stated maturities. As a result of such sales, the Company recognized net gains of $7 million in 2002 and $1 million in 2001. These net gains were included in interest and other income, net.

As of September 28, 2002, approximately $1.087 billion of the Company's short-term investments had underlying maturities of between 1 and 5 years. The remaining short-term investments as of September 28, 2002 all had maturities of between 3 and 12 months. As of September 29, 2001, approximately $313 million of the Company's short-term investments in U.S. agency securities had underlying maturities of between 1 and 4 years. The remaining short-term investments as of September 29, 2001, all had maturities of between 3 and 12 months.

Accounts Receivable

Trade Receivables

The Company distributes its products through third-party computer resellers and directly to certain education and consumer customers. The Company generally does not require collateral from its customers. However, when possible the Company does attempt to limit credit risk on trade receivables through the use of flooring arrangements for selected customers with third-party financing companies and credit insurance for certain customers in Latin America and Asia. However, considerable trade receivables that are not covered by collateral or credit insurance are outstanding with the Company's distribution and retail channel partners. Trade receivables from a single customer, Ingram Micro, Inc., accounted for approximately 10.8% and 9.4% of net accounts receivable as of September 28, 2002, and September 29, 2001, respectively.

The following table summarizes the activity in the allowance for doubtful accounts (in millions).

	2002	2001	2000
Beginning allowance balance	$ 51	$ 64	$ 68
Charged to costs and expenses	10	7	5
Deductions (a)	(10)	(20)	(9)
Ending allowance balance	$ 51	$ 51	$ 64

(a) Represent amounts written off against the allowance, net of recoveries.

Non-Trade Receivables

The Company has non-trade receivables from certain of its manufacturing vendors resulting from the sale by the Company of raw material components to these manufacturing vendors who manufacture sub-assemblies or assemble final products for the Company. The Company purchases these raw material components directly from suppliers. These non-trade receivables, which are included in the consolidated balances sheets in other current assets, totaled $142 million and $68 million as of September 28, 2002, and September 29, 2001, respectively. The Company does not recognize any profits on these sales or reflect the sale of these components in its net sales.

Inventory Prepayment

In April 2002, the Company made a $100 million prepayment to an Asian supplier for the purchase of components over the following nine months. In return for this deposit, the supplier agreed to supply the Company with a specified level of components in the three consecutive fiscal quarters ending December 28, 2002. If the supplier fails to supply the agreed upon level of components in any of those three fiscal quarters, the Company may cancel the arrangement and receive the amount of the prepayment not utilized plus a penalty. Approximately $53 million of this deposit remained unused as of September 28, 2002, and is reflected in the condensed consolidated balance sheets in other current assets. The amount of the prepayment not utilized by the Company on or before December 31, 2002, is refundable to the Company by January 31, 2003.

Although the supplier's existing debt is unrated, its public debt pricing is consistent with other BBB rated companies. The deposit is unsecured and has no stated interest component. The Company is imputing an amount to cost of sales and interest income during each period the deposit is outstanding at an appropriate market interest rate to reflect the economics of this transaction. In light of the supplier's implied debt rating and because the Company's prepayment is unsecured, non-performance by and/or economic deterioration of the supplier could place all or some of the Company's deposit at risk.

Derivative Financial Instruments

The Company uses derivatives to partially offset its business exposure to foreign exchange and interest rate risk. Foreign currency forward and option contracts are used to offset the foreign exchange risk on certain existing assets and liabilities and to hedge the foreign exchange risk on expected future cash flows on certain forecasted revenues and cost of sales. From time to time, the Company enters into interest rate swap agreements to modify the interest rate profile of certain investments and debt. The Company's accounting policies for these instruments are based on whether the instruments are designated as hedge or non-hedge instruments. The Company records all derivatives on the balance sheet at fair value.

The following table shows the notional principal, net fair value, and credit risk amounts of the Company's interest rate derivative and foreign currency instruments as of September 28, 2002 and September 29, 2001 (in millions).

	September 28, 2002			September 29, 2001		
	Notional Principal	**Fair Value**	**Credit Risk Amounts**	**Notional Principal**	**Fair Value**	**Credit Risk Amounts**
Transactions qualifying as accounting hedges:						
Interest rate instruments:						
Swaps	$ —	$ —	$ —	$ —	$ —	$ —
Foreign exchange instruments:						
Spot/Forward contracts, net	$ 462	$ 1	$ 1	$ 562	$ 8	$ 8
Purchased options, net	$ 196	$ —	$ —	$ 551	$ 11	$ 11
Sold options, net	$ 392	$ (4)	$ —	$ 712	$ (8)	$ —
Transactions other than accounting hedges:						
Foreign exchange instruments:						
Spot/Forward contracts, net	$ 302	$ —	$ —	$ 455	$ (4)	$ —
Purchased options, net	$ —	$ —	$ —	$ 334	$ 1	$ 1
Sold options, net	$ —	$ —	$ —	$ 354	$ (1)	$ —

The notional principal amounts for derivative instruments provide one measure of the transaction volume outstanding as of year-end, and do not represent the amount of the Company's exposure to credit or market loss. The credit risk amount shown in the table above represents the Company's gross exposure to potential accounting loss on these transactions if all counterparties failed to perform according to the terms of the contract, based on then-current currency exchange and interest rates at each respective date. The Company's exposure to credit loss and market risk will vary over time as a function of interest rates and currency exchange rates.

The estimates of fair value are based on applicable and commonly used pricing models using prevailing financial market information as of September 28, 2002 and September 29, 2001. In certain instances where judgment is required in estimating fair value, price quotes were obtained from several of the Company's counterparty financial institutions. Although the table above reflects the notional principal, fair value, and credit risk amounts of the Company's interest rate and foreign exchange instruments, it does not reflect the gains or losses associated with the exposures and transactions that the interest rate and foreign exchange instruments are intended to hedge. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

Foreign Exchange Risk Management

The Company enters into foreign currency forward and option contracts with financial institutions primarily to protect against foreign exchange risk associated with existing assets and liabilities, certain firmly committed transactions and certain probable but not firmly committed transactions. Generally, the Company's practice is to hedge a majority of its existing material foreign exchange transaction exposures. However, the Company may not hedge certain foreign exchange transaction exposures due to immateriality, prohibitive economic cost of hedging particular exposures, or availability of appropriate hedging instruments.

In accordance with SFAS No. 133, hedges related to probable but not firmly committed transactions of an anticipatory nature are designated and documented at hedge inception as cash flow hedges and evaluated for hedge effectiveness quarterly. For currency forward contracts, hedge effectiveness is measured based on changes in the total fair value of the contract attributable to changes in the forward exchange rate. Changes in the expected future cash flows on the forecasted hedged transaction and changes in the fair value of the forward hedge are both measured from the contract rate to the forward exchange rate associated with the forward contract's maturity date.

For currency option contracts, hedge effectiveness is measured based on changes in the total fair value of the option contract. Hedge effectiveness is assessed by comparing the present value of the cumulative change in expected future cash flows on the hedged transaction determined as the sum of the probability-weighted outcomes with respect to the option strike rates with the total change in fair value of the option hedge. The net gains or losses on derivative instruments qualifying as cash flow hedges are reported as components of other comprehensive income in stockholders' equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Any residual changes in fair value of these instruments are recognized in current earnings in other income and expense.

To protect gross margins from fluctuations in foreign currency exchange rates, the Company's U.S. dollar functional subsidiaries hedge a portion of forecasted foreign currency revenues, and the Company's non-U.S. dollar functional subsidiaries selling in local currencies hedge a portion of forecasted inventory purchases not denominated in the subsidiaries' functional currency. Other comprehensive income associated with hedges of foreign currency revenues is recognized as a component of net sales in the same period as the related sales are recognized, and other comprehensive income related to inventory purchases is recognized as a component of cost of sales in the same period as the related costs are recognized. Typically, the Company hedges portions of its forecasted foreign currency exposure associated with revenues and inventory purchases over a time horizon of 3 to 9 months.

The Company also enters into foreign currency forward and option contracts to offset the foreign exchange gains and losses generated by the re-measurement of certain recorded assets and liabilities in non-functional currencies. Changes in the fair value of these derivatives are recognized in current earnings in other income and expense as offsets to the changes in the fair value of the related assets or liabilities.

The Company may enter into foreign currency forward contracts to offset the translation and economic exposure of a net investment position in a foreign subsidiary. Hedge effectiveness on forwards designated as net investment hedges is measured based on changes in the fair value of the contract attributable to changes in the spot exchange rate. The effective portion of the net gain or loss on a derivative instrument designated as a hedge of the net investment position in a foreign subsidiary is reported in the same manner as a foreign currency translation adjustment. Any residual changes in fair value of the forward contract, including changes in fair value based on the differential between the spot and forward exchange rates are recognized in current earnings in other income and expense.

As discussed above, the Company enters into foreign currency option contracts as items that provide an offset to the re-measurement of certain recorded assets and liabilities denominated in non-functional currencies. All changes in the fair value of these derivative contracts based on changes in option time value are recorded in current earnings in other income and expense. Due to market movements, changes in option time value can lead to increased volatility in other income and expense.

Derivative instruments designated as cash flow hedges must be de-designated as hedges when it is probable that the forecasted hedged transaction will not occur in the initially identified time period or within a

subsequent 2 month time period. Deferred gains and losses in other comprehensive income associated with such derivative instruments are immediately reclassified into earnings in other income and expense. Any subsequent changes in fair value of such derivative instruments are also reflected in current earnings unless they are re-designated as hedges of other transactions. During 2002, the Company recorded net gains of $2.5 million in other income and expense related to the loss of hedge designation on discontinued cash flow hedges due to changes in the Company's forecast of future net sales and cost of sales and due to prevailing market conditions. During 2001, the Company recorded a net gain of $5.1 million in other income and expense related to the loss of hedge designation on discontinued cash flow hedges due to changes in the Company's forecast of future net sales and cost of sales.

Interest Rate Risk Management

The Company sometimes enters into interest rate derivative transactions, including interest rate swaps, collars, and floors, with financial institutions in order to better match the Company's floating-rate interest income on its cash equivalents and short-term investments with its fixed-rate interest expense on its long-term debt, and/or to diversify a portion of the Company's exposure away from fluctuations in short-term U.S. interest rates. The Company may also enter into interest rate contracts that are intended to reduce the cost of the interest rate risk management program. The Company does not hold or transact in such financial instruments for purposes other than risk management.

As of September 30, 2000, the Company had entered into interest rate swaps with financial institutions in order to better match the Company's floating-rate interest income on its cash equivalents and short-term investments with its fixed-rate interest expense on its long-term debt, and to diversify a portion of the Company's exposure away from fluctuations in short-term U.S. interest rates. The interest rate swaps generally required the Company to pay a floating interest rate based on the three- or six-month U.S. dollar LIBOR and receive a fixed rate of interest without exchanges of the underlying notional amounts. These swaps effectively converted the

Company's fixed-rate 10-year debt to floating-rate debt and converted a portion of the floating rate investments to fixed rate. The Company assumed no ineffectiveness with regard to the debt interest swaps as each debt interest rate swap met the criteria for accounting under the short-cut method defined in SFAS No. 133 for fair value hedges of debt instruments. Accordingly, no net gains or losses were recorded in income relative to the Company's underlying debt interest rate swaps. During fiscal 2001, the Company closed out all of its existing debt interest rate swap positions due to prevailing market interest rates realizing a gain of $17 million. This gain was deferred, recognized in long-term debt and is being amortized to other income and expense over the remaining life of the debt.

The unrealized loss on the assets swaps as of September 30, 2000, of $5.7 million was deferred and then recognized in income in 2001 as part of the SFAS No. 133 transition adjustment effective on October 1, 2000. The Company closed out all of its existing interest rate asset swaps during 2001 realizing a gain of $1.1 million.

As of September 28, 2002, the Company had no interest rate derivatives outstanding. Due to perceived market risk, the Company entered into interest rate swaps in early 2002. These interest rate swaps were entered into with financial institutions in order to better match the Company's floating-rate interest income on its cash equivalents and short-term investments with its fixed-rate interest expense on its long-term debt. The interest rate swaps required the Company to pay a floating interest rate based on six-month U.S. dollar LIBOR and receive a fixed rate of interest without exchanges of the underlying notional amounts. These swaps effectively converted the Company's fixed-rate 10-year debt to floating-rate debt. The Company assumed no ineffectiveness with regard to the debt interest swaps as each debt interest rate swap met the criteria for accounting under the short-cut method defined in SFAS No. 133 for fair

value hedges of debt instruments. Accordingly, no net gains or losses were recorded in income relative to the Company's underlying debt interest rate swaps during fiscal 2002 until the Company closed out the positions in late 2002 due to prevailing market interest rates. Closing the debt interest rate swaps resulted in a realized gain of $6 million. This gain was deferred, recognized in long-term debt and is being amortized to other income and expense over the remaining life of the debt.

Long-Term Debt

During 1994, the Company issued $300 million aggregate principal amount of 6.5% unsecured notes in a public offering registered with the SEC. The notes were sold at 99.925% of par, for an effective yield to maturity of 6.51%. The notes pay interest semiannually and mature on February 15, 2004. As of September 28, 2002 and September 29, 2001, the carrying amount of these notes, including unamortized deferred gains associated with closed debt interest rate swaps, was $316 million and $317 million, respectively, while the fair value was $299 million and $295 million, respectively. The fair value of the notes is based on their listed market values as of September 28, 2002 and September 29, 2001.

Non-Current Debt and Equity Investments and Related Gains and Losses

The Company has held significant investments in EarthLink Network, Akamai Technologies, Inc. (Akamai), ARM Holdings plc (ARM), and Samsung Electronics Co., Ltd (Samsung). These investments have been reflected in the consolidated balance sheets as non-current debt and equity investments, and their combined fair value was $39 million and $128 million as of September 28, 2002, and September 29, 2001, respectively.

EarthLink

In January 2000, the Company invested $200 million in EarthLink, an Internet service provider (ISP). The investment is in EarthLink's Series C Convertible Preferred Stock, which is convertible by the Company after January 4, 2001, into approximately 7.1 million shares of EarthLink common stock. Concurrent with this investment, EarthLink and the Company entered into a multi-year agreement to deliver ISP service to Macintosh users in the United States. Under the terms of the agreement, the Company profits from each new Mac customer that subscribes to EarthLink's ISP service for a specified period of time, and EarthLink is the default ISP in the Company's Internet Setup Software included with all Macintosh computers sold in the United States.

During the second quarter of 2001, the Company determined that the then current decline in the fair value of its investment in EarthLink was other-than-temporary requiring that its cost basis be written down to fair value as a new cost basis and the amount of the write-down be included in earnings. As a result, the Company recognized a $114 million charge to earnings to write-down the basis of its investment in EarthLink to $86 million. This charge was included in gains (losses) on non-current investments, net. During the fourth quarter of 2001, the Company sold a total of approximately 425,000 shares of EarthLink stock for net proceeds of approximately $6 million and recorded a gain before taxes of approximately $800,000. As of September 29, 2001, the Company held 6.7 million shares of EarthLink stock with a fair value of approximately $102 million.

During the first quarter of 2002, the Company sold 117,000 shares of EarthLink stock for net proceeds of $2 million and a gain before taxes of $223,000. No sales of EarthLink were made in any of the subsequent quarters of fiscal 2002. However, during the fourth quarter of 2002, the Company determined that the then current decline in the fair value of its investment in EarthLink was other-than-temporary. As a result, the Company recognized a $44 million charge to earnings to write-down the basis of its investment in

EarthLink to $35 million. This charge was included in gains (losses) on non-current investments, net. As of September 28, 2002, the Company holds 6.5 million shares of EarthLink stock valued at $35 million.

Akamai

In June 1999, the Company invested $12.5 million in Akamai, a global Internet content delivery service. The investment was in the form of convertible preferred stock that converted into 4.1 million shares of Akamai common stock (adjusted for subsequent stock splits) at the time of Akamai's initial public offering in October 1999. Beginning in the first quarter of 2000, the Company categorized its shares in Akamai as available-for-sale. The fair value of the Company's investment in Akamai was approximately $216 million as of September 30, 2000. During 2001, the Company sold a total of approximately 1 million shares of Akamai stock for net proceeds of approximately $39 million and recorded a gain before taxes of approximately $36 million. As of September 29, 2001, the Company held 3.1 million shares of Akamai stock valued at $9 million.

During the first quarter of 2002, the Company sold 250,000 shares of Akamai stock for net proceeds of $2 million and a gain before taxes of $710,000. No sales of Akamai were made in any of the subsequent quarters of fiscal 2002. However, during the fourth quarter of 2002, the Company determined that the decline in the fair value of its investment in Akamai was other-than-temporary. As a result, the Company recognized a $6 million charge to earnings to write-down the basis of its investment in Akamai to $3 million. This charge was included in gains (losses) on non-current investments, net. As of September 28, 2002, the Company holds 2.9 million shares of Akamai stock valued at $3 million.

ARM Holdings

ARM is a publicly held company in the United Kingdom involved in the design and licensing of high performance microprocessors and related technology. During the first quarter of 2002, the Company sold 4.7 million shares of ARM stock for both net proceeds and a gain before taxes of $21 million. No sales of ARM were made in any of the subsequent quarters of fiscal 2002. As of September 28, 2002, the Company holds 278,000 shares of ARM stock valued at $578,000.

During 2001, the Company sold a total of approximately 29.8 million shares of ARM stock for net proceeds of approximately $176 million and recorded a gain before taxes of approximately $174 million. As of September 29, 2001, the Company held 5 million shares of ARM stock valued at $17 million. During 2000, the Company sold a total of approximately 45.2 million shares of ARM stock for net proceeds of approximately $372 million and recorded a gain before taxes of approximately $367 million.

Samsung

During the fourth quarter of 1999, the Company invested $100 million in Samsung to assist in the further expansion of Samsung's TFT-LCD flat-panel display production capacity. The investment was in the form of three year unsecured bonds, which were convertible into approximately 550,000 shares of Samsung common stock beginning in July 2000. The bonds carried an annual coupon rate of 2% and pay a total yield to maturity of 5% if redeemed at their maturity. The fair value of the Company's investment in Samsung was approximately $123 million as of September 30, 2000.

Prior to its sale, the Company had categorized its investment in Samsung as available-for-sale requiring that it be carried at fair value with unrealized gains and losses, net of taxes, reported in equity as a component of accumulated other comprehensive income. The fair value of the Company's investment in Samsung was approximately $123 million as of September 30, 2000. With the adoption of SFAS No. 133 on October 1, 2000, the Company was required to account for the conversion option embedded in the

Samsung bonds separately from the related debt. The conversion feature was carried at fair value with any changes in fair value recognized in earnings in the period in which they occur. Included in the $17 million gross SFAS No. 133 transition adjustment recorded in earnings during the first quarter of fiscal 2001 was a $23 million favorable adjustment for the restatement to fair value as of

October 1, 2000, of the derivative component of the Company's investment in Samsung. To adjust the carrying value of the derivative component of its investment in Samsung to fair value as of December 30, 2000, the Company recognized an unrealized loss of approximately $13 million during the first quarter of 2001. During the second quarter of 2001, the Company sold this investment for book value, including accrued interest, and received net proceeds of approximately $117 million.

Other Strategic Investments

The Company has made additional minority debt and equity investments in several privately held technology companies which were reflected in the consolidated balance sheets in other assets. These investments are inherently risky because the products and/or markets of these companies are typically not fully developed. During 2001 the Company determined that the decline in fair value of certain of these investments was other-than-temporary and, accordingly, recognized a charge to earnings of approximately $8 million. This charge was included in gains (losses) on non-current investments, net. During 2002, the Company determined that the decline in fair value of certain of these investments was other-than-temporary and, accordingly, recognized a charge to earnings of $15 million. These charges were included in gains (losses) on non-current investments, net. As of September 28, 2002, the Company has no private debt or equity investments reflected in its consolidated balance sheet.

Note 3—Consolidated Financial Statement Details

Inventories (in millions)

	2002	2001
Purchased parts	$ 9	$ 1
Work in process	—	—
Finished goods	36	10
Total inventories	$ 45	$ 11

Property, Plant, and Equipment (in millions)

	2002	2001
Land and buildings	$ 342	$ 337
Machinery and equipment	183	182
Office furniture and equipment	67	63
Internal-use software	184	192
Leasehold improvements	281	186
	1,057	960
Accumulated depreciation and amortization	(436)	(396)
Net property, plant, and equipment	$ 621	$ 564

Accrued Expenses (in millions)

	2002	2001
Accrued compensation and employee benefits	$ 93	$ 88
Accrued marketing and sales programs	136	131
Deferred revenue	253	184
Accrued warranty and related costs	69	87

Other current liabilities	196	227
Total accrued expenses	$ 747	$ 717

Interest and Other Income, Net (in millions)

	2002	2001	2000
Interest income	$ 118	$ 218	$ 210
Interest expense	(11)	(16)	(21)
Foreign currency gain (loss), net	4	15	1
Net premiums and discounts on foreign exchange instruments	(11)	(8)	7
Miscellaneous other income and expense	12	8	6
Total interest and other income, net	$ 112	$ 217	$ 203

Note 4—Acquisitions

Goodwill and Other Acquisition-Related Intangibles

The following table summarizes the components of gross and net intangible asset balances (in millions):

	September 28, 2002			September 29, 2001		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Goodwill (a)	$ 85	—	$ 85	$ 66	—	$ 66
Other acquired intangible assets	5	(5)	—	5	(4)	1
Acquired technology	42	(8)	34	12	(3)	9
Total acquired intangible assets	$ 132	$ (13)	$ 119	$ 83	$ (7)	$ 76

(a) Accumulated amortization related to goodwill of $55 million arising prior to the adoption of SFAS No. 142 has been reflected in the gross carrying amount of goodwill as of September 28, 2002 and September 29, 2001.

Expected annual amortization expense related to acquired technology is as follows (in millions):

Fiscal Years:	
2003	$ 9
2004	7
2005	6
2006	3
Thereafter	9
Total expected annual amortization expense	$ 34

Amortization expense related to acquired intangible assets is as follows (in millions):

	2002	2001	2000
Goodwill amortization	$ —	$ 16	$ 21
Other acquired intangible assets amortization	1	3	3
Acquired technology amortization	5	2	—
Total amortization	$ 6	$ 21	$ 24

Net income (loss) and net income (loss) per share adjusted to exclude amortization of goodwill in fiscal periods prior to 2002 follows (in millions, except per share amounts):

	2002	2001	2000
Net income (loss), as reported	$ 65	$ (25)	$ 786
Add: goodwill amortization	$ —	$ 16	$ 21
Net income (loss), as adjusted	$ 65	$ (9)	$ 807
Basic earnings (loss) per share, as reported	$ 0.18	$ (0.07)	$ 2.42
Add: goodwill amortization	$ —	$ 0.04	$ 0.06
Basic earnings (loss) per share, as adjusted	$ 0.18	$ (0.03)	$ 2.48
Diluted earnings (loss) per share, as reported	$ 0.18	$ (0.07)	$ 2.18
Add: goodwill amortization	$ —	$ 0.04	$ 0.06
Diluted earnings (loss) per share, as adjusted	$ 0.18	$ (0.03)	$ 2.24

Acquisition of Emagic

During the fourth quarter of 2002, the Company acquired Emagic GmbH, a provider of professional software solutions for computer based music production, for approximately $30 million in cash; $26 million of which was paid immediately upon closing of the deal and $4 million of which was held-back for future payment contingent on continued employment by certain employees that will be allocated to future compensation expense in the appropriate periods over the next 3 years. The acquisition has been accounted for as a purchase. The portion of the purchase price allocated to purchased in-process research and development (IPR&D) was expensed immediately, and the portion of the purchase price allocated to

acquired technology and to tradename will be amortized over their estimated useful lives of 3 years. Total consideration was allocated as follows (in millions):

Net tangible assets acquired	$ 2.3
Acquired technology	3.8
Tradename	0.8
In-process research and development	0.5
Goodwill	18.6
Total consideration	$ 26.0

The amount of the purchase price allocated to IPR&D was expensed upon acquisition, because the technological feasibility of products under development had not been established and no alternative future uses existed. The IPR&D relates primarily to Emagic's Logic series technology and extensions. At the date of the acquisition, the products under development were between 43%-83% complete, and it was expected that the remaining work would be completed during the Company's fiscal 2003 at a cost of approximately $415,000. The remaining efforts include finalizing user interface design and development, and testing. The fair value of the IPR&D was determined by an independent third-party valuation using the income approach, which reflects the projected free cash flows that will be generated by the IPR&D projects and that are attributable to the acquired technology, and discounting the projected net cash flows back to their present value using a discount rate of 25%.

Acquisition of certain assets of Zayante, Inc., Prismo Graphics, and Silicon Grail

During fiscal 2002 the Company acquired certain technology and patent rights of Zayante, Inc., Prismo Graphics, and Silicon Grail Corporation for a total of $20 million in cash. These transactions have been accounted for as asset acquisitions. The purchase price for these asset acquisitions, except for $1 million identified as contingent consideration which will be allocated to compensation expense over the next 3 years, has been allocated to acquired technology and will be amortized on a straight-line basis over 3 years, except for certain assets acquired from Zayante associated with patent royalty streams that will be amortized over 10 years.

Acquisition of Nothing Real, LLC

During the second quarter of 2002, the Company acquired certain assets of Nothing Real, LLC (Nothing Real), a privately-held company that develops and markets high performance tools designed for the digital image creation market. Of the $15 million purchase price, the Company has allocated $7 million to acquired technology, which will be amortized over its estimated life of 5 years. The remaining $8 million, which has been identified as contingent consideration, rather than recorded as an additional component of the cost of the acquired assets, will be allocated to future compensation expense in the appropriate periods over the next 3 years.

Acquisition of Spruce Technologies, Inc.

In July 2001, the Company acquired Spruce Technologies, Inc. (Spruce), a privately-held company that develops and markets DVD authoring products, for $14.9 million in cash. Goodwill associated with the acquisition of Spruce is not subject to amortization pursuant to the transition provisions of SFAS No. 142.

The consolidated financial statements include the operating results of Spruce from the date of acquisition. Total consideration was allocated as follows (in millions):

Net tangible liabilities assumed	$ (0.7)
Identifiable intangible assets	5.9
Goodwill	9.7
Total consideration	$ 14.9

Acquisition of PowerSchool, Inc.

In May 2001, the Company acquired PowerSchool, Inc. (PowerSchool), a provider of web-based student information systems for K-12 schools and districts that enables schools to record, access, report, and manage their student data and performance in real-time, and gives parents real-time web access to track their children's progress. The consolidated financial statements include the operating results of PowerSchool from the date of acquisition.

The purchase price of approximately $66.1 million consisted of the issuance of approximately 2.4 million shares of the Company's common stock with a fair value of $61.2 million, the issuance of stock options with a fair value of $4.5 million, and $300,000 of direct transaction costs. The fair value of the common stock options issued was determined using a Black-Scholes option pricing model with the following assumptions: volatility of 67%, expected life of 4 years, dividend rate of 0%, and risk-free rate of 4.73%. Total consideration was allocated as follows (in millions):

Net tangible assets acquired	$ 0.2
Deferred stock compensation	12.8
Identifiable intangible assets	2.6
In-process research and development	10.8

Goodwill	39.7
Total consideration	$ 66.1

The amount of the purchase price allocated to IPR&D was expensed upon acquisition, because the technological feasibility of products under development had not been established and no alternative future uses existed. The IPR&D relates to technologies representing processes and expertise employed to design, develop, and deploy a functioning, scalable web-based student information system for use by K-12 schools. At the date of the acquisition, the product under development was approximately 50% complete, and it was expected that the remaining 50% would be completed during the Company's fiscal 2002 at a cost of approximately $9.25 million. The remaining efforts, which were completed in 2002, included completion of coding, finalizing user interface design and development, and testing. The fair value of the IPR&D was determined by an independent third-party valuation using the income approach, which reflects the projected free cash flows that will be generated by the IPR&D projects and that are attributable to the acquired technology, and discounting the projected net cash flows back to their present value using a discount rate of 25%. The acquired intangibles are being amortized over their estimated useful lives of three years, respectively. Deferred stock compensation associated with restricted stock and options is being amortized over the required future vesting period of three years.

In the fourth quarter of 2001, an adjustment was made to increase goodwill associated with the acquisition of PowerSchool by $5.9 million due to the identification of previously unidentified loss contingencies that were in existence prior to consummation of the acquisition.

Acquisition-Related Deferred Stock Compensation

The Company allocated $12.8 million of its purchase consideration for PowerSchool to acquisition-related deferred stock compensation within shareholders' equity. This amount represents the intrinsic value of stock options assumed that vest as future services are provided by employees and related to 445,000 common shares issued contingent on continued employment of certain PowerSchool employee stockholders.

Pro Forma Financial Information

The unaudited pro forma financial information below presents the condensed consolidated financial results of the Company assuming that PowerSchool and Spruce, acquired in 2001, had been acquired at the beginning of 2000 and includes the effect of amortization of goodwill and other acquired identifiable intangible assets from that date. The impact of the charge for IPR&D associated with the acquisition of PowerSchool has been excluded. This pro forma financial information is presented for informational purposes only and is not necessarily indicative of the results of future operations that would have been achieved had the acquisitions taken place at the beginning of 2000. Pro forma information follows (in millions, except per share amounts):

	2001	2000
Net sales	$ 5,370	$ 7,994
Net income (loss)	$ (44)	$ 767
Basic earnings (loss) per common share	$ (0.13)	$ 2.35
Diluted earnings (loss) per common share	$ (0.13)	$ 2.11

Note 5—Special Charges

Restructuring Actions

2002 Restructuring Actions

During fiscal 2002, the Company recorded total restructuring charges of approximately $30 million related to actions intended to eliminate certain activities and better align the Company's operating expenses with existing general economic conditions and to partially offset the cost of continuing investments in new product development and investments in the Company's Retail operating segment.

During the fourth quarter of 2002, the Company's management approved and initiated restructuring actions with a total cost of approximately $6 million designed to reduce headcount costs in Corporate operations and sales and to adjust its PowerSchool product strategy. These restructuring actions resulted in the elimination of approximately 180 positions worldwide at a cost of $1.8 million, 161 of which were eliminated by September 28, 2002. Eliminated positions were primarily in Corporate operations, sales, and PowerSchool related research and development. The shift in product strategy at PowerSchool included discontinuing development and marketing of PowerSchool's PSE product. This shift resulted in the impairment of previously capitalized development costs associated with the PSE product in the amount of $4.5 million. As of September 28, 2002, substantially all of the $6 million accrual had been utilized, except for insignificant severance and related costs associated with the 19 remaining positions.

During the first quarter of 2002, the Company's management approved and initiated restructuring actions with a total cost of approximately $24 million. These restructuring actions will result in the elimination of approximately 425 positions worldwide, 415 of which were eliminated by September 28, 2002, at a cost of $8 million. Positions were eliminated primarily in the Company's operations, information systems, and administrative functions. In addition, these restructuring actions also included significant changes in the Company's information systems strategy resulting in termination of equipment leases and cancellation of existing projects and activities. Related lease and contract cancellation charges totaled $12 million, and charges for asset impairments totaled $4 million. Of the original $24 million restructuring charge made during the first quarter of 2002, approximately $23 million had been spent as of September 28, 2002 and approximately $250,000 was reversed during the second quarter of 2002 due to lower actual costs than originally estimated for certain lease commitments and severance benefits. The remaining $1 million accrual relates primarily to future payments on abandoned operating leases.

2000 Restructuring Actions

During the first quarter of 2000, the Company initiated restructuring actions resulting in recognition of an $8 million restructuring charge. This charge was comprised of $3 million for the write-off of various operating assets and $5 million for severance payments to approximately 95 employees associated with consolidation of various domestic and international sales and marketing functions. Of the $5 million accrued for severance, $2.5 million had been spent before the end of 2000, and the remainder was spent in 2001. Of the $3 million accrued for the write-off of various assets, substantially all was utilized before the end of 2000.

Executive Bonus

During the first quarter of 2000, the Company's Board of Directors approved a special executive bonus for the Company's Chief Executive Officer for past services in the form of an aircraft with a total cost to the Company of approximately $90 million, the majority of which was not tax deductible. Approximately half of the total charge is for the cost of the aircraft. The other half represents all other costs and taxes associated with the bonus. In the fourth quarter of 2002, all significant work and payments associated with the aircraft were complete. Of the original $90 million accrual, $2.4 million remained unspent at the end of fiscal 2002 and was reversed.

Technology Acquisition

As discussed in Note 4, during both 2002 and 2001 in its acquisition of Emagic and PowerSchool, respectively, the Company acquired certain technology that was under development and had no alternative future use. This resulted in the recognition of purchased in-process research and development in the amount of $551,000 for Emagic and $10.8 million for PowerSchool, which was charged to operations upon acquisition.

Note 6—Income Taxes

The provision for income taxes consisted of the following (in millions):

	2002	2001	2000
Federal:			
Current	$ 8	$ (20)	$ 9
Deferred	(28)	(8)	239

	(20)	(28)	248
State:			
Current	2	—	—
Deferred	7	(10)	23
	9	(10)	23
Foreign:			
Current	29	21	37
Deferred	4	2	(2)
	33	23	35
Provision for income taxes	$ 22	$ (15)	$ 306

The foreign provision for income taxes is based on foreign pretax earnings of approximately $284 million, $363 million and $1.019 billion in 2002, 2001, and 2000, respectively. As of September 28, 2002, approximately half of the Company's cash, cash equivalents, and short-term investments is held by foreign subsidiaries and is generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries would be subject to U.S. income taxation on repatriation to the United States. The Company's consolidated financial statements fully provide for any related tax liability on amounts that may be repatriated, aside from undistributed earnings of certain of the Company's foreign subsidiaries that are intended to be indefinitely reinvested in operations outside the United States. U.S. income taxes have not been provided on a cumulative total of $755 million of such earnings. It is not practicable to determine the income tax liability that might be incurred if these earnings were to be distributed.

Deferred tax assets and liabilities reflect the effects of tax losses, credits, and the future income tax effects of temporary differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases and are measured using enacted tax rates that apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

As of September 28, 2002 and September 29, 2001, the significant components of the Company's deferred tax assets and liabilities were (in millions):

	2002	2001
Deferred tax assets:		
Accounts receivable and inventory reserves	$ 23	$ 26
Accrued liabilities and other reserves	102	110
Basis of capital assets and investments	35	54
Tax losses and credits	209	319
Total deferred tax assets	369	509
Less valuation allowance	30	33
Net deferred tax assets	339	476
Deferred tax liabilities:		
Unremitted earnings of subsidiaries	308	489
Available-for-sale securities	1	14
Other	26	18
Total deferred tax liabilities	335	521
Net deferred tax asset (liability)	$ 4	$ (45)

As of September 28, 2002, the Company had operating loss carryforwards for federal tax purposes of approximately $72 million, which expire from 2009 through 2021. These carryforwards are comprised of remaining operating loss carryforwards acquired from NeXT and other acquisitions, the utilization of which is subject to certain limitations imposed by the Internal Revenue Code. The Company also has Federal credit carryforwards and various state and foreign tax loss and credit carryforwards, the tax effect of which is approximately $94 million and which expire between 2003 and 2022. The remaining benefits from tax losses and credits do not expire. As of September 28, 2002, a valuation allowance of $30 million was recorded against the deferred tax asset for the benefits of tax losses that may not be realized. The valuation allowance relates primarily to the operating loss carryforwards acquired from NeXT and other acquisitions. Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets.

A reconciliation of the provision for income taxes, with the amount computed by applying the statutory federal income tax rate (35% in 2001, 2000, and 1999) to income (loss) before provision for income taxes, is as follows (in millions):

	2002	2001	2000
Computed expected tax (benefit)	$ 30	$ (18)	$ 382
State taxes, net of federal effect	7	(7)	15
Indefinitely invested earnings of foreign subsidiaries	—	—	(82)
Nondeductible executive compensation	(1)	—	32
Purchase accounting and asset acquisitions	3	10	—
Change in valuation allowance	(16)	—	(27)
Research & development credit, net	(8)	(5)	(5)
Nondeductible expenses	4	3	—
Other items	3	2	(9)
Provision for (benefit from) income taxes	$ 22	$ (15)	$ 306
Effective tax rate	25%	30%	28%

The Internal Revenue Service (IRS) has completed audits of the Company's federal income tax returns through 1997. Substantially all IRS audit issues for years through 1997 have been resolved. The IRS is currently auditing the Company's federal income tax returns for fiscal years 1998 through 2000. Management believes that adequate provision has been made for any adjustments that may result from tax examinations.

Note 7—Shareholders' Equity

Stock Repurchase Plan

In July 1999, the Company's Board of Directors authorized a plan for the Company to repurchase up to $500 million of its common stock. This repurchase plan does not obligate the Company to acquire any specific number of shares or acquire shares over any specified period of time. During 2000, the Company repurchased a total of 2.55 million shares of its common stock at a cost of $116 million. During the fourth quarter of 2001, the Company entered into a forward purchase agreement to acquire 1.5 million shares of its common stock in September of 2003 at an average price of $16.64 per share for a total cost of $25.5 million. The Company engaged in no transactions relating to the stock repurchase plan in fiscal 2002. Since inception of the repurchase plan, the Company has repurchased or committed to repurchase a total of 6.55 million shares of its common stock at a cost of $217 million.

Preferred Stock

In August 1997, the Company and Microsoft Corporation (Microsoft) entered into a patent cross license and technology agreements. In addition, Microsoft purchased 150,000 shares of Apple Series A nonvoting convertible preferred stock ("preferred stock") for $150 million. These shares were convertible by Microsoft after August 5, 2000, into shares of the Company's common stock at a conversion price of $8.25 per share. During 2000, 74,250 shares of preferred stock were converted to 9 million shares of the Company's common stock. During 2001, the remaining 75,750 preferred shares were converted into 9.2 million shares of the Company's common stock.

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Comprehensive Income

The following table summarizes the components of accumulated other comprehensive income, net of taxes, (in millions):

	2002	2001	2000
Unrealized gains on available-for-sale securities	$ 13	$ 30	$ 297
Unrealized gains (losses) on derivative investments	(11)	4	—
Cumulative translation adjustments	(51)	(56)	(53)
Accumulated other comprehensive income (loss)	$ (49)	$ (22)	$ 244

The following table summarizes activity in other comprehensive income related to available-for-sale securities, net of taxes (in millions):

	2002	2001	2000
Change in fair value of available-for-sale securities	$ (49)	$ (183)	$ 427
Less: adjustment for net (gains) losses realized and included in net income	32	(84)	(272)
Change in unrealized gain on available-for-sale securities	$ (17)	$ (267)	$ 155

The tax effect related to the change in unrealized gain on available-for-sale securities was $10 million, $157 million, $(91) million for fiscal 2002, 2001, and 2000, respectively. The tax effect on the reclassification adjustment for net gains included in net income was $10 million, $35 million and $94 million for fiscal 2002, 2001, and 2000, respectively.

The following table summarizes activity in other comprehensive income related to derivatives, net of taxes, held by the Company (in millions):

	2002	2001
Cumulative effect of adopting SFAS No. 133	$ —	$ 12
Changes in fair value of derivatives	4	45
Less: adjustment for net gains realized and included in net income	(19)	(53)
Change in unrealized gain on derivatives	$ (15)	$ 4

The tax effect related to the cumulative effect of adopting SFAS No. 133 was $(5) as of September 29, 2001. The tax effect related to the changes in fair value of derivatives was $(2) million and $(19) million for fiscal 2002 and 2001, respectively. The tax effect related to derivative gains reclassified from OCI was $8 million and $23 million for fiscal 2002 and 2001, respectively.

Note 8—Employee Benefit Plans

1998 Executive Officer Stock Plan

The 1998 Executive Officer Stock Plan (the 1998 Plan) is a shareholder approved plan which replaced the 1990 Stock Option Plan terminated in April 1998, the 1981 Stock Option Plan terminated in October 1990, and the 1987 Executive Long Term Stock Option Plan terminated in July 1995. Options granted before these plans' termination dates remain outstanding in accordance with their terms. Options may be granted under the 1998 Plan to the Chairman of the Board of Directors, executive officers of the Company at the level of Senior Vice President and above, and other key employees. These options generally become exercisable over a period of 4 years, based on continued employment, and generally expire 10 years after the grant date. The 1998 Plan permits the granting of incentive stock options, nonstatutory stock options, stock appreciation rights, and stock purchase rights.

1997 Employee Stock Option Plan

In August 1997, the Company's Board of Directors approved the 1997 Employee Stock Option Plan (the 1997 Plan), a non-shareholder approved plan for grants of stock options to employees who are not officers of the Company. Options may be granted under the 1997 Plan to employees at not less than the fair market value on the date of grant. These options generally become exercisable over a period of 4 years, based on continued employment, and generally expire 10 years after the grant date.

1997 Director Stock Option Plan

In August 1997, the Company's Board of Directors adopted a shareholder approved Director Stock Option Plan (DSOP) for non-employee directors of the Company. Initial grants of 30,000 options under the DSOP vest in three equal installments on each of the first through third anniversaries of the date of grant, and subsequent annual grants of 10,000 options are fully vested at grant. Prior to adoption of the DSOP, 60,000 options were granted in total to two then-current members of the Company's Board of Directors.

Employee Stock Purchase Plan

The Company has a shareholder approved employee stock purchase plan (the Purchase Plan), under which substantially all employees may purchase common stock through payroll deductions at a price equal to 85% of the lower of the fair market values as of the beginning and end of six-month offering periods. Stock purchases under the Purchase Plan are limited to 10% of an employee's compensation, up to a maximum of $25,000 in any calendar year. During 2002, 2001, and 2000, 1.8 million, 1.8 million and 766,000 shares, respectively, were issued under the Purchase Plan. As of September 28, 2002, approximately 2.1 million shares were reserved for future issuance under the Purchase Plan.

Employee Savings Plan

The Company has an employee savings plan (the Savings Plan) qualifying as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code. Under the Savings Plan, participating U.S. employees may defer a portion of their pre-tax earnings, up to the Internal Revenue Service annual contribution limit ($11,000 for calendar year 2002). The Company matches 50% to 100% of each employee's contributions, depending on length of service, up to a maximum 6% of the employee's earnings. The Company's matching contributions to the Savings Plan were approximately $19 million, $17 million, and $16 million in 2002, 2001, and 2000, respectively.

Stock Option Activity

A summary of the Company's stock option activity and related information for the years ended September 28, 2002, September 29, 2001 and September 30, 2000 follows (option amounts are presented in thousands):

		Outstanding Options	
	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price
Balance at 9/25/99	41,727	36,808	$ 13.20
Additional Options Authorized	13,500	—	—
Options Granted	(45,662)	45,662	$ 46.52
Options Cancelled	4,846	(4,846)	$ 28.42
Options Exercised	—	(6,866)	$ 9.62
Plan Shares Expired	(2,881)	—	—
Balance at 9/30/00	11,530	70,758	$ 34.01

Additional Options Authorized	27,000	—	—
Options Granted	(34,857)	34,857 $	18.58
Options Cancelled	6,605	(6,605) $	29.32
Options Exercised	—	(1,831) $	10.05
Plan Shares Expired	(203)	—	—
Balance at 9/29/01	10,075	97,179 $	29.24
Additional Options Authorized	15,000	—	—
Options Granted	(23,239)	23,239 $	19.89
Options Cancelled	4,737	(4,737) $	30.98
Options Exercised	—	(6,251) $	11.99
Plan Shares Expired	(2)	—	—
Balance at 9/28/02	6,571	109,430 $	28.17

The options outstanding as of September 28, 2002, have been segregated into five ranges for additional disclosure as follows (option amounts are presented in thousands):

	Options Outstanding			Options Exercisable	
	Options Outstanding as of September 28, 2002	Weighted-Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Options Exercisable as of September 28, 2002	Weighted Average Exercise Price
$0.83-$17.31	22,000	6.63	$ 14.26	13,459	$ 12.74
$17.32-$18.50	26,785	8.32	$ 18.40	10,138	$ 18.38
$18.51-$25.93	20,851	8.86	$ 21.35	4,902	$ 21.14
$25.94-$43.59	21,492	7.27	$ 42.92	20,896	$ 43.16
$43.60-$69.78	18,302	7.37	$ 49.64	8,529	$ 49.71
$0.83-$69.78	109,430	7.72	$ 28.17	57,924	$ 30.85

The Company had exercisable options to purchase 42.1 million shares outstanding as of September 29, 2001 with a weighted average exercise price of $32.15. As of September 30, 2000, the Company had exercisable options outstanding to purchase 23.7 million shares with a weighted average exercise price of $31.94.

Note 9—Stock-Based Compensation

Pro forma information regarding net income (loss) per share is required by SFAS No. 123 and has been determined as if the Company had accounted for its employee stock options granted and employee stock purchase plan purchases subsequent to September 29, 1995, under the fair value method of that statement. The fair values for these options and stock purchases were estimated at the date of grant and beginning of the period, respectively, using a Black-Scholes option pricing model. The assumptions used for each of the last three fiscal years and the resulting estimate of weighted-average fair value per share of options granted during those years are as follows:

	2002	2001	2000
Expected life of stock options	4 years	4 years	4 years
Expected life of stock purchases	6 months	6 months	6 months
Interest rate—stock options	2.90%	4.90%	6.20%
Interest rate—stock purchases	2.71%	5.97%	6.21%
Volatility—stock options	64%	66%	67%
Volatility—stock purchases	51%	90%	60%
Dividend yields	0	0	0

Weighted-average fair value of options granted during the year	$	10.11	$	10.15	$	25.92
Weighted-average fair value of stock purchases during the year	$	6.73	$	11.15	$	10.66

For purposes of pro forma disclosures, the estimated fair value of the options and shares are amortized to pro forma net income over the options' vesting period and the shares' plan period. The Company's pro forma information for each of the last three fiscal years follows (in millions, except per share amounts):

	2002		2001		2000	
Net income (loss)—as reported	$	65	$	(25)	$	786
Net income (loss)—pro forma	$	(164)	$	(396)	$	483
Net income (loss) per common share—as reported						
Basic	$	0.18	$	(0.07)	$	2.42
Diluted	$	0.18	$	(0.07)	$	2.18
Net income (loss) per common share—pro forma						
Basic	$	(0.46)	$	(1.15)	$	1.49
Diluted	$	(0.46)	$	(1.15)	$	1.38

Note 10—Commitments and Contingencies

Lease Commitments

The Company leases various facilities and equipment under noncancelable operating lease arrangements. The major facilities leases are for terms of 5 to 10 years and generally provide renewal options for terms of 3 to 5 additional years. Leases for retail space are for terms of 5 to 12 years and often contain multi-year renewal options. Rent expense under all operating leases, including both cancelable and noncancelable leases, was $92 million, $80 million, and $72 million in 2002, 2001, and 2000, respectively. Future minimum lease payments under noncancelable operating leases having remaining terms in excess of one year as of September 28, 2002, are as follows (in millions):

Fiscal Years		
2003	$	83
2004		78
2005		66
2006		55
2007		42
Later years		140
Total minimum lease payments	$	464

Concentrations in the Available Sources of Supply of Materials and Product

Although certain components essential to the Company's business are generally available from multiple sources, other key components (including microprocessors and application-specific integrated circuits, or ("ASICs")) are currently obtained by the Company from single or limited sources. Some other key components, while currently available to the Company from multiple sources, are at times subject to industry-wide availability and pricing pressures. In addition, the Company uses some components that are not common to the rest of the personal computer industry, and new products introduced by the Company often initially utilize custom components obtained from only one source until the Company has evaluated whether there is a need for and subsequently qualifies additional suppliers. If the supply of a key single-sourced component to the Company were to be delayed or curtailed or in the event a key manufacturing vendor delays shipments of completed products to the Company, the Company's ability to ship related products in desired quantities and in a timely manner could be adversely affected. The Company's business and financial performance could also be adversely affected depending on the time required to obtain sufficient quantities from the original source, or to identify and obtain sufficient quantities from an alternative source. Continued availability of these components may be affected if producers were to decide to concentrate on the production of common components instead of components customized to meet the Company's requirements. Finally, significant portions of the Company's CPUs, logic boards, and assembled products are now manufactured by outsourcing partners, the majority of which occurs in various parts of Asia. Although the Company works closely with its outsourcing partners on manufacturing schedules and levels, the Company's operating results could be adversely affected if its outsourcing partners were unable to meet their production obligations.

Contingencies

Beginning on September 27, 2001, three shareholder class action lawsuits were filed in the United States District Court for the Northern District of California against the Company and its Chief Executive Officer. These lawsuits are substantially identical, and purport to bring suit on behalf of persons who purchased the Company's publicly traded common stock between July 19, 2000, and September 28, 2000. The complaints allege violations of the 1934 Securities Exchange Act and seek unspecified compensatory damages and other relief. The Company believes these claims are without merit and intends to defend them vigorously. The Company filed a motion to dismiss on June 4, 2002, which was heard by the Court on September 13, 2002. On December 11, 2002, the Court granted the Company's motion to dismiss for failure to state a cause of action, with leave to plaintiffs to amend their complaint within thirty days.

The Company is subject to certain other legal proceedings and claims that have arisen in the ordinary course of business and have not been fully adjudicated. In the opinion of management, the Company does not have a potential liability related to any current legal proceedings and claims that would have a material adverse effect on its financial condition, liquidity or results of operations. However, the results of legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

The parliament of the European Union is working on finalizing the Waste Electrical and Electronic Equipment Directive (the Directive). The Directive makes producers of electrical goods, including personal computers, financially responsible for the collection, recycling, and safe disposal of past and future products. The Directive must now be approved and implemented by individual European Union governments by June 2004, while the producers' financial obligations are scheduled to start June 2005. The Company's potential liability resulting from the Directive related to past sales of its products and expenses associated with future sales of its product may be substantial. However, because it is likely that specific laws, regulations, and enforcement policies will vary significantly between individual European member states, it is not currently possible to estimate the Company's existing liability or future expenses resulting from the Directive. As the European Union and its individual member states clarify specific requirements and policies with respect to the Directive, the Company will continue to assess its potential financial impact. Similar legislation may be enacted in other geographies, including federal and state legislation in the United States, the cumulative impact of which could be significant.

Note 11—Segment Information and Geographic Data

The Company manages its business primarily on a geographic basis. The Company's reportable segments are comprised of the Americas, Europe, Japan, and Retail. The Americas segment includes both North and South America, except for the activities of the Company's Retail segment. The Europe segment includes European countries as well as the Middle East and Africa. The Japan segment includes only Japan. The Retail segment operates Apple-owned retail stores in the United States. Other operating segments include Asia-Pacific, which includes Australia and Asia except for Japan, and the Company's subsidiary, Filemaker, Inc. Each reportable geographic operating segment provides similar products and services, and the accounting policies of the various segments are the same as those described in the Summary of Significant Accounting Policies in Note 1, except as described below for the Retail segment.

The Company evaluates the performance of its operating segments based on net sales and operating income. Net sales for geographic segments are based on the location of the customers. Operating income for each segment includes revenue from third-parties, cost of sales, and operating expenses directly attributable to the segment. Operating income for each segment excludes other income and expense and certain expenses that are managed outside the operating segments. Costs excluded from segment operating income include various corporate expenses, manufacturing costs not included in standard costs, income taxes, and various nonrecurring charges. Corporate expenses include research and development, corporate marketing expenses, and other separately managed general and administrative expenses including certain corporate expenses associated with support of the Retail segment. The Company does not include intercompany transfers between segments for management reporting purposes. Segment assets exclude corporate assets.

Corporate assets include cash, short-term and long-term investments, manufacturing facilities, miscellaneous corporate infrastructure, goodwill and other acquired intangible assets, and retail store construction-in-progress which is not subject to depreciation. Except for the Retail segment, capital expenditures for long-lived assets are not reported to management by segment. Capital expenditures by the Retail segment were $106 million in 2002 and $92 million in 2001.

Operating income for all segments except Retail includes cost of sales at standard cost. Certain manufacturing expenses and related adjustments not included in segment cost of sales, including variances between standard and actual manufacturing costs and the mark-up above standard cost for product supplied to the Retail segment, are included in corporate expenses.

To assess the operating performance of the Retail segment several significant items are included in its results for internal management reporting that are not included in results of the Company's other segments. First, cost of sales for the Retail segment includes a mark-up above the Company's standard cost to approximate the price normally charged to the Company's major channel partners in the United States. For the twelve-month period ended September 28, 2002 and September 29, 2001, this resulted in the recognition of additional cost of sales above standard cost by the Retail segment and an offsetting benefit to corporate expenses of approximately $52 million and $4 million, respectively. Second, the Retail segment includes in its net sales proceeds from sales of the Company's extended warranty and support contracts. This treatment is consistent with how the Company's major channel partners account for the sale of the Company's extended warranty and support contracts. Because the revenue from these contracts has yet to be earned by the Company, an offset to this amount is reflected as a decrease in other segments' net sales. For the twelve-month period ended September 28, 2002, this resulted in the recognition of additional net sales by the Retail segment, and an offsetting reduction to other segments' net sales of $4.8 million. This amount was insignificant in 2001. Third, a portion of the operating expenses associated with certain high profile retail stores are allocated from the Retail segment to corporate marketing expense. Allocation of these expenses reflects the unique nature of these stores which, given their larger size and extraordinary design elements, function as vehicles for general corporate marketing, corporate events, and brand

awareness. Allocated operating costs are those in excess of operating costs incurred by one of the Company's more typical retail locations. Stores were open in two such high profile locations in New York and Los Angeles as of September 28, 2002, both of which were opened in fiscal 2002. Expenses allocated to corporate marketing resulting from the operations of these two stores was $1 million in 2002.

Summary information by operating segment follows (in millions):

	2002	2001	2000
Americas:			
Net sales	$ 3,088	$ 2,996	$ 4,298
Operating income	$ 280	$ 133	$ 614
Depreciation and amortization	$ 4	$ 4	$ 5
Segment assets(a)	$ 395	$ 334	$ 618
Europe:			
Net sales	$ 1,251	$ 1,249	$ 1,817
Operating income	$ 122	$ 68	$ 243
Depreciation and amortization	$ 4	$ 6	$ 4
Segment assets	$ 165	$ 137	$ 248
Japan:			
Net sales	$ 710	$ 713	$ 1,345
Operating income	$ 140	$ 98	$ 352
Depreciation and amortization	$ 2	$ 2	$ 2
Segment assets	$ 50	$ 44	$ 137
Retail:			
Net sales	$ 283	$ 19	—
Operating income	$ (22)	$ (21)	—
Depreciation and amortization(b)	$ 16	$ 2	—
Segment assets(b)	$ 141	$ 46	—

Other Segment:			
Net sales	$ 410	$ 386	$ 523
Operating income	$ 88	$ 63	$ 137
Depreciation and amortization	$ 2	$ 2	$ 3
Segment assets	$ 67	$ 70	$ 95

(a) The Americas asset figures do not include fixed assets held in the United States. Such fixed assets are not allocated specifically to the Americas segment and are included in the corporate assets figures below.

(b) Retail segment depreciation and asset figures reflect the cost and related depreciation of its retail stores and related infrastructure. Retail store construction-in-progress, which is not subject to depreciation, is reflected in corporate assets.

A reconciliation of the Company's segment operating income, and assets to the consolidated financial statements follows (in millions):

	2002	2001	2000
Segment operating income	$ 608	$ 341	$ 1,346
Corporate expenses, net	(562)	(674)	(726)
Purchased in-process research and development	(1)	(11)	—
Restructuring costs	(30)	—	(8)
Executive bonus	2	—	(90)
Consolidated operating income	$ 17	$ (344)	$ 522
Segment assets	$ 818	$ 630	$ 1,098
Corporate assets	$ 5,480	$ 5,391	$ 5,705
Consolidated assets	$ 6,298	$ 6,021	$ 6,803
Segment depreciation and amortization	$ 28	$ 16	$ 14
Corporate depreciation and amortization	90	86	70
Consolidated depreciation and amortization	$ 118	$ 102	$ 84

A large portion of the Company's net sales is derived from its international operations. Also, a majority of the raw materials used in the Company's products is obtained from sources outside of the United States, and a majority of the products sold by the Company is assembled internationally in the Company's facilities in Cork, Ireland and Singapore or by third-party vendors in Taiwan, Korea, Mexico, the People's Republic of China, and the Czech Republic. As a result, the Company is subject to risks associated with foreign operations, such as obtaining governmental permits and approvals, currency exchange fluctuations, currency restrictions, political instability, labor problems, trade restrictions, and changes in tariff and freight charges. During 2000, a single distributor, Ingram Micro Inc. accounted for approximately 11.5% of the Company's net sales. Net sales during 2000 to Ingram Micro Inc. in the Americas and Europe segments were $651 million and $255 million, respectively. Net sales to Ingram Micro Inc. in all other segments were $14 million. No other single customer accounted for more than 10% of net sales in 2000. No single customer accounted for more than 10% of net sales in 2002 or 2001.

Net sales and long-lived assets related to operations in the United States, Japan, and other foreign countries are as follows (in millions):

	2002	2001	2000
Net Sales:			
United States	$ 3,272	$ 2,936	$ 4,145
Japan	710	713	1,345
Other Foreign Countries	1,760	1,714	2,493
Total Net Sales	$ 5,742	$ 5,363	$ 7,983
Long-Lived Assets:			
United States	$ 561	$ 498	$ 387
Japan	2	3	5
Other Foreign Countries	69	77	52
Total Long-Lived Assets	$ 632	$ 578	$ 444

Information regarding net sales by product is as follows (in millions):

	2002	2001	2000
Net Sales:			
Power Macintosh(a)	$ 1,380	$ 1,664	$ 2,747
PowerBook	831	813	948
iMac	1,448	1,117	2,381
iBook	875	809	809
Software, Service, and Other Net Sales	1,208	960	1,098
Total Net Sales	$ 5,742	$ 5,363	$ 7,983

(a) Includes server sales and amounts previously reported as G4 Cube.

Note 12—Earnings Per Common Share

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except net income (loss) and per share amounts):

For the Years Ended	September 28, 2002	September 29, 2001	September 30, 2000
Numerator (in millions):			
Income (loss) before accounting change	$ 65	$ (37)	$ 786
Denominator:			
Weighted-average shares outstanding	355,022	345,613	324,568
Effect of dilutive securities:			
Convertible preferred stock	—	—	17,914
Dilutive options	6,763	—	17,842
Dilutive potential common shares	6,763	—	35,756

Denominator for diluted earnings (loss) per share	361,785	345,613	360,324
Basic earnings (loss) per share before accounting change	$ 0.18	$ (0.11)	$ 2.42
Cumulative effect of accounting change, net of tax	—	$ 0.04	—
Basic earnings (loss) per share after accounting change	$ 0.18	$ (0.07)	$ 2.42
Diluted earnings (loss) per share before accounting change	$ 0.18	$ (0.11)	$ 2.18
Cumulative effect of accounting change, net of tax	—	$ 0.04	—
Diluted earnings (loss) per share after accounting change	$ 0.18	$ (0.07)	$ 2.18

Options to purchase 101.8 million shares of common stock were outstanding at the end of 2002 that were not included in the computation of diluted earnings per share for that year because the options' exercise price was greater than the average market price of the Company's common shares for that year and, therefore, the effect would be antidilutive. At September 29, 2001, the Company had options to purchase 97.2 million shares of its common stock outstanding, all of which were excluded from the computation of diluted loss per share for 2001 because the effect would have been antidilutive. Options to purchase 2.5 million shares of common stock were outstanding at the end of 2000 that were not included in the computation of diluted earnings per share for that year because the options' exercise price was greater than the average market price of the Company's common shares for that year and, therefore, the effect would be antidilutive.

Note 13—Related Party Transactions

Mr. Jerome York, a member of the Board of the Directors of the Company, is a member of an investment group that purchased MicroWarehouse, Inc. ("*MicroWarehouse*") in January 2000. He also serves as its Chairman, President and Chief Executive Officer. MicroWarehouse is a multi-billion dollar specialty catalog and online retailer and direct marketer of computer products, including products made by the

Company, through its MacWarehouse catalog. MicroWarehouse accounted for 3.3% and 2.89% of the Company's net sales in 2002 and 2001, respectively. Trade receivables from MicroWarehouse were $20.9 million and $7.6 million as of September 28, 2002, and September 29, 2001, respectively. These receivables are subject to the same credit risk as the Company's other trade receivables. In addition, the Company purchases miscellaneous equipment and supplies from MicroWarehouse. Total purchases amounted to approximately $2.9 million in 2002 and $3.4 million in 2001.

In March 2002, the Company entered into a Reimbursement Agreement with its Chief Executive Officer, Mr. Steven P. Jobs, for the reimbursement of expenses incurred by Mr. Jobs in the operation of his private plane when used for Apple business. The Reimbursement Agreement is effective for expenses incurred by Mr. Jobs for Apple business purposes since he took delivery of the plane in May 2001. During 2002, the Company recognized a total of $1,168,000 in expenses pursuant to this reimbursement agreement related to expenses incurred by Mr. Jobs during 2001 and 2002.

In connection with a relocation assistance package, the Company loaned Mr. Ronald B. Johnson, Senior Vice President, Retail, $1.5 million for the purchase of his principal residence. The loan is secured by a deed of trust and is due and payable in May 2004. Under the terms of the loan, Mr. Johnson agreed that should he exercise any of his stock options prior to the due date of the loan, that he would pay the Company an amount equal to the lesser of (1) an amount equal to 50% of the total net gain realized from the exercise of the options; or (2) $375,000 multiplied by the number of years between the exercise date and the date of the loan.

Note 14—Selected Quarterly Financial Information (Unaudited)

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter

	(Tabular amounts in millions, except per share amounts)							
2002								
Net sales	$	1,443	$	1,429	$	1,495	$	1,375
Gross margin	$	381	$	391	$	409	$	422
Net income (loss)	$	(45)	$	32	$	40	$	38
Earnings (loss) per common share:								
Basic	$	(0.13)	$	0.09	$	0.11	$	0.11
Diluted	$	(0.13)	$	0.09	$	0.11	$	0.11
2001								
Net sales	$	1,450	$	1,475	$	1,431	$	1,007
Gross margin	$	437	$	434	$	385	$	(21)
Net income (loss)	$	66	$	61	$	43	$	(195)
Earnings (loss) per common share:								
Basic	$	0.19	$	0.17	$	0.12	$	(0.58)
Diluted	$	0.19	$	0.17	$	0.12	$	(0.58)

Basic and diluted earnings per share are computed independently for each of the quarters presented. Therefore, the sum of quarterly basic and diluted per share information may not equal annual basic and diluted earnings per share.

Net income for the fourth quarter of 2002 included several non-recurring items, net of tax: the write-down of certain equity investments totaling $49 million; a restructuring charge of $4 million; an in-process research and development charge of approximately $1 million; and the reversal of a portion of a previous

executive compensation expense resulting in a favorable impact of $2 million. Net income for the first quarter of 2002 included a restructuring charge, net of tax, $18 million. Net income during the first quarter of 2002 also included gains, net of tax, of $17 million related to non-current investments.

Net income during the fourth, third, second, and first quarters of 2001 included after-tax net gains related to non-current investments of $1 million, $8 million, $4 million, and $41 million, respectively. Net income for the third quarter of 2001 included an after-tax charge for purchased IPR&D of $8 million associated with the Company's acquisition of PowerSchool. Net income for the first quarter of 2001 includes an after-tax favorable cumulative-effect-type adjustment for the adoption of SFAS No. 133 of $12 million.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Shareholders
Apple Computer, Inc.:

We have audited the accompanying consolidated balance sheets of Apple Computer, Inc. and subsidiaries as of September 28, 2002 and September 29, 2001, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended September 28, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Apple Computer, Inc. and subsidiaries as of September 28, 2002 and September 29, 2001, and the results of their operations and their cash flows for each of the years in the three-year period ended September 28, 2002, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for goodwill in 2002 and changed its method of accounting for derivative instruments and hedging activities in 2001.

KPMG LLP

Mountain View, California
October 15, 2002

PART III

Item 10. Directors and Executive Officers of the Registrant

Directors

Listed below are the Company's five directors whose terms expire at the next annual meeting of shareholders.

Name	Position With the Company	Age	Director Since
William V. Campbell	Director	62	1997
Millard S. Drexler	Director	58	1999
Steven P. Jobs	Director and Chief Executive Officer	47	1997
Arthur D. Levinson	Director	52	2000
Jerome B. York	Director	64	1997

William V. Campbell has been Chairman of the Board of Directors of Intuit, Inc. *(Intuit)* since August 1998. From September 1999 to January 2000, Mr. Campbell acted as Chief Executive Officer of Intuit. From April 1994 to August 1998, Mr. Campbell was President and Chief Executive Officer and a director of Intuit. From January 1991 to December 1993, Mr. Campbell was President and Chief Executive Officer of GO Corporation. Mr. Campbell also serves on the board of directors of SanDisk Corporation and Loudcloud, Inc.

Millard S. Drexler was Chief Executive Officer of Gap Inc. from 1995 and President from 1987 until September 2002. Mr. Drexler was also a member of the Board of Directors of Gap Inc. from November 1983 until October 2002. He also served as the President of the Gap Division from 1983 to 1987.

Steven P. Jobs is one of the Company's co-founders and currently serves as its Chief Executive Officer. Mr. Jobs is also the Chairman and Chief Executive Officer of Pixar Animation Studios. In addition, Mr. Jobs co-founded NeXT Software, Inc. (*NeXT*) and served as the Chairman and Chief Executive Officer of NeXT from 1985 until 1997 when NeXT was acquired by the Company.

Arthur D. Levinson, Ph.D. has been President, Chief Executive Officer and a director of Genentech Inc. (*Genentech*) since July 1995. Dr. Levinson has been Chairman of the Board of Directors of Genentech since September 1999. He joined Genentech in 1980 and served in a number of executive positions, including Senior Vice President of R&D from 1993 to 1995.

Jerome B. York is Chairman and Chief Executive Officer of Micro Warehouse, Inc. Previously, he was Vice Chairman of Tracinda Corporation from September 1995 to October 1999. In May 1993, he joined International Business Machines Corporation (*IBM*) as Senior Vice President and Chief Financial Officer, and he served as a director of IBM from January 1995 to August 1995. Prior to joining IBM, Mr. York served in a number of executive positions at Chrysler Corporation, including Executive Vice President-Finance and Chief Financial Officer from May 1990 to May 1993. He also served as a director of Chrysler Corporation from 1992 to 1993. Mr. York is also a director of Tyco International Ltd. and Metro-Goldwyn- Mayer, Inc.

In September 2002, **Lawrence J. Ellison** resigned as a director. Mr. Ellison had served as a director since 1997.

Executive Officers

The following sets forth certain information regarding executive officers of the Company. Information pertaining to Mr. Jobs, who is both a director and an executive officer of the Company, may be found in the section entitled "**Directors.**"

Fred D. Anderson, Executive Vice President and Chief Financial Officer (age 58), joined the Company in April 1996. Prior to joining the Company, Mr. Anderson was Corporate Vice President and Chief Financial Officer of Automatic Data Processing, Inc., a position he held from August 1992 to March 1996. Mr. Anderson also serves as a director of 3Com Corporation.

Timothy D. Cook, Executive Vice President, Worldwide Sales and Operations (age 42), joined the Company in February 1998. Prior to joining the Company, Mr. Cook held the position of Vice President, Corporate Materials for Compaq Computer Corporation (*Compaq*). Previous to his work at Compaq, Mr. Cook was the Chief Operating Officer of the Reseller Division at Intelligent Electronics. Mr. Cook also spent 12 years with IBM, most recently as Director of North American Fulfillment.

Nancy R. Heinen, Senior Vice President, General Counsel and Secretary (age 46), joined the Company in September 1997. Prior to joining the Company, Ms. Heinen held the position of Vice President, General Counsel and Secretary of the Board of Directors at NeXT from February 1994 until the acquisition of NeXT by the Company in February 1997.

Ronald B. Johnson, Senior Vice President, Retail (age 44), joined the Company in January 2000. Prior to joining the Company, Mr. Johnson spent 10 years with Target Stores, most recently as Senior Merchandising Executive.

Peter Oppenheimer, Senior Vice President of Finance and Corporate Controller (age 40), joined the Company in July 1996. Mr. Oppenheimer also served with the Company in the position of Vice President and Corporate Controller and as Senior Director of Finance for the Americas. Prior to joining the Company, Mr. Oppenheimer was CFO of one of the four business units for Automatic Data Processing (*ADP*). Prior to joining ADP, Mr. Oppenheimer spent six years in the Information Technology Consulting Practice with Coopers and Lybrand.

Jonathan Rubinstein, Senior Vice President, Hardware Engineering (age 46), joined the Company in February 1997. Before joining the Company, Mr. Rubinstein was Executive Vice President and Chief Operating Officer of FirePower Systems Incorporated, from May 1993 to August 1996. Mr. Rubinstein also serves as a member of the Board of Directors of Immersion Corporation.

Philip W. Schiller, Senior Vice President, Worldwide Product Marketing (age 42), rejoined the Company in 1997. Prior to rejoining the Company, Mr. Schiller was Vice President of Product Marketing at Macromedia, Inc. from December 1995 to March 1997 and was Director of Product Marketing at FirePower Systems, Inc. from 1993 to December 1995. Prior to that Mr. Schiller spent six years at the Company in various marketing positions.

Sina Tamaddon, Senior Vice President, Applications (age 45), joined the Company in September 1997. Mr. Tamaddon has also served with the Company in the position of Senior Vice President Worldwide Service and Support, and Vice President and General Manager, Newton Group. Before joining the Company, Mr. Tamaddon held the position of Vice President, Europe with NeXT from September 1996 through March 1997. From August 1994 to August 1996, Mr. Tamaddon held the position of Vice President, Professional Services with NeXT.

Avadis Tevanian, Jr., Ph.D., Senior Vice President, Software Engineering (age 41), joined the Company in February 1997 upon the Company's acquisition of NeXT. With NeXT, Dr. Tevanian held several positions, including Vice President, Engineering, from April 1995 to February 1997. Prior to April 1995, Dr. Tevanian worked as an engineer with NeXT and held several management positions.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires the Company's officers and directors, and persons who own more than ten percent of a registered class of the Company's equity securities, to file reports of securities ownership and changes in such ownership with the Securities and Exchange Commission (the "*SEC*"). Officers, directors and greater than ten percent shareholders also are

required by rules promulgated by the SEC to furnish the Company with copies of all Section 16(a) forms they file.

Based solely upon a review of the copies of such forms furnished to the Company or written representations that no Forms 5 were required, the Company believes that, during fiscal year 2002, its officers, directors and greater than ten percent beneficial owners complied with all applicable Section 16(a) filing requirements.

Item 11. Executive Compensation

Information Regarding Executive Compensation

The following table summarizes compensation information for the last three fiscal years for (i) Mr. Jobs, Chief Executive Officer and (ii) the four most highly compensated executive officers other than the Chief Executive Officer who were serving as executive officers of the Company at the end of the fiscal year (collectively, the *Named Executive Officers*).

SUMMARY COMPENSATION TABLE

		Annual Compensation		Long-Term Compensation	
Name and Principal Position	Fiscal Year	Salary ($)	Bonus ($)	Securities Underlying Options* (#)	All Other Compensation ($)
Steven P. Jobs	2002	1	2,268,698(1)	7,500,000	1,302,795(1)
Chief Executive Officer	2001	1	43,511,534(1)	—	40,484,594(1)
	2000	1		20,000,000	—
Fred D. Anderson	2002	656,631	—	—	11,000(2)
Executive Vice President and Chief Financial	2001	657,039	—	1,000,000	7,312(2)
Officer	2000	660,414	—	—	6,750(2)
Timothy D. Cook	2002	563,829	—	—	8,025(2)
Executive Vice President, Worldwide Sales	2001	452,219	500,000(3)	1,000,000	7,875(2)
and Operations	2000	451,673	—	—	6,352(2)
Jonathan Rubinstein	2002	452,588	—	—	9,996(2)
Senior Vice President, Hardware Engineering	2001	469,737	—	1,000,000	7,875(2)
	2000	451,949	—	—	6,577(2)
Avadis Tevanian, Jr. Ph.D	2002	492,212	—	—	10,700(2)
Senior Vice President, Software Engineering	2001	460,873	500(4)	1,000,000	10,200(2)
	2000	451,673	—	—	10,200(2)

(1) In December 1999, Mr. Jobs was given a special executive bonus for serving as the Company's interim Chief Executive Officer for past services, in the form of an aircraft with a total cost to the Company of approximately $90,000,000. This amount was previously reported as a bonus for fiscal year 2000 in the Company's 2000 Form 10-K and 2000 Proxy Statement. Because the aircraft was transferred to Mr. Jobs in 2001, the amount of approximately $43.5 million paid by the Company during fiscal year 2001 towards the purchase of the plane and the related tax assistance of approximately $40.5 million was reported as income to Mr. Jobs. In fiscal 2002, approximately $2.27 million paid by the Company towards the purchase of the plane and approximately $1.3 million in related tax assistance was reported as income to Mr. Jobs. Accordingly, the $90 million previously reported as a bonus in 2000 has been removed from the table above, and the amounts reported as taxable income by Mr. Jobs related to the aircraft during each of fiscal 2001 and 2002 is reported as compensation.

(2) Consists of matching contributions made by the Company in accordance with the terms of the 401(k) plan.

(3) A special executive bonus was given to Mr. Cook for accepting the position of Senior Vice President, Worldwide Sales Service & Support in addition to holding the position of Senior Vice President Operations. In January 2002, Mr. Cook was named Executive Vice President, Worldwide Sales and Operations.

(4) Patent award.

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Option Grants in Last Fiscal Year

The following table provides information about option grants to the Named Executive Officers during fiscal year 2002.

OPTION GRANTS IN LAST FISCAL YEAR

	Individual Grants				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term (3)	
Name	Number of Securities Underlying Options Granted (#)	Percent of Total Options Granted to Employees in Fiscal Year(1)	Exercise or Base Price ($/Sh)(2)	Expiration Date	5% ($)	10% ($)
Steven P. Jobs	7,500,000	32.27%	$ 18.30	10/19/2011	$ 86,315,788	$ 218,741,153
Fred D. Anderson	—	—	—	—	—	—
Timothy D. Cook	—	—	—	—	—	—
Jonathan Rubinstein	—	—	—	—	—	—
Avadis Tevanian, Jr.	—	—	—	—	—	—

(1) Based on an aggregate of 23,239,444 options granted to all employees during fiscal year 2002. Options granted in fiscal year 2002 typically vest over four years in sixteen equal quarterly increments. Options granted to executive officers including those granted to the Named Executive Officers typically vest in four equal annual installments commencing on the first anniversary of the date of grant. Of the options granted to Mr. Jobs, 25% were vested as of the date of grant and the remainder vest in three equal annual installments commencing on the first anniversary of the date of grant.

(2) All options were granted at an exercise price equal to the fair market value based on the closing market value of Common Stock on the Nasdaq National Market on the date of grant.

(3) Potential gains are net of exercise price, but before taxes associated with exercise. These amounts represent certain assumed rates of appreciation only, based on SEC rules, and do not represent the Company's estimate or projection of the price of the Company's stock in the future. Actual gains, if any, on stock option exercises depend upon the actual future price of Common Stock and the continued employment of the option holders throughout the vesting period. Accordingly, the potential realizable values set forth in this table may not be achieved.

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Options Exercised and Year-End Option Holdings

The following table provides information about stock option exercises by the Named Executive Officers during fiscal year 2002 and stock options held by each of them at fiscal year-end.

AGGREGATED OPTION EXERCISES IN THE LAST FISCAL YEAR

AND FISCAL YEAR-END OPTION VALUES

Name	Shares Acquired on Exercise (#)	Value Realized ($)(1)	Number of Securities Underlying Unexercised Options at Fiscal Year-End (#) Exercisable	Unexercisable	Value of Unexercised In-the-Money Options at Fiscal Year-End ($)(2) Exercisable	Unexercisable
Steven P. Jobs	—	—	21,935,000(3)	5,625,000	$ 193,200	$ 0
Fred D. Anderson	583,332	$ 10,122,169	600,000	1,350,000	$ 0	$ 0
Timothy D. Cook	700,000	$ 10,710,393	250,000	1,350,000	$ 0	$ 0
Jonathan Rubinstein	—	—	1,050,000	1,350,000	$ 3,960,000	$ 0
Avadis Tevanian, Jr.	87,920	$ 1,514,782	1,050,000	1,350,000	$ 2,996,283	$ 0

(1) Market value of underlying securities (based on the fair market value of Common Stock on the Nasdaq National Market) at the time of exercise, minus the exercise price.

(2) Market value of securities underlying in-the-money options at the end of fiscal year 2002 (based on $14.72 per share, the closing price of Common Stock on the Nasdaq National Market on September 28, 2002), minus the exercise price.

(3) Includes 60,000 options granted to Mr. Jobs in his capacity as a director pursuant to the 1997 Director Stock Option Plan.

Director Compensation

In 1997, the Company ended its practice of paying cash retainers and fees to directors, and approved the Apple Computer, Inc. 1997 Director Stock Option Plan (the *Director Plan*). The Director Plan was approved by the shareholders in April 1998 and 800,000 shares have been reserved for issuance under the Director Plan. Pursuant to the Director Plan, the Company's non-employee directors are granted an option to acquire 30,000 shares of Common Stock upon their initial election to the Board (*Initial Options*). On the fourth anniversary of a non-employee director's initial election to the Board and on each subsequent anniversary, the director will be entitled to receive an option to acquire 10,000 shares of Common Stock (*Annual Options*). Initial Options vest and become exercisable in equal annual installments on each of the first through third anniversaries of the date of grant. Annual Options are fully vested and immediately exercisable on their date of grant. As of the end of the fiscal year, there were options for 360,000 shares outstanding under the Director Plan. Since accepting the position of CEO, Mr. Jobs is no longer eligible for grants under the Director Plan.

Compensation Committee Interlocks and Insider Participation

The current members of the Compensation Committee are Messrs. William V. Campbell, Millard S. Drexler and Arthur B. Levinson, none of whom are employees of the Company and all of whom are considered "independent" directors under the applicable NASDAQ rules. During fiscal 2002, William V. Campbell, Arthur D. Levinson and Jerome B. York served as members of the Compensation Committee, none of whom were employees of the Company. No person who was an employee of the Company in fiscal year 2002 served on the Compensation Committee. During fiscal year 2002, Mr. Jobs served as a director of Gap Inc. ("Gap") (though not on the compensation committee of that board of directors) and Mr. Drexler served as a director of the Company. Mr. Jobs resigned as a director of Gap in September 2002. Mr. Drexler resigned as president and CEO of Gap in September 2002 and resigned as a

director of Gap in October 2002. Subsequently, in November 2002, Mr. York resigned from the committee, and Mr. Drexler was appointed as a member of the Compensation Committee. No executive officer of the Company (i) served as a member of the compensation committee (or other board committee performing similar functions or, in the absence of any such committee, the board of directors) of another entity, one of whose executive officers served on the Company's Compensation Committee, (ii) served as a director of another entity, one of whose executive officers served on the Company's Compensation Committee, or (iii) served as a member of the compensation committee (or other board committee performing similar functions or, in the absence of any such committee, the board of directors) of another entity, one of whose executive officers served as a director of the Company.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth certain information as of October 31, 2002 (the "*Table Date*") with respect to the beneficial ownership of the Company's Common Stock by (i) each person the Company believes beneficially holds more than 5% of the outstanding shares of Common Stock; (ii) each director; (iii) each Named Executive Officer listed in the Summary Compensation Table under the heading **"Executive Compensation;"** and (iv) all directors and executive officers as a group. On the Table Date, 359,007,837 shares of Common Stock were issued and outstanding. Unless otherwise indicated, all persons named as beneficial owners of Common Stock have sole voting power and sole investment power with respect to the shares indicated as beneficially owned.

Security Ownership of Directors, Nominees and Executive Officers

Name of Beneficial Owner	Shares of Common Stock Beneficially Owned(1)	Percent of Common Stock Outstanding
Lord, Abbett & Co	29,381,015(2)	7.56%
Steven P. Jobs	23,810,002(3)	6.22%
Fred D. Anderson	602,672(4)	*
William V. Campbell	80,502(5)	*
Timothy D. Cook	253,091(6)	*
Millard S. Drexler	80,000(7)	*
Arthur D. Levinson	221,600(8)	*
Jonathan Rubinstein	1,058,275(9)	*
Avadis Tevanian, Jr.	1,051,252(10)	*
Jerome B. York	100,000(5)	*
All executive officers and directors as a group (14 persons)	29,376,803	7.56%

(1) Represents shares of Common Stock held and/or options held by such individuals that were exercisable at the Table Date or within 60 days thereafter.

(2) Based on a Form 13F-HR/A filed October 10, 2002 by Lord, Abbett & Co., 767 Fith Avenue, New York, NY 10153.

(3) Includes 23,810,000 shares of Common Stock which Mr. Jobs has the right to acquire by exercise of stock options.

(4) Includes 600,000 shares of Common Stock which Mr. Anderson has the right to acquire by exercise of stock options.

(5) Includes 80,000 shares of Common Stock which Messrs. Campbell and York each have the right to acquire by exercise of stock options.

(6) Includes 250,000 shares of Common Stock which Mr. Cook has the right to acquire by exercise of stock options.

(7) Includes 60,000 shares of Common Stock which Mr. Drexler has the right to acquire by exercise of stock options.

(8) Includes 1,400 shares of Common Stock which Mr. Levinson holds indirectly and 20,000 shares of Common Stock which Mr. Levinson has the right to acquire by exercise of stock options.

(9) Includes 1,050,000 shares of Common Stock which Mr. Rubinstein has the right to acquire by exercise of stock options.

(10) Includes 1,050,000 shares of Common Stock which Dr. Tevanian has the right to acquire by exercise of stock options.

* Represents less than 1% of the issued and outstanding shares of Common Stock on the Table Date.

Equity Compensation Plan Information

The following table sets forth certain information, as of September 28, 2002, concerning shares of common stock authorized for issuance under all of the Company's equity compensation plans (shares in thousands).

	(a) Number of Securities to be Issued Upon Exercise of Options		(b) Weighted Average Exercise price of Outstanding Options	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by shareholders	44,867	$	29.75	7,497(1)
Equity compensation plans not approved by shareholders	64,563	$	27.07	1,221(2)
Total equity compensation plans	109,430	$	28.17	8,718

(1) This number includes 2,146,906 shares of common stock reserved for issuance under the Employee Stock Purchase Plan, 360,000 shares available for issuance under the 1997 Director Stock Option Plan and 4,989,890 shares available for issuance under the 1998 Executive Officer Stock Plan. It does not include shares under the 1990 Stock Option Plan which was terminated in 1997. No new options can be granted under the 1990 Stock Option Plan.

(2) Reflects shares authorized for future issuance under the 1997 Employee Stock Option Plan.

1997 Employee Stock Option Plan

In August 1997, the Company's Board of Directors approved the 1997 Employee Stock Option Plan (the 1997 Plan), a non-shareholder approved plan for grants of stock options to employees who are not officers of the Company. Options may be granted under the 1997 Plan to employees at not less than the fair market value on the date of grant. These options generally become exercisable over a period of 4 years, based on continued employment, and generally expire 10 years after the grant date.

Change In Control Arrangements—Stock Options

In the event of a "change in control" of the Company, all outstanding options under the Company's stock option plans, except the Director Plan, will, unless otherwise determined by the plan administrator, become exercisable in full, and will be cashed out at an amount equal to the difference between the applicable "change in control price" and the exercise price. The Director Plan provides that upon a

"change in control" of the Company, all unvested options held by non-employee directors will automatically become fully vested and exercisable and will be cashed out at an amount equal to the difference between the applicable "change in control price" and the exercise price of the options. A "change in control" under these plans is generally defined as (i) the acquisition by any person of 50% or more of the combined voting power of the Company's outstanding securities or (ii) the occurrence of a transaction requiring shareholder approval and involving the sale of all or substantially all of the assets of the Company or the merger of the Company with or into another corporation.

In addition, options granted to the Named Executive Officers generally provide that in the event there is a "change in control", as defined in the Company's stock option plans, and if in connection with or following such "change in control", their employment is terminated without "Cause" or if they should resign for "Good Reason", those options outstanding that are not yet vested and exercisable as of the date of such "change in control" shall become fully vested and exercisable. Generally, "Cause" is defined to include a felony conviction, willful disclosure of confidential information or willful and continued failure to perform his or her employment duties. "Good Reason" includes resignation of employment as a result of a substantial diminution in position or duties, or an adverse change in title or reduction in annual base salary.

Item 13. Certain Relationships and Related Transactions

In connection with a relocation assistance package, the Company loaned Mr. Johnson (Senior Vice President, Retail) $1,500,000 for the purchase of his principal residence. The loan is secured by a deed of trust and is due and payable in May 2004. Under the terms of the loan, Mr. Johnson agreed that should he exercise any of his stock options prior to the due date of the loan, that he would pay the Company an amount equal to the lesser of (1) an amount equal to 50% of the total net gain realized from the exercise of the options; or (2) $375,000 multiplied by the number of years between the exercise date and the date of the loan. The largest amount of the indebtedness outstanding on this loan during fiscal year 2002 was $1,500,000.

Mr. Jerome York, a member of the Board of the Directors of the Company, is a member of an investment group that purchased MicroWarehouse, Inc. (*MicroWarehouse*) in January 2000. He also serves as its Chairman, President and Chief Executive Officer. MicroWarehouse is a multi-billion dollar specialty catalog and online retailer and direct marketer of computer products, including products made by the Company, through its MacWarehouse catalogue. During fiscal year 2002, MicroWarehouse accounted for 3.3% of the Company's net sales. The Company also purchases products from MicroWarehouse for its own internal use.

In March 2002, the Company entered into a Reimbursement Agreement with its Chief Executive Officer, Mr. Steven P. Jobs, for the reimbursement of expenses incurred by Mr. Jobs in the operation of his private plane when used for Apple business. The Reimbursement Agreement is effective for expenses incurred by Mr. Jobs for Apple business purposes since he took delivery of the plane in May 2001. During 2002, the Company recognized a total of $1,168,000 in expenses pursuant to this reimbursement agreement related to expenses incurred by Mr. Jobs during 2001 and 2002.

Item 14. Controls and Procedures

Based on an evaluation under the supervision and with the participation of the Company's management as of a date within 90 days of the filing date of this Annual Report on Form 10-K, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934, as amended (*Exchange Act*) are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation. There were no significant deficiencies or material weaknesses, and therefore there were no corrective actions taken. However, the design of any system of controls is based in part upon certain assumptions about the likelihood of future events and there is no certainty that any design will succeed in achieving its stated goal under all potential future considerations, regardless of how remote.

PART IV

Item 15. Exhibits

(a) Items Filed as Part of Report:

1. Financial Statements

   The financial statements of the Company filed as part of this report on Form 10-K are set forth in the Index to Consolidated Financial Statements under Part II, Item 8 of this Form 10-K.

2. Financial Statement Schedules

   All financial statement schedules have been omitted, since the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Consolidated Financial Statements and Notes thereto under Part II, Item 8 of this Form 10-K.

3. Exhibits

The following exhibits are filed as part of this Form 10-K.

Exhibit Number	Description
10.A.49**	1997 Employee Stock Option Plan, as amended through October 19, 2001.
21	Subsidiaries of Apple Computer, Inc.
23.1	Consent of KPMG LLP
99.1	Certificate of Apple Computer, Inc. Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

** Represents a management contract or compensatory plan or arrangement

(b) Reports on Form 8-K

The Company filed a current report on Form 8-K on August 8, 2002, to report that the Company had submitted to the Securities and Exchange Commission the Statements under Oath of Principal Executive Officer and Principal Financial Officer in accordance with the SEC's June 27, 2002 Order requiring the filing of sworn statements pursuant to Section 21(a)(1) of the Securities and Exchange Act of 1934.

The Company filed a current report on Form 8-K on August 1, 2002, to report the filing of a SEC Form 4 Statement of Changes in Beneficial Ownership filed with the Securities and Exchange Commission by Mr. Arthur Levinson on August 2, 2002.

(c) Exhibits Incorporated by Reference

Exhibit Number	Notes*	Description
3.1	88-S3	Restated Articles of Incorporation, filed with the Secretary of State of the State of California on January 27, 1988.
3.2	00/3Q	Amendment to Restated Articles of Incorporation, filed with the Secretary of State of the State of California on May 4, 2000.
3.3	00/3Q	By-Laws of the Company, as amended through April 20, 2000.
4.2	94/2Q	Indenture dated as of February 1, 1994, between the Company and Morgan Guaranty Trust Company of New York (the Indenture").

4.3	94/2Q	Supplemental Indenture dated as of February 1, 1994, among the Company, Morgan Guaranty Trust Company of New York, as resigning trustee, and Citibank, N.A., as successor trustee.
4.5	94/2Q	Form of the Company's 6 1/2% Notes due 2004.
4.8	96-S3/A	Registration Rights Agreement, dated June 7, 1996 among the Company and Goldman, Sachs & Co. and Morgan Stanley & Co. Incorporated.
4.9	97K	Certificate of Determination of Preferences of Series A Non-Voting Convertible Preferred Stock of Apple Computer Inc.
10.A.1	93/3Q**	1981 Stock Option Plan, as amended.
10.A.3	91K**	Apple Computer, Inc. Savings and Investment Plan, as amended and restated effective as of October 1, 1990.

10.A.3-1	92K**	Amendment of Apple Computer, Inc. Savings and Investment Plan dated March 1, 1992.
10.A.3-2	97/2Q**	Amendment No. 2 to the Apple Computer, Inc. Savings and Investment Plan.
10.A.5	98/1Q**	1990 Stock Option Plan, as amended through November 5, 1997.
10.A.6	99K**	Apple Computer, Inc. Employee Stock Purchase Plan, as amended through October 6, 1999.
10.A.8	97K**	Form of Indemnification Agreement between the Registrant and each officer of the Registrant.
10.A.43	97/2Q**	NeXT Computer, Inc. 1990 Stock Option Plan, as amended.
10.A.50	98/2Q**	1997 Director Stock Option Plan.
10.A.51	02/3Q**	1998 Executive Officer Stock Plan, as amended through April 24, 2002.
10.A.52	02/3Q**	Reimbursement Agreement.
10.B.8	91-8K-8	Participation in the Customer Design Center by the Registrant dated as of September 30, 1991 between IBM and the Registrant.
10.B.9	91-8K-9	Agreement for Purchase of IBM Products (Original Equipment Manufacturer) dated as of September 30, 1991 between IBM and the Registrant.
10.B.12	92K	Microprocessor Requirements Agreement dated January 31, 1992 between the Registrant and Motorola, Inc.
10.B.16	96/3Q	Fountain Manufacturing Agreement dated May 31, 1996 between Registrant and SCI Systems, Inc.
24.1	02K	Power of Attorney.

* Notes appear on page 101.

** Represents a management contract or compensatory plan or arrangement

NOTES

88-S3	Incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-3 (file no. 33-23317) filed July 27, 1988.
91K	Incorporated by reference to the exhibit of that number in the Company's Annual Report on Form 10-K for the fiscal year ended September 27, 1991 (the "1991 Form 10-K").
91-8K-8	Incorporated by reference to Exhibit 8 to the October 1991 Form 8-K.
91-8K-9	Incorporated by reference to Exhibit 9 to the October 1991 Form 8-K.
92K	Incorporated by reference to the exhibit of that number in the Company's Annual Report on Form 10-K for the fiscal year ended September 25, 1992 (the "1992 Form 10-K").
93/3Q	Incorporated by reference to Exhibit 10.A.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 25, 1993.
94/2Q	Incorporated by reference to the exhibit of that number in the Company's Quarterly Report on Form 10-Q for the quarter ended April 1, 1994.
96/2Q	Incorporated by reference to the exhibit of that number in the Company's Quarterly

	Report on Form 10-Q for the quarter ended March 29, 1996.
96-S3/A-4.1.1, -4.2.1, -4.3.1, -4.8	Incorporated by reference to the exhibit 4.1, 4.2, 4.3, and 4.8, respectively, in the Company's Registration Statement on Form S-3/A (file no. 333-10961) filed October 30, 1996.
97/2Q	Incorporated by reference to the exhibit of that number in the Company's Quarterly Report on Form 10-Q for the quarter ended March 28, 1997.
97K	Incorporated by reference to the exhibit of that number in the Company's Annual Report on Form 10-K for the fiscal year ended September 26, 1997 (the "1997 Form 10-K").
98/1Q	Incorporated by reference to the exhibit of that number in the Company's Quarterly Report on Form 10-Q for the quarter ended December 26, 1997.
98/2Q	Incorporated by reference to the exhibit of that number in the Company's Quarterly Report on Form 10-Q for the quarter ended March 27, 1998.
99K	Incorporated by reference to the exhibit of that number in the Company's Annual Report on Form 10-K for the fiscal year ended September 25, 1999 (the "1999 Form 10-K").
00/3Q	Incorporated by reference to the exhibit of that number in the Company's Quarterly Report on Form 10-Q for the quarter ended July 1, 2000.
02/3Q	Incorporated by reference to the exhibit of that number in the Company's Quarterly Report on Form 10-Q for the quarter ended June 29, 2002.
02K	Incorporated by reference to Page 102 of this Annual Report on Form 10-K for the fiscal year ended September 28, 2002 (the "2002 Form 10-K").

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, this 19th day of December 2002.

APPLE COMPUTER, INC.

By: /s/ FRED D. ANDERSON

Fred D. Anderson
Executive Vice President and
Chief Financial Officer

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Steven P. Jobs and Fred D. Anderson, jointly and severally, his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this Annual Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

Name	Title	Date

/s/ STEVEN P. JOBS STEVEN P. JOBS	Chief Executive Officer and Director (Principal Executive Officer)	December 19, 2002
/s/ FRED D. ANDERSON FRED D. ANDERSON	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	December 19, 2002
/s/ WILLIAM V. CAMPBELL WILLIAM V. CAMPBELL	Director	December 19, 2002
/s/ MILLARD S. DREXLER MILLARD S. DREXLER	Director	December 19, 2002
/s/ ARTHUR D. LEVINSON ARTHUR D. LEVINSON	Director	December 19, 2002
/s/ JEROME B. YORK JEROME B. YORK	Director	December 19, 2002

I, Steven P. Jobs, certify that:

1. I have reviewed this annual report on Form 10-K of Apple Computer, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

    a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

    b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

    c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

    a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

December 19, 2002

By: /s/ STEVEN P. JOBS

Steven P. Jobs
Chief Executive Officer

I, Fred D. Anderson, certify that:

1. I have reviewed this annual report on Form 10-K of Apple Computer, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes

in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

December 19, 2002

By: /s/ FRED D. ANDERSON

Fred D. Anderson
Executive Vice President and
Chief Financial Officer

QuickLinks

EXHIBIT 2

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended September 27, 2003

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ______________ to ______________

Commission file number 0-10030

APPLE COMPUTER, INC.

(Exact name of registrant as specified in its charter)

CALIFORNIA (State or other jurisdiction of incorporation or organization)	**942404110** (I.R.S. Employer Identification No.)
1 Infinite Loop **Cupertino, California** (Address of principal executive offices)	**95014** (Zip Code)

Registrant's telephone number, including area code: **(408) 996-1010**

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, no par value
(Titles of classes)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference to Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ☒ No ☐

The aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant, as of March 29, 2003, was approximately $4,479,669,616 based upon the closing price reported for such date on the NASDAQ National Market. For purposes of this disclosure, shares of Common Stock held by persons who hold more than 5% of the outstanding shares of Common Stock and shares held by executive officers and directors of the registrant have been excluded because such persons may be deemed to be affiliates. This determination of executive officer or affiliate status is not necessarily a conclusive determination for other purposes.

367,734,960 shares of Common Stock Issued and Outstanding as of December 5, 2003

PART I

The Business section and other parts of this Annual Report on Form 10-K ("Form 10-K") contain forward-looking statements that involve risks and uncertainties. Many of the forward-looking statements are located in "Management's Discussion and Analysis of Financial Condition and Results of Operations." Forward-looking statements can also be identified by words such as "anticipates," "expects," "believes," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and the Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Factors That May Affect Future Results and Financial Condition" under Part II, Item 7 of this Form 10-K. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Item 1. Business

Company Background

Apple Computer, Inc. ("Apple" or the "Company") was incorporated under the laws of the State of California on January 3, 1977. The Company designs, manufactures and markets personal computers and related software, peripherals and personal computing and communicating solutions. The Company's products include the Macintosh® line of desktop and notebook computers, the Mac OS® X operating system, the iPod™ digital music player, and a portfolio of software and peripheral products for education, creative, consumer and business customers. The Company sells its products through its online stores, direct sales force, third-party wholesalers and resellers, and its own retail stores. The Company's fiscal year ends on the last Saturday of September. Unless otherwise stated, all information presented in this Form 10-K is based on the Company's fiscal calendar.

Business Strategy

Digital Hub

Apple is committed to bringing the best possible personal computing experience to students, educators, creative professionals, businesses and consumers around the world through its innovative hardware, software, peripherals and Internet offerings, including .Mac™ and the iTunes® Music Store™. The Company believes that personal computing has entered a new era in which the personal computer functions for both professionals and consumers as the digital hub for advanced new digital devices such as the Company's iPod digital music players, personal digital assistants, cellular phones, digital still and movie cameras, CD and DVD players, and other electronic devices. The attributes of the personal computer, including its ability to run complex applications, possess a high quality user interface, contain large and relatively inexpensive storage, and easily connect to the Internet in multiple ways and at varying speeds, can individually add value to these devices and interconnect them as well. Apple is the only company in the personal computer industry that designs and manufactures the entire personal computer—from the hardware and operating system to sophisticated applications. Apple provides innovative industrial design, intuitive ease-of-use, and built-in networking, graphics, and multimedia capabilities. Thus, the Company is uniquely positioned to offer digital hub products and solutions.

Apple develops products and technologies that adhere to many industry standards in order to provide an optimized user experience through interoperability with peripherals and devices from other companies. Apple has played a role in the development, enhancement, promotion, and/or use of numerous of these industry standards, many of which are discussed below.

Retail

Since inception of its retail initiative in 2001, the Company has opened 65 retail stores in the United States through fiscal year 2003 and during the first quarter of 2004 opened 9 additional stores, including its first international store in the Ginza in Tokyo, Japan. The Company has located its stores at high traffic

locations in quality shopping malls and urban shopping districts. In addition to its own hardware, software and peripheral products, the Company's stores carry a variety of third-party hardware and software products.

One of the main goals of the retail initiative is to bring new customers to the Company and expand its installed base through sales to both first time personal computer buyers and those switching to the Macintosh platform from competing operating system platforms. By operating its own stores, the Company is able to better control the customer retail experience. The stores are designed to simplify and enhance the presentation and marketing of personal computing products. To that end, retail store configurations have expanded to various sizes in order to accommodate market demands. The stores employ experienced and knowledgeable personnel, provide post-sale advice and support, offer a wide selection of third-party products selected to complement the Company's own products, host training and marketing presentations, and provide certain hardware support services. Additionally, the stores provide a forum in which the Company is able to present entire computing solutions to users in areas such as digital photography, digital video, music, children's software, and home and small business computing.

Education

For more than 25 years, the Company has focused on the use of technology in education. The Company believes that effective integration of technology into classroom instruction can result in higher levels of student achievement, especially when used to support collaboration, information access, and the expression and representation of student thought and ideas. The Company provides a range of products and services designed to help schools maximize their investments in technology. This is manifested in many of the Company's products and services, including hardware products like the eMac™ and the iBook® that are designed to meet the needs of education customers, video editing solutions, wireless networking capabilities, student information systems, one-to-one learning solutions, and high-quality curriculum and professional development solutions.

Creative Professionals

Creative professionals constitute one of the Company's most important markets for both hardware and software products. This market is also important to many third-party developers who provide Macintosh compatible hardware and software solutions. Creative customers utilize the Company's products for a variety of creative activities including digital video and film production and editing; digital video and film special effects, compositing, and titling; digital still photography; graphic design, publishing, and print production; music performance and production; audio production and sound design; and web design, development, and administration.

The Company designs its high-end hardware solutions, including servers and desktop and portable Macintosh systems, to incorporate the power, expandability, and features desired by creative professionals. Additionally, the Company's operating system, Mac OS X, incorporates powerful graphics and audio technologies and features developer tools to optimize system and application performance when running powerful creative solutions provided by the Company or by third-party developers. The Company also offers various software solutions to meet the needs of its creative customers, many of which are described below.

Business Organization

The Company manages its business primarily on a geographic basis. The Company's reportable operating segments are the Americas, Europe, Japan, and Retail. The Americas segment includes both North and South America, except for the activities of the Company's Retail segment. The Europe segment includes European countries as well as the Middle East and Africa. The Japan segment includes only Japan, except for the activities of the Company's Retail segment. The Retail segment currently operates Apple-owned retail stores in the United States and in the first quarter of fiscal 2004, opened its first international store in Tokyo, Japan. Other operating segments include Asia-Pacific, which includes Australia and Asia except for

Japan, and the Company's subsidiary, FileMaker, Inc. Each reportable operating segment provides similar hardware and software products and similar services. Further information regarding the Company's operating segments may be found in Part II, Item 7 of this Form 10-K under the heading "Segment Operating Performance," and in Part II, Item 8 on this Form 10-K in the Notes to Consolidated Financial Statements at Note 11, "Segment Information and Geographic Data."

Hardware Products

The Company offers a range of personal computing products including desktop and notebook personal computers, related devices and peripherals, networking and connectivity products, and various third-party hardware products. All of the Company's Macintosh products utilize PowerPC® RISC-based microprocessors. The Company's entire line of Macintosh systems, excluding servers, features the Company's suite of software for digital photography, music, and movies.

Power Mac®

The Power Mac line of desktop personal computers is targeted at business and professional users and is designed to meet the speed, expansion and networking needs of the most demanding Macintosh user. Powered by the PowerPC G5 processor, designed by IBM and Apple, and featuring up to a 1 GHz front-side bus and the ability to address up to 8GB of memory, the current Power Mac G5 utilizes 64-bit processing technology for advanced 64-bit computation, while running existing 32-bit applications natively. The PowerPC G5 processor architecture is based on a completely new execution core that features massively parallel computation, full symmetric multi-processing, two double precision floating point units and an optimized Velocity Engine™. Power Mac G5 systems, encased in a professional aluminum enclosure with computer controlled cooling for quiet operation, also include on all models SuperDrive CD-RW/DVD-R drives, digital audio and PCI-X expansion, and advanced input and output technologies including Gigabit Ethernet, FireWire® and USB ports. The system also supports 54 Mbps AirPort Extreme® wireless networking and is Bluetooth ready for wireless connections to a host of Bluetooth-enabled peripherals. Prior to the availability of the Power Mac G5 in August 2003, the Company's Power Mac line during most of fiscal 2003 featured PowerPC G4 processors in all models. The Company continues to offer a Power Macintosh G4 system with a single or dual 1.25 Ghz processor configuration.

Xserve® and Xserve RAID Storage System

Xserve, the Company's first ever rack-mount server product, was designed for simple setup and remote management of intensive input/output (I/O) applications such as digital video, high-resolution digital imagery, and large databases. In February 2003, the Company upgraded its Xserve 1U rack servers with more powerful processors, more storage capacity, and a FireWire 800 interface. At the same time, the Company introduced the Xserve RAID Storage System, a rack storage system that holds up to 14 hot-swapable drive modules capable of holding up to 3.5 terabytes of data. Xserve RAID architecture combines affordable, high-capacity ATA/100 drive technology with a Fibre Channel interface for reliable and fast data access. Xserve RAID provides RAID level 5 throughput that supports affordable real-time high definition (HD) 1080i video editing.

PowerBook®

The PowerBook family of portable computers is designed to meet the mobile computing needs of professionals and advanced consumer users. The 17-inch PowerBook G4 features a 17-inch wide-format active-matrix display, is encased in a durable aluminum alloy enclosure, is 1-inch thick, and weighs as little as 6.9 pounds. The 17-inch PowerBook G4 also features built-in support for AirPort Extreme 54 Mbps 802.11g wireless networking, new high-speed FireWire 800, a backlit keyboard with ambient light sensors, and built-in Bluetooth for wireless connection to cell phones and other Bluetooth equipped peripherals. The 12-inch PowerBook G4 features a 12-inch, active-matrix display housed in a lightweight, durable aluminum alloy enclosure weighing approximately 4.6 pounds. The 12-inch PowerBook G4 features a high-speed PowerPC G4 processor, NVIDIA graphics, built-in Bluetooth wireless networking, and battery

life of up to five hours on a single charge. In September 2003, the Company introduced a new 15-inch PowerBook G4, which features a 15.2-inch widescreen display, and is encased in a sleek aluminum design weighing as little as 5.6 pounds. This product line addition complements the Company's other two PowerBook models, the 12-inch and 17-inch PowerBook G4s that were introduced in January 2003 and updated in September 2003.

iMac®

The iMac line of desktop computers is targeted to education and consumer markets. The Company's iMac product line features an innovative industrial design that incorporates an adjustable 15-inch or 17-inch thin film transistor (TFT) active-matrix flat panel display and an ultra-compact base. In November 2003, a new 20-inch iMac model was released. All models utilize PowerPC G4 processors, fast 333 MHz DDR memory, NVIDIA graphics, two FireWire 400 and three high-speed USB 2.0 ports. The iMac also offers the latest in wireless communications with support for 54 Mbps AirPort Extreme and Bluetooth wireless connectivity.

eMac™

The eMac, which is targeted primarily at the Company's education and consumer customers, features a PowerPC G4 processor, a high resolution 17-inch flat cathode ray tube (CRT) display, a SuperDrive option, and preserves the all-in-one compact design of the original iMac favored by many of the Company's education and consumer customers.

iBook®

The iBook is designed to meet the portable computing needs of education and consumer users. The current iBooks, upgraded in October 2003, feature PowerPC G4 processors and either a 12-inch or 14-inch display. These systems offer advanced connectivity with AirPort Extreme and Bluetooth, and certain models include 256 MB of DDR memory and slot-load Combo drives for burning CDs and watching DVDs. Each iBook is outfitted with a sleek polycarbonate plastic enclosure and weighs as little as 4.9 pounds.

Peripheral Products

The Company sells certain associated Apple-branded computer hardware peripherals, including iPod™ digital music players, iSight™ digital video cameras, and a range of high quality flat panel TFT active-matrix digital color displays. The Company also sells a variety of third-party Macintosh compatible hardware products directly to end users through both its retail and online stores, including computer printers and printing supplies, storage devices, computer memory, digital video and still cameras, personal digital assistants, and various other computing products and supplies.

iPod™

The Company's newest iPod portable music player, compatible with both the Macintosh and Windows platforms, is smaller and lighter than previous versions and is available in three models with storage capacity of either 10GB, 20GB, or 40GB; the latter holding up to 10,000 songs. In addition to MP3, iPod now supports the Advanced Audio Coding (AAC) audio format. The new iPod models also feature solid-state interfaces and the 20GB and 40GB models include the iPod Dock, which facilitates fast and easy connection to a computer or stereo. The iPod's functionality extends well beyond playing music. Other key capabilities include data storage, calendar and contact information utility, and a selection of games. With the addition of third-party iPod peripherals, the capabilities of certain iPods can be enhanced to include voice recording and photo downloading from certain digital cameras. Along with the iPod, the Company has developed a seamless end-to-end music solution with the Company's iTunes® digital music management software and the iTunes Music Store, a service that consumers may use to purchase music over the Internet. Further discussion on these related music offerings may be found below under the headings "Software Products and Computer Technologies" and "Internet Software, Integration, and Services."

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iSight™

The Company introduced the iSight digital video camera and the beta version of its iChat™ AV software application in June 2003. Together they enable high-quality audio and videoconferences between two Macintosh systems over broadband connections. iSight is a small, portable aluminum alloy camera with all audio, video and power provided by a single FireWire cable. iSight features a custom designed lens with auto-focus and a high-end CCD sensor to provide high-resolution images and full-motion video at up to 30 frames per second. iSight includes an integrated microphone that suppresses ambient noise for clear digital audio. With its on-board processor, iSight automatically adjusts color, white balance, sharpness and contrast to provide high-quality images with accurate color reproduction in most lighting conditions. iSight is designed to be center-mounted on the top of a computer screen and uses its integrated tilt and rotate mechanism to easily position the camera for natural, face-to-face video conferencing.

Displays

The Company's all-digital, active-matrix LCD flat panel displays, including the 23-inch Cinema HD Display®, 20-inch Apple Cinema Display® and the 17-inch Apple Studio Display®, produce flicker-free images with twice the brightness, sharpness, and contrast ratio of a typical CRT display.

Software Products and Computer Technologies

The Company offers a range of software products for education, creative, consumer and business customers, including Mac OS X, the Company's proprietary operating system software for the Macintosh; server software and related solutions; professional application software; and consumer, education and business oriented application software.

Operating System Software

During 2001, the Company introduced the first customer release of its new client operating system, Mac OS X, and its first significant upgrade, Mac OS X version 10.1. At its introduction, Mac OS X offered advanced functionality built on an open-source UNIX-based foundation and incorporated the most fundamental changes in both core technology and user interface design made by the Company to the Mac OS in a single upgrade since the original introduction of the Macintosh in 1984. Mac OS X features memory protection, pre-emptive multi-tasking, and symmetric multiprocessing. Mac OS X includes Apple's Quartz™® 2D graphics engine (based on the Internet-standard Portable Document Format) for enhanced graphics and broad font support, OpenGL for enhanced 3D graphics and gaming, and Apple's new user interface named "Aqua®," which combines superior ease-of-use with new functionality. In January 2002, the Company made Mac OS X the default operating system on all new Macintosh systems.

In August 2002, the Company introduced Mac OS X version 10.2 (code named "Jaguar"), the second significant upgrade to the original Mac OS X version. Jaguar included a new Mail application designed to manage junk mail; iChat, an AIM-compatible instant messenger; a system-wide Address Book; Inkwell™ handwriting recognition; improved Universal Access; an enhanced Finder™; an updated version of QuickTime®, the Company's multimedia software for playing, interacting with or viewing video, audio, and graphics files; and an updated version of Sherlock®, the Company's advanced Internet search engine. Jaguar also featured accelerated graphics performance, increased compatibility with Windows networks, and a UNIX-based foundation with enhancements including FreeBSD 4.4 and GCC 3.1-based developer tools.

In October 2003, the Company released Mac OS X version 10.3 (code named "Panther"), the Company's current version of Mac OS X. Panther incorporates more than 150 new features including a completely new Finder™; Exposé, a new way to organize windows and instantly see all open windows at once; FileVault™, a new feature that secures the contents of a home directory with 128-bit AES encryption; iChat AV, a complete desktop video conferencing solution; and enhanced support for use on Windows-based networks.

Server Software and Server Solutions

Mac OS X server software was initially introduced in May 2001, followed by Mac OS X Server version 10.2 (code named "Jaguar Server") that was released in August 2002. Jaguar Server delivers high-performance services for Internet and web serving, filing, printing, and networking services needed to manage a network of Mac, UNIX, and Windows clients. It provides performance and stability through full pre-emptive multi-tasking, symmetric multiprocessing, protected memory, advanced virtual memory, software RAID support, and support for networking and security standards. Jaguar Server also includes Apple's Open Directory architecture for centralized management of network resources using LDAPv3 directory services and a suite of built-in, standards-based Internet services like an optimized Apache web server for high-performance hosting of secure dynamic web sites and QuickTime Streaming Server and QuickTime Broadcaster for streaming live events over the Internet. Jaguar Server also comes with a flexible mail server that supports POP and secure IMAP, as well as WebMail for browser-based email access.

In October 2003, the Company began shipping the current version of its server operating system, which is called Mac OS X Server version 10.3 "Panther Server." This release integrates leading open source and open standards server software with easy-to-use management tools that make it easy to serve Macintosh, Windows and Linux clients. Panther Server includes powerful open source solutions and easy-to-use server management capabilities. New features in Panther Server include Server Admin tool for easily setting up multiple servers; Open Directory 2 for hosting scalable LDAP directory and Kerberos authentication services; Samba 3 for providing login and home directory support for Windows clients; and the JBoss application server for running powerful J2EE applications.

Apple Remote Desktop™ for Mac OS X software enables users, teachers and administrators to remotely manage other Macintosh systems anywhere on a local network, AirPort® wireless network or across the Internet. With Apple Remote Desktop, teachers can view students' computer screens, perform group demonstrations and help individuals with real-time screen-sharing, text chat and the "request attention" command. System administrators can provide remote assistance, get comprehensive system profiles, reconfigure system settings and quickly and easily distribute software applications across hundreds of computers—all from one central location over both Ethernet and AirPort wireless networks. Apple Remote Desktop supports multiple levels of administrator access, each with its own password, providing a secure way for teachers or department-level administrators to assist users while restricting privileges for deleting items or changing system settings.

Professional Application Software

Final Cut Pro® is a video editing application designed to meet the demanding needs of professional video editors by providing them with a high-performance, scalable, and cost-effective solution for editing in virtually any format: DV, SD, HD and film. Final Cut Pro includes tools for editing, compositing and effects, color-correction and audio. Final Cut Pro 4, released in June 2003, introduced RT Extreme, a multi-stream real-time effects engine, new interface customization tools, high performance codecs for uncompressed SD and HD video, and 32-bit floating point (per channel) image processing. Final Cut Pro 4 also includes three completely new integrated tools—LiveType for creating animated, broadcast-quality titles, Soundtrack for music composition, and Compressor for batch encoding and output of high-quality MPEG-2, MPEG-4, and QuickTime files directly from Final Cut Pro 4's timeline. Version 4.1 of Final Cut Pro was released in November 2003 and included optimizations for the Power Mac G5 and Mac OS X Panther.

Shake® 3, an upgrade of the Company's compositing and visual effects software designed for large format film and video productions, was announced in April 2003 and released in June 2003. Shake 3 includes new Mac OS X only features such as the Shake Qmaster network render management software and unlimited network rendering licenses which allow visual effects artists to easily distribute rendering tasks across a cluster of Apple's Xserve rack servers or desktop Power Macintosh computers for enhanced performance

and efficiency. Shake 3 also includes new visual effects features available to Mac OS X, Linux and IRIX customers including motion-tracking and real-time broadcast preview.

The Company acquired Emagic, a leading provider of professional software and hardware solutions for computer based music production, during the fourth quarter of 2002. Emagic's most popular product, Logic®, is actively used by musicians around the world and by professionals in music production, film scoring, and post-production facilities. It combines composition, notation and audio production facilities in one comprehensive product. Logic Platinum offers a comprehensive set of music creation tools featuring rock-solid MIDI timing and synchronization, mixing and automation with total recall, and non-destructive real-time editing of both audio and MIDI. It also offers MIDI timing with 960 PPQN and sends and receives synchronized MIDI clock, MTC, MMC and word clock signals, making it ideal for film, TV and video post-production facilities.

DVD Studio Pro® 2 was announced in April 2003 and released in August 2003. It is a completely new DVD authoring product, rebuilt from the ground up with a new user interface, professionally designed and fully customizable templates, an innovative new menu editor, timeline-based track editing and a new software-based MPEG-2 encoder.

Consumer, Education and Business Oriented Application Software

Introduced in January 2003, iLife™ is the Company's integrated suite of digital lifestyle applications that features the Company's iTunes®, iPhoto™, iMovie™®, and iDVD™ software applications. These applications are integrated to allow users easy access to their digital music, photos and movies from within each application. All of these iLife applications come preinstalled on the Company's Macintosh systems, except for iDVD, which is only available on Macintosh systems configured with a SuperDrive.

iTunes® is a digital music management application that lets users create and manage their own digital music library. iTunes organizes music using searching, browsing and playlist features. It supports both audio and MP3 CD burning, features a graphic equalizer and cross fading between songs, and supports automatic synchronization with the music stored on an iPod. In July 2002, the Company introduced iTunes 3, featuring Smart Playlists, which automatically and dynamically updates playlists based on simple rules set by the user, and Sound Check for consistent volume playback. In April 2003, the Company launched iTunes 4, which integrated the Company's iTunes Music Store. Further discussion on the iTunes Music Store may be found below under the heading "Internet Software, Integration, and Services." In October 2003, the Company launched iTunes for Windows, the first version of the Company's digital music management software for users of Windows-based personal computers. iTunes for Windows includes all of the same features as the Macintosh version, including MP3 and AAC encoding from audio CDs, Smart Playlists, free Internet radio stations, and the ability to burn custom playlists to CDs and MP3 CDs, burn content to DVDs to back-up an entire music collection and share music between networked computers via Rendezvous™, the Company's zero configuration networking technology.

iMovie®, the Company's easy-to-use consumer digital video editing software for creation of home and classroom movies, features an enhanced user interface, improved audio editing capabilities, enhanced controls for titling and transitions, and added special effects.

iDVD™ is consumer oriented software that makes it easy to turn iMovie files, QuickTime files and digital pictures into DVDs that can be played on most consumer DVD players. iDVD simplifies DVD authoring by including professionally designed themes and drag-and-drop simplicity.

iPhoto™ is consumer oriented digital photo software that makes it easy to import, edit, save, share, and print digital photos, as well as organize and manage an entire digital photo collection containing thousands of photos. Users are able to view their photos in full-screen; use the slide show feature accompanied by their favorite music; automatically create custom web pages of their photos; email photos to friends and family; order professionally-processed prints and enlargements online; or easily design and order custom-

printed, linen-covered hard bound photo books online. Prints, enlargements, and hardbound book production are currently only available to U.S. and Canadian customers.

The Company's iChat AV software application and the iSight digital video camera together enable high-quality audio and video conferences between two Macintosh systems over broadband connections. iChat AV also enables audio conferences over dial-up connections to the Internet. iChat AV requires no setup or configuration beyond installing the software and plugging in a FireWire video camera and microphone, such as iSight or certain third-party FireWire based cameras with microphones.

Final Cut® Express, introduced in January 2003, is based on Apple's award-winning Final Cut Pro software. Final Cut Express enables small business users, educators, students and advanced hobbyists to perform professional-quality digital video editing. Final Cut Express includes key features used by video editors such as the same interface and workflow as Final Cut Pro, powerful video editing tools, hundreds of special effects, and easy delivery of output to DVD, the Internet, or tape.

Keynote™ is the Company's presentation software introduced in January 2003 that gives users the ability to create high-quality presentations. Designed to be easy to use, Keynote includes professionally designed themes, advanced typography, professional-quality image resizing, animated charts and tables that can be created quickly, and cinematic-quality transitions. Keynote imports and exports PowerPoint, QuickTime, and PDF files to simplify the creation and sharing of presentations.

AppleWorks® 6.2 is an integrated productivity application that incorporates word processing, page layout, image manipulation, spreadsheets, databases and presentations in a single application. Intended to be an easy-to-use product for the Company's consumer and education customers, AppleWorks makes it simple to create professional-looking documents in the classroom and at home.

FileMaker Corporation, a wholly owned subsidiary of the Company, develops, publishes, and distributes desktop-based database management application software for Mac OS and Windows-based systems. The FileMaker® Pro database software and related products offer strong relational databases and advanced desktop-to-web publishing capabilities.

Third-Party Software Products

Thousands of third-party software titles and solutions are available for the Macintosh platform. The Company sells a variety of these third-party software products directly to end users through both its retail and online stores.

Internet Software, Integration, and Services

Apple's Internet strategy is focused on delivering seamless integration with and access to the Internet throughout the Company's product lines. The Company's Internet products and technologies adhere to many industry standards in order to provide an optimized user experience through interoperability. An easy Internet Setup Assistant is included with the Mac OS.

iTunes Music Store™

In April 2003, the Company launched the iTunes Music Store in the United States, an online music store that allows Macintosh customers to find, purchase, and download music for 99 cents per song or, in most cases, $9.99 per album. The iTunes Music Store is fully integrated with a one-click download directly into the latest version of the iTunes software, allowing customers to purchase, download, organize, share, and transfer their digital music to an iPod using a single software application. Requiring no subscription fee, the iTunes Music Store with iTunes software offers customers a broad range of personal rights to the songs purchased, including playing songs on up to three computers, burning songs onto an unlimited number of CDs for personal use, playing songs on an unlimited number of iPods, and using songs in certain applications such as iPhoto, iMovie, and iDVD. Users can easily search the contents of the entire music store to locate songs by title, artist, or album, or browse the entire contents of the music store by genre and artist. Users can also listen to a free 30-second preview of any song in the store.

The second generation of the iTunes Music Store for both Macintosh and Windows users became available in October 2003. New features of the music store include online gift certificates that can be sent to family and friends via e-mail, an "allowance" feature that enables users to automatically deposit funds into an iTunes Music Store account every month, and the availability of audio books for purchase directly from the iTunes Music Store. The Company is exploring ways to enhance awareness and promote use of the iTunes Music Store, including arrangements with America Online, Inc. (AOL) to integrate links to the iTunes Music Store into AOL's Music site and Pepsi-Cola North America to give away songs from the iTunes Music Store.

Safari™

In June 2003, the Company introduced Safari 1.0, the Company's new Mac OS X compatible web browser that is capable of loading web pages rapidly. Safari uses the advanced interface technologies underlying Mac OS X and includes built-in Google search; SnapBack™ to instantly return to search results; a new way to name, organize and present bookmarks; tabbed browsing; and automatic "pop-up" ad blocking. The Company also released a software development kit that allows developers to embed the Safari HTML rendering engine directly into their applications.

Quicktime®

QuickTime, the Company's multimedia software for Macintosh and Windows platforms, features streaming of live and stored video and audio over the Internet and playback of high-quality audio and video on computers. The current version of QuickTime, QuickTime 6, features support for the open-standard MPEG 4 format. QuickTime 6 includes the new Instant-On Streaming feature that eliminates buffer delays and provides users with the ability to quickly and easily scrub through streaming media content to locate and instantly view specific sections. In addition, QuickTime 6 running on Mac OS X now supports JPEG 2000, the next generation JPEG standard that allows users to capture still images in a higher quality and smaller file size than ever before. QuickTime 6 also includes AAC, the standard MPEG-4 audio format. AAC is the next generation professional-quality audio format that delivers superior sound quality with reduced file sizes.

The Company also offers several other QuickTime products, including QuickTime Pro, a suite of software tools that allows creation and editing of Internet-ready audio and video files and allows a user to add special effects and other features to QuickTime movies; QuickTime Streaming Server which facilitates the broadcasting of streaming digital video; and QuickTime Broadcaster that allows users to quickly and easily produce professional-quality live events for online delivery.

.Mac™

The Company's .Mac offering is a suite of Internet services that for an annual fee provides Macintosh users with powerful Internet tools. .Mac features email service with IMAP, POP or web-based access, 100MB of iDisk Internet storage, and hosting for personalized homepages and shared digital photo albums. Also included with .Mac is McAfee's Virex anti-virus software and Backup, a personal back-up solution allowing users to archive data to their Internet storage, CD, or DVD.

Wireless Connectivity and Networking

AirPort Extreme™®

AirPort Extreme, introduced in January 2003, is the Company's next generation of Wi-Fi wireless networking technology based on the new ultra-fast 802.11g standard. With speeds up to 54 Mbps, AirPort Extreme delivers almost five times the data rate of today's 802.11b based products, yet is fully compatible with the millions of 802.11b Wi-Fi devices around the world. AirPort Extreme Base Stations can serve up

to 50 Macintosh and Windows users simultaneously, provide wireless bridging to extend the range beyond just one base station, and support USB printer sharing to allow multiple users to wirelessly share USB printers connected directly to the base station.

Embedded into Mac OS X is Bluetooth technology. Bluetooth is an emerging industry standard for wirelessly connecting computers and peripherals that supports transmission of data at up to 1 Mbps within a range of approximately 30 feet. The Company's Bluetooth technology for Mac OS X lets customers wirelessly share files between Macintosh systems, synchronize and share contact information with Palm-OS based PDAs, and access the Internet through Bluetooth-enabled cell phones. A Bluetooth USB adaptor can Bluetooth-enable any USB-based Macintosh computer running in Mac OS X version 10.1.4 or higher.

The Company's Rendezvous™ networking technology is based on open Internet Engineering Task Force (IETF) Standard Protocols such as IP, ARP and DNS. Rendezvous uses industry standard networking protocols and zero configuration technology to automatically discover and connect devices over any IP network, including Ethernet or 802.11-based wireless networks like the Company's AirPort product. Major developers such as Canon, Epson, Hewlett-Packard, Lexmark, Philips, Sybase, World Book and Xerox have announced support for Rendezvous in a broad range of products including network printers, consumer electronics, enterprise database management and educational applications. The Company has made the

Rendezvous source code freely available allowing developers to use Rendezvous technology in their network-enabled devices or software applications. The Rendezvous source code includes software to support UNIX, Linux, and Windows-based systems and devices. Rendezvous support is built into Mac OS X.

The Company developed FireWire® technology, also referred to as IEEE 1394, which is a high-speed serial I/O technology for connecting digital devices such as digital camcorders and cameras to desktop and portable computers. With its high data-transfer speed and "hot plug-and-play" capability, FireWire has become an established cross-platform industry standard for both consumers and professionals and is the data interface of choice for today's digital video and audio devices, as well as external hard drives and other high-speed peripherals. FireWire is currently included on all Macintosh systems and is a data transfer technology utilized by iPod.

Product Support and Services

AppleCare® offers a range of support options for Apple customers. These options include assistance that is built into software products, printed and electronic product manuals, online support including comprehensive product information as well as technical assistance, and the AppleCare Protection Plan. The AppleCare Protection Plan is a fee-based service that typically includes three years of phone support and hardware repairs, dedicated web-based support resources, and user diagnostic tools.

Apple Training offers comprehensive system administration and development training on Apple technologies, together with certification programs that test customers' skills and verify their technical proficiency. Apple Professional Services offers a range of custom, personalized technical services, including Internet consulting and setup, installation and integration services. The Company also offers specialized loan programs including loans for consumers, students, and educators. Apple also provides leasing solutions for its education institution customers and its business and professional customers. The Company uses several third-party lenders to originate and carry these loans and leases, all of which are non-recourse to the Company.

Specialized Education Products and Services

The Company offers a variety of unique services and products to its education customers, including a separate online store for education customers offering special education price lists and promotions; special financing programs for K-12 and higher education students, faculty, and staff; a special edition of its productivity software suite, AppleWorks, that is cross platform for both Macintosh and Windows computers; the iBook Wireless Mobile Lab that allows teachers and students to share iBook computers, a printer, and a wireless network/Internet connection stored on a cart for mobility between classrooms; and

three special Digital Media Studio solutions designed for education, including one that is integrated into a mobile cart. Additionally, Apple Professional Services offers a range of technical services to education customers.

In 2001, Apple acquired PowerSchool Inc., a privately held provider of web-based student information systems for K-12 schools and school districts. PowerSchool® software products give school administrators and teachers the ability to easily and cost-effectively manage student records and give parents real-time access to track their children's performance via the Internet. PowerSchool offers the option of remote hosting with an application service provider model.

Markets and Distribution

The Company's customers are primarily in the education, creative, consumer, and business markets. Certain customers are attracted to Macintosh computers for a variety of reasons, including the reduced amount of training resulting from the Macintosh computer's intuitive ease of use, advanced graphics capabilities, industrial design features of the Company's hardware products, and ability of Macintosh computers to network and communicate with other computer systems and environments. Apple personal computers were first introduced to education customers in the late 1970s. Over 18% of the Company's net sales in 2003 were to education customers in the United States, including sales to elementary and secondary schools and college and university customers.

The Company distributes its products through wholesalers, resellers, national and regional retailers and cataloguers. No individual customer accounted for more than 10% of net sales in 2003, 2002 or 2001. The Company also sells many of its products and resells certain third-party products in most of its major markets directly to education customers, consumers, businesses, and certain resellers through its retail stores in the United States, or through one of its online stores around the world. Total direct and indirect sales attributable to the Company's online stores totaled approximately $2.9 billion, $2.4 billion, and $2.0 billion for fiscal years 2003, 2002 and 2001, respectively.

Competition

The Company is confronted by aggressive competition in all areas of its business. The market for the design, manufacture, and sale of personal computers and related software and peripheral products is highly competitive. This market continues to be characterized by rapid technological advances in both hardware and software development, which have substantially increased the capabilities and applications of these products, and have resulted in the frequent introduction of new products and significant price, feature, and performance competition. Over the past several years, price competition in the market for personal computers has been particularly intense. The Company's competitors who sell personal computers based on other operating systems have aggressively cut prices and lowered their product margins to gain or maintain market share. The Company's results of operations and financial condition have been, and in the future may continue to be, adversely affected by these and other industry-wide downward pressures on gross margins.

The principal competitive factors in the market for personal computers include relative price/performance, product quality and reliability, design innovation, availability of software, product features, marketing and distribution capability, service and support, availability of hardware peripherals, and corporate reputation. Further, as the personal computer industry and its customers place more reliance on the Internet, an increasing number of Internet devices that are smaller, simpler, and less expensive than traditional personal computers may compete for market share with the Company's existing products.

The Company is currently taking and will continue to take steps to respond to the competitive pressures being placed on its personal computer sales as a result of innovations in competing platforms. The Company's future operating results and financial condition are substantially dependent on its ability to continue to develop improvements to the Macintosh platform in order to maintain perceived functional and design advantages over competing platforms.

The Company's initial success with the development of an end-to-end music offering, which includes the iTunes digital music management software, iTunes Music Store and iPod digital music player, has already encouraged significant competition in this area from other companies, many of whom have greater financial, marketing, and manufacturing resources than those of the Company. The Company believes it maintains a competitive advantage by more effectively integrating the entire end-to-end music solution, including the hardware (iPod), software (iTunes) and music content (iTunes Music Store).

Raw Materials

Although most components essential to the Company's business are generally available from multiple sources, certain key components (including microprocessors and application-specific integrated circuits ("ASICs")) are currently obtained by the Company from single or limited sources. Some other key components, while currently available to the Company from multiple sources, are at times subject to industry wide availability constraints and pricing pressures. In addition, the Company uses some components that are not common to the rest of the personal computer industry, and new products introduced by the Company often initially utilize custom components obtained from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. If the supply of a key or single-sourced component to the Company were to be delayed or curtailed or in the event a key manufacturing vendor delays shipments of completed products to the Company, the Company's ability to ship related products in desired quantities and in a timely manner could be adversely affected. The Company's business and financial performance could also be adversely affected depending on the time required to obtain sufficient quantities from the original source, or to identify and obtain sufficient quantities from an alternative source. Continued availability of these components may be affected if producers were to decide to concentrate on the production of common components instead of components customized to meet the Company's requirements. The Company attempts to mitigate these potential risks by working closely with these and other key suppliers on product introduction plans, strategic inventories, coordinated product introductions, and internal and external manufacturing schedules and levels. Consistent with industry practice, the Company acquires components through a combination of formal purchase orders, supplier contracts, and open orders based on projected demand information. Such purchase commitments typically cover the Company's requirements for periods ranging from 30 to 130 days.

The Company believes there are several component suppliers and manufacturing vendors whose loss to the Company could have a material adverse effect upon the Company's business and financial position. At this time, such vendors include Agere Systems, Inc., Ambit Microsystems Corporation, ASUSTeK Corporation, ATI Technologies, Inc., Broadcom Corporation, Compal Corporation, Hon Hai Precision Industry Co., Ltd., IBM Corporation, International Display Technology, Inventec Appliances Corporation, LG. Phillips Co., Ltd., Matsushita, Mitsubishi Electric Corporation, Motorola, Inc., Nvidia Corp., Quanta Computer, Inc., Samsung Electronics, Synaptics, Inc., and Toshiba Corporation.

Research and Development

Because the personal computer industry is characterized by rapid technological advances, the Company's ability to compete successfully is heavily dependent upon its ability to ensure a continuing and timely flow of competitive products and technology to the marketplace. The Company continues to develop new products and technologies and to enhance existing products in the areas of hardware and peripherals, system software, applications software, networking and communications software and solutions, and the Internet. The Company's research and development expenditures, before any charges for purchased in-process research and development, totaled $471 million, $446 million, and $430 million in 2003, 2002, and 2001, respectively.

Patents, Trademarks, Copyrights and Licenses

The Company currently holds rights to patents and copyrights relating to certain aspects of its computer systems, peripheral systems, and software. In addition, the Company has registered, and/or has applied to register, trademarks and service marks in the United States and a number of foreign countries for "Apple," the Apple logo, "Macintosh," and numerous other trademarks and service marks. Although the Company believes the ownership of such patents, copyrights, trademarks and service marks is an important factor in its business and that its success does depend in part on the ownership thereof, the Company relies primarily on the innovative skills, technical competence, and marketing abilities of its personnel.

Many of the Company's products are designed to include intellectual property obtained from third-parties. While it may be necessary in the future to seek or renew licenses relating to various aspects of its products and business methods, the Company believes that based upon past experience and industry practice, such licenses generally could be obtained on commercially reasonable terms; however, there is no guarantee that such licenses could be obtained at all. Because of technological changes in the computer industry, current extensive patent coverage, and the rapid rate of issuance of new patents, it is possible certain components of the Company's products and business methods may unknowingly infringe existing patents of others. The Company has from time to time been notified that it may be infringing certain patents or other intellectual property rights of others.

Foreign and Domestic Operations and Geographic Data

The United States represents the Company's largest geographic marketplace. Approximately 58% of the Company's net sales in fiscal 2003 came from sales to customers inside the United States. Final assembly of products sold by the Company is conducted in the Company's manufacturing facilities in Sacramento, California, and Cork, Ireland, and by external vendors in Fremont, California, Fullerton, California, Taiwan, Korea, the Netherlands, the People's Republic of China, and the Czech Republic. Currently, manufacture of many of the components used in the Company's products and final assembly of substantially all of the Company's portable products including PowerBooks, iBooks, and the iPod are performed by third-party vendors in Japan, Taiwan and China. Margins on sales of Apple products in foreign countries, and on sales of products that include components obtained from foreign suppliers, can be adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including tariffs and antidumping penalties.

Information regarding financial data by geographic segment is set forth in Part II, Item 8 of this Form 10-K in the Notes to Consolidated Financial Statements at Note 11, "Segment Information and Geographic Data."

Seasonal Business

Although the Company does not consider its business to be highly seasonal, it has historically experienced increased net sales in its first and fourth fiscal quarters, compared to other quarters in its fiscal year, due to seasonal demand related to the holiday season and the school year, respectively. Past performance should not be considered a reliable indicator of the Company's future net sales or financial performance.

Warranty

The Company offers a basic limited parts and labor warranty on its hardware products. The basic warranty period for hardware products is typically one year from the date of purchase by the end-user. The Company also offers a 90-day basic warranty for Apple software and for Apple service parts used to repair Apple hardware products. In addition, consumers may purchase extended service coverage on most Apple hardware products in all of the Company's major markets.

Backlog

In the Company's experience, the actual amount of product backlog at any particular time is not a meaningful indication of its future business prospects. In particular, backlog often increases in anticipation

of or immediately following new product introductions because of over ordering by dealers anticipating shortages. Backlog often is reduced once dealers and customers believe they can obtain sufficient supply. Because of the foregoing, backlog should not be considered a reliable indicator of the Company's ability to achieve any particular level of revenue or financial performance.

Environmental Laws

Compliance with federal, state, local, and foreign laws enacted for the protection of the environment has to date had no material effect upon the Company's capital expenditures, earnings, or competitive position. Although the Company does not anticipate any material adverse effects in the future based on the nature of its operations and the subject of these laws, there is no assurance that such existing laws or future laws will not have a material adverse affect on the Company.

Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations including, in some instances, the requirement that the Company provide consumers with the ability to return to the Company product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have recently been passed in several jurisdictions in which the Company operates, including various European Union member states, Japan and California. Although the Company does not anticipate any material adverse effects in the future based on the nature of its operations and the thrust of such laws, there is no assurance that such existing laws or future laws will not have a material adverse affect on the Company.

Employees

As of September 27, 2003, Apple and its subsidiaries worldwide had 10,912 employees and an additional 2,654 temporary employees and contractors.

Available Information

Beginning in fiscal 2003, the Company's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available on its website at www.apple.com/investor when such reports are available on the Securities and Exchange Commission (SEC) website. The public may read and copy any materials filed by the Company with the SEC at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at http://www.sec.gov. The contents of these websites are not incorporated into this filing. Further, the Company's references to the URLs for these websites are intended to be inactive textual references only.

Item 2. Properties

The Company's headquarters are located in Cupertino, California. The Company has manufacturing facilities in Sacramento, California and Cork, Ireland. As of September 27, 2003, the Company leased approximately 3.2 million square feet of space, primarily in the United States, and to a lesser extent, in Europe, Japan, and the Asia Pacific region. Leased space in the United States includes 538,000 square feet of retail space. The major facility leases are for terms of 5 to 10 years and generally provide renewal options for terms of 3 to 5 additional years. Leases for retail space are for terms of 5 to 15 years and often contain multi-year renewal options.

The Company owns its manufacturing facility in Cork, Ireland, which has approximately 352,000 square feet. The Company also owns a 752,000 square-foot facility in Sacramento, California, which is used as a manufacturing, warehousing and distribution center. The Sacramento and Cork facilities also house

customer support call centers. In addition, the Company owns 930,000 square feet of facilities located in Cupertino, California, used for research and development and corporate functions. Outside the United States, the Company owns additional facilities totaling approximately 169,000 square feet.

The Company believes its existing facilities and equipment are well maintained and in good operating condition. The Company has invested in internal capacity and strategic relationships with outside manufacturing vendors, and therefore believes it has adequate manufacturing capacity for the foreseeable future. The Company continues to make investments in capital equipment as needed to meet anticipated demand for its products.

Item 3. Legal Proceedings

The Company is subject to various legal proceedings and claims that are discussed below. The Company is also subject to certain other legal proceedings and claims that have arisen in the ordinary course of business and which have not been fully adjudicated. In the opinion of management, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate have a material adverse effect on its financial condition, liquidity or results of operations. However, the results of legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected. The Company settled certain legal matters in 2003, which did not individually or in the aggregate have a material impact on the Company's results of operations.

Antor Media Corporation v. Apple Computer, Inc. et al.

Plaintiff, Antor Media filed this action on September 5, 2003 in the United States District Court in the Eastern District of Texas alleging infringement by the Company and other defendants of patent 5,754,961 relating to a "Method and Apparatus for Transmitting Information Recorded on Information Storage Means from a Central Server to Subscribers via a High Data Rate Digital Telecommunications Network." Plaintiff seeks unspecified damages and other relief. The Company has answered the complaint, denying all allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims requesting declaratory judgment for non-infringement and invalidity.

Apple Corps Ltd. v. Apple Computer, Inc.; Apple Computer, Inc. v. Apple Corps Ltd.

Plaintiff, Apple Corps filed this action on July 4, 2003 in the High Court of Justice, Chancery Division, in London alleging that the Company has breached a 1991 agreement which resolved earlier trademark litigation regarding use of the Apple marks. Plaintiff seeks unspecified damages and other relief. The Company filed a motion on October 13, 2003, challenging jurisdiction in the U.K. On October 8, 2003, the Company filed a case in the United States District Court for the Northern District of California requesting a declaratory judgment that the Company has not breached the 1991 agreement.

Articulate Systems, Inc. v. Apple Computer, Inc.

Plaintiff Articulate filed this action in March 1996 in the United States District Court in Massachusetts claiming patent infringement relating to voice recognition technology. Plaintiff seeks unspecified damages and other relief. The Company has answered the complaint, denying all allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims requesting declaratory judgment for non-infringement, unenforceability and invalidity. The case was stayed for several months pending resolution of four summary judgment motions filed by the Company, all of which were denied by the Court. Through a series of corporate transactions the assets belonging to Plaintiff were acquired by a subsidiary, Lernout & Hauspie Speech Products N.V. ("L&H"). L&H filed for bankruptcy in November 2000 and is being liquidated as part of the bankruptcy. The case has been inactive since approximately May 2002, pending the resolution of the L&H bankruptcy and liquidation.

Bancroft v. Apple Computer, Inc.

Plaintiff Bancroft filed this purported class action on January 30, 2002 in Los Angeles Superior Court on behalf of a potentially nationwide class of purchasers of certain Power Macintosh G3 computers. Plaintiff alleged violation of the Consumer Legal Remedies Act ("CLRA") arising from allegedly poor performance while running the Company's Mac OS X operating system, specifically relating to 2D hardware acceleration, QuickTime movie hardware acceleration, 3D graphics performance and DVD movie playback. The parties reached a settlement and the Court granted preliminary approval on September 2, 2003. The final approval hearing is set for January 26, 2004. Settlement of the matter will not have a material effect on the Company's financial position or results of operations.

BIAX Corporation v. Apple Computer, Inc.

Plaintiff BIAX filed this action on September 5, 2001 in the United States District Court in Delaware claiming patent infringement relating to dual processor technology. IBM and Motorola were added as defendants in an amended complaint. Plaintiff sought unspecified damages and other relief. The Company answered the complaint, denied all allegations and asserted numerous affirmative defenses. The Company also asserted counterclaims for declaratory judgment for non-infringement, unenforceability and invalidity. The parties settled this case in August 2003 and the matter is concluded. Settlement of this matter did not have a material effect on the Company's financial position or results of operations.

Dan, et al. v. Apple Computer, Inc. et al.

Plaintiffs filed this purported class action on September 22, 2003 in Los Angeles Superior Court against the Company and other members of the industry on behalf of a nationwide class of purchasers of certain computer hard drives. The case alleges violations of Civil Code Section 17200 ("Unfair Competition"), the Consumer Legal Remedies Act ("CLRA") and false advertising related to the size of the drives. Plaintiffs allege that calculation of hard drive size using the decimal method misrepresents the actual size of the drive. The complaint seeks unspecified damages and other relief. The case is stayed pending resolution of whether the case will be considered "complex" and potentially a new judge assigned. The Company is beginning its investigation of these allegations.

Digital Development Corporation v. Apple Computer, Inc.

Plaintiff, Digital Development Corporation filed this action on April 25, 2003 in the United States District Court in New Jersey, claiming patent infringement of two patents, 4,975,950 and 5,121,345, related to a "System and Method of Protecting Integrity of Computer Data and Software." Plaintiff requests unspecified damages and other relief. The complaint has not yet been served on the Company.

Dowhal v. Apple Computer, Inc.

Plaintiff filed this representative action in San Francisco County Superior Court on February 4, 2003 alleging that the Company and numerous other defendants have participated in false advertising and unfair business practices related to alleged misrepresentation of printer speed. Plaintiff asserts causes of action for violation of California Business and Professions Code §17200 and §17500. Plaintiff requests an injunction, restitution and other unspecified damages and relief. The Company was served on February 10, 2003. Apple filed a response on March 12, 2003. The parties are in discovery.

Dynacore Holdings Corp. v. Apple Computer, Inc.

Plaintiff Dynacore filed this action on June 6, 2001 in United States District Court for the Southern District of New York against the Company and thirteen other defendants claiming patent infringement relating to IEEE 1394 technology, also known as FireWire. Plaintiff claims that any computer system or other electronic product that uses or complies with the IEEE 1394 standard violates the patent. Plaintiff seeks unspecified damages and other relief. The Company has answered the complaint, denying all allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims requesting declaratory judgment for non-infringement and invalidity. Defendants are seeking to amend the

pleading to assert a counterclaim for inequitable conduct against Dynacore. The case was initially stayed pending the Federal Circuit's decision in Datapoint Corp. v. Standard Microsystems Corp., a related case in which plaintiff claimed that its patent was infringed by products complying with the fast Ethernet standard. In February 2002, the Federal Circuit affirmed the judgment of non-infringement in Datapoint, and the District Court lifted the stay in this action. The defendants in this action filed a joint motion for summary judgment based upon the decision in Datapoint. The Court heard the motion on October 4, 2002 and granted summary judgment in favor of the defendants on February 11, 2003. Dynacore has appealed the ruling. The parties have filed their respective briefs, and the case is scheduled for oral argument before the Federal Circuit Court on January 5, 2004.

Hawaii Structural Iron Workers and Pension Trust Fund v. Apple Computer, Inc. and Steven P. Jobs; Young v. Apple Computer, Inc. et al; Hsu v. Apple Computer Inc. et al

Beginning on September 27, 2001, three shareholder class action lawsuits were filed in the United States District Court for the Northern District of California against the Company and its Chief Executive Officer. These lawsuits are substantially identical, and purport to bring suit on behalf of persons who purchased the Company's publicly traded common stock between July 19, 2000, and September 28, 2000. The complaints allege violations of the 1934 Securities Exchange Act and seek unspecified compensatory damages and other relief. The Company believes these claims are without merit and intends to defend them vigorously. The Company filed a motion to dismiss on June 4, 2002, which was heard by the Court on September 13, 2002. On December 11, 2002, the Court granted the Company's motion to dismiss for failure to state a cause of action, with leave to Plaintiffs to amend their complaint within thirty days. Plaintiffs filed their amended complaint on January 31, 2003, and on March 17, 2003, the Company filed a motion to dismiss the amended complaint. The Court heard the Company's motion on July 11, 2003 and dismissed Plaintiff's claims with prejudice on August 12, 2003. Plaintiffs have appealed the ruling.

John W. Davis v Apple Computer, Inc.

Plaintiff filed this purported class action in San Francisco County Superior Court on December 5, 2002, alleging that the Company has engaged in unfair and deceptive business practices relating to its AppleCare Extended Service and Warranty Plan. Plaintiff asserts causes of action for violation of the California Business and Professions Code §17200 and §17500, breach of the Song-Beverly Warranty Act, intentional misrepresentation and concealment. The Company was served on December 11, 2002 and is continuing its investigation of the allegations. Plaintiff requests unspecified damages and other relief. Apple filed a motion on October 29, 2003 to disqualify Plaintiff's counsel, which the Court approved. The case is set for trial on February 23, 2004.

MacTech v. Apple Computer, Inc.; Macadam v. Apple Computer, Inc.; Computer International, Inc. v. Apple Computer, Inc.; Elite Computers and Software, Inc. v. Apple Computer, Inc.; The Neighborhood Computer Store v. Apple Computer, Inc. (All in Santa Clara County Superior Court).

Five resellers have filed similar lawsuits against the Company for various causes of action including breach of contract, fraud, negligent and intentional interference with economic relationship, negligent misrepresentation, trade libel, unfair competition and false advertising. Plaintiffs request unspecified damages and other relief. The parties are in discovery. On October 1, 2003, one of the resellers, Macadam was deauthorized as an Apple reseller. Macadam filed a motion for a temporary order to re-instate it as a reseller, which the Court denied. A hearing on its motion for a preliminary injunction is scheduled for December 18, 2003.

Palmieri v. Apple Computer, Inc.

Plaintiff filed this purported class action on September 5, 2003 in Los Angeles Superior Court on behalf of a nationwide class of purchasers of certain PowerBooks. The case alleges violations of Civil Code Section 17200 (Unfair Competition) and the Consumer Legal Remedies Act ("CLRA") arising from an alleged design defect in the PowerBooks which purportedly causes marks and dead pixels in the LCD

screens. Plaintiffs amended their complaint to allege an additional defect in the new 15" PowerBook, introduced in September, 2003, which purportedly causes "white spots" on the screen. The complaint seeks unspecified damages and other relief. The Company's response is not yet due. The Company is beginning its investigation of these allegations.

TIBCO Software, Inc. v. Apple Computer, Inc.

Plaintiff filed this case on August 27, 2003 in United States District Court for the Northern District of California alleging trademark infringement by the Company for using the mark "Rendezvous." Plaintiff's mark is "TIBCO Rendezvous." The complaint seeks unspecified damages and other relief. The Company answered the complaint denying all allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims requesting a declaratory judgment for non-infringement, invalidity and no dilution.

UNOVA, Inc. v. Apple Computer, Inc., et al.

Plaintiff UNOVA filed this patent infringement action against the Company and six other defendants on May 8, 2002 in the Central District of California for infringement of eight UNOVA patents related to "Smart Battery Management." Plaintiff alleges that the Company's portable computers manufactured since 1996 infringe these eight patents. Plaintiff has filed similar lawsuits against other companies in addition to the co-defendants in this case. Plaintiff seeks unspecified damages and other relief. The Company has answered the complaint, denying all allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims requesting a declaratory judgment for non-infringement, invalidity and unenforceability. The case is in discovery and is set for trial on March 16, 2004.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of the Company's fiscal year ended September 27, 2003.

PART II

Item 5. Market for the Registrant's Common Equity and Related Shareholder Matters

The Company's common stock is traded on the over-the-counter market and is quoted on the Nasdaq National Market under the symbol AAPL, on the Tokyo Stock Exchange under the symbol APPLE, and on the Frankfurt Stock Exchange under the symbol APCD. As of December 5, 2003, there were 29,015 shareholders of record.

On June 21, 2000, the Company effected a two-for-one stock split in the form of a Common Stock dividend to shareholders of record as of May 19, 2000. All share price and per share data and numbers of common shares have been retroactively adjusted to reflect the stock split. The Company did not pay cash dividends in either fiscal 2003 or 2002. The Company anticipates that, for the foreseeable future, it will retain any earnings for use in the operation of its business. The price range per share of common stock presented below represents the highest and lowest closing prices for the Company's common stock on the Nasdaq National Market during each quarter.

		Fourth Quarter		Third Quarter		Second Quarter		First Quarter
Fiscal 2003 price range per common share	$	23.10-$19.06	$	19.29-$13.12	$	15.27-$13.80	$	17.22-$13.59
Fiscal 2002 price range per common share	$	18.74-$13.99	$	26.11-$16.55	$	25.45-$20.78	$	23.76-$14.98

Item 6. Selected Financial Data

The following selected financial information has been derived from the audited consolidated financial statements. The information set forth below is not necessarily indicative of results of future operations, and should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and related notes thereto included in Item 8 of this Form 10-K in order to fully understand factors that may affect the comparability of the information presented below.

Five fiscal years ended September 27, 2003 (In millions, except share and per share amounts)		2003		2002		2001		2000		1999
Net sales	$	6,207	$	5,742	$	5,363	$	7,983	$	6,134
Net income (loss)	$	69	$	65	$	(25)	$	786	$	601
Earnings (loss) per common share:										
Basic	$	0.19	$	0.18	$	(0.07)	$	2.42	$	2.10
Diluted	$	0.19	$	0.18	$	(0.07)	$	2.18	$	1.81
Cash dividends declared per common share	$	—	$	—	$	—	$	—	$	—
Shares used in computing earnings (loss) per share (in thousands):										
Basic		360,631		355,022		345,613		324,568		286,314
Diluted		363,466		361,785		345,613		360,324		348,328
Cash, cash equivalents, and short-term investments	$	4,566	$	4,337	$	4,336	$	4,027	$	3,226
Total assets	$	6,815	$	6,298	$	6,021	$	6,803	$	5,161
Long-term debt (including current maturities)	$	304	$	316	$	317	$	300	$	300
Total liabilities	$	2,592	$	2,203	$	2,101	$	2,696	$	2,057
Shareholders' equity	$	4,223	$	4,095	$	3,920	$	4,107	$	3,104

Net gains before taxes related to the Company's non-current debt and equity investments of $10 million, $75 million, $367 million, and $230 million were recognized in 2003, 2001, 2000, and 1999, respectively. A net loss before taxes related to the Company's non-current debt and equity investments of $42 million was

recognized in 2002. In 2002, the Company acquired Emagic resulting in a charge of approximately $1 million for acquired in-process technologies with no alternative future use. The Company recognized a similar charge of $11 million in 2001 related to its acquisition of PowerSchool. Net charges related to Company restructuring actions of $26 million, $30 million, $8 million, and $27 million were recognized in 2003, 2002, 2000, and 1999, respectively. During 2000, the Company recognized the cost of a special executive bonus for the Company's Chief Executive Officer for past services in the form of an aircraft with a total cost to the Company of approximately $90 million. In 2002, of the original $90 million accrual, $2 million remained unspent and was reversed. In 2003, settlement of the Company's forward stock purchase agreement resulted in a gain of $6 million. Favorable cumulative-effect type adjustments of $1 million and $12 million were recognized in 2003 and 2001, respectively.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This section and other parts of this Form 10-K contain forward-looking statements that involve risks and uncertainties. Forward-looking statements can also be identified by words such as "anticipates," "expects," "believes," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and the Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Factors That May Affect Future Results and Financial Condition" below. The following discussion should be read in conjunction with the consolidated financial statements and notes thereto included in Item 8 of this Form 10-K. All information presented herein is based on the Company's fiscal calendar. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles and the Company's discussion and analysis of its financial condition and results of operations requires the Company's management to make judgments, assumptions and estimates that affect the amounts reported in its consolidated financial statements and accompanying notes. Note 1 of the Notes to Consolidated Financial Statements in Item 8 of this Form 10-K describe the significant accounting policies and methods used in the preparation of the Company's consolidated financial statements. Management bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates.

Management believes the following to be critical accounting policies. That is, they are both important to the portrayal of the Company's financial condition and results, and they require management to make judgments and estimates about matters that are inherently uncertain.

Revenue Recognition

Net sales consist primarily of revenue from the sale of products (i.e., hardware, software, and peripherals), and extended warranty and support contracts. The Company recognizes revenue pursuant to applicable accounting standards, including Statement of Position (SOP) No. 97-2, *Software Revenue Recognition*, as amended, and Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements*.

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection is probable. Product is considered delivered to the customer once it has been shipped, and title and risk of loss have been transferred. For most of the Company's product sales, these criteria are met at the time the product is shipped. For online sales to individuals, for some sales to education customers in the United States, and for certain other sales, the Company defers revenue until the customer receives the product because the Company legally retains

a portion of the risk of loss on these sales during transit. If at the outset of an arrangement the Company determines the arrangement fee is not, or is presumed to not be, fixed and determinable, revenue is deferred and subsequently recognized as amounts become due and payable.

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end-user rebates, and other sales programs and volume-based incentives. The estimated cost of these programs is accrued as a reduction to revenue in the period the Company has sold the product and committed to a plan. The Company also records reductions to revenue for expected future product returns based on the Company's historical experience. Future market conditions and product transitions may require the Company to increase customer incentive programs and incur incremental price protection obligations that could result in additional reductions of revenue at the time such programs are offered. Additionally, certain customer incentive programs require management to estimate the number of customers who will actually redeem the incentive based on historical experience and the specific terms and conditions of particular incentive programs. If a greater than estimated proportion of customers redeem such incentives, the Company would be required to record additional reductions to revenue, which could have a material adverse impact on the Company's results of operations.

Allowance for Doubtful Accounts

The Company distributes its products through third-party resellers and directly to certain education, consumer, and commercial customers. The Company generally does not require collateral from its customers. However, when possible the Company does attempt to limit credit risk on trade receivables with credit insurance for certain customers in Latin America, Europe and Asia and by arranging with third-party financing companies to provide flooring arrangements and other loan and lease programs to the Company's direct customers. These credit-financing arrangements are directly between the third-party financing company and the end customer. As such, the Company does not assume any recourse or credit risk sharing related to any of these arrangements. However, considerable trade receivables that are not covered by collateral, third-party flooring arrangements, or credit insurance are outstanding with the Company's distribution and retail channel partners.

The allowance for doubtful accounts is based on management's assessment of the collectibility of specific customer accounts and includes consideration of the credit worthiness and financial condition of those specific customers. The Company records an allowance to reduce the specific receivables to the amount that is reasonably believed to be collectible. The Company also records an allowance for all other trade receivables based on multiple factors including historical experience with bad debts, the general economic environment, the financial condition of the Company's distribution channels, and the aging of such receivables. If there is a deterioration of a major customer's financial condition, if the Company becomes aware of additional information related to the credit worthiness of a major customer, or if future actual default rates on trade receivables in general differ from those currently anticipated, the Company may have to adjust its allowance for doubtful accounts, which would affect earnings in the period the adjustments are made.

Inventory Valuation and Inventory Purchase Commitments

The Company must order components for its products and build inventory in advance of product shipments. The Company records a write-down for inventories of components and products, including third-party products held for resale, which have become obsolete or are in excess of anticipated demand or net realizable value. The Company performs a detailed review of inventory each period that considers multiple factors including demand forecasts, product lifecycle status, product development plans, current sales levels, and component cost trends. The personal computer industry is subject to a rapid and unpredictable pace of product and component obsolescence and demand changes. If future demand or market conditions for the Company's products are less favorable than forecasted or if unforeseen technological changes negatively impact the utility of component inventory, the Company may be required

to record additional write-downs which would negatively affect gross margins in the period when the write-downs are recorded.

The Company accrues necessary reserves for cancellation fees related to component orders that have been cancelled. Consistent with industry practice, the Company acquires components through a combination of formal purchase orders, supplier contracts, and open orders based on projected demand information. These commitments typically cover the Company's requirements for periods ranging from 30 to 130 days. If there is an abrupt and substantial decline in demand for one or more of the Company's products or an unanticipated change in technological requirements for any of the Company's products, the Company may be required to record additional reserves for cancellation fees that would negatively affect gross margins in the period when the cancellation fees are identified.

Valuation of Long-Lived Assets Including Acquired Intangibles

The Company reviews property, plant, and equipment and certain identifiable intangible assets for impairment whenever events or changes in circumstances indicate the carrying amount of such an asset may not be recoverable. Recoverability of these assets is measured by comparison of their carrying amount to future undiscounted cash flows the assets are expected to generate. If such assets are considered to be impaired, the impairment to be recognized in earnings equals the amount by which the carrying value of the assets exceeds their fair market value. Although the Company has recognized no material impairment adjustments related to its property, plant, and equipment or identifiable intangibles during the past three fiscal years, except those made in conjunction with restructuring actions, deterioration in the Company's business in a geographic region or business segment in the future, including deterioration in the performance of individual retail stores, could lead to such impairment adjustments in the future periods in which such business issues are identified.

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*, in the first quarter of fiscal 2002. As a result, the Company no longer amortizes goodwill but instead performs a review of goodwill for impairment annually, or earlier if indicators of potential impairment exist. The review of goodwill for potential impairment is highly subjective and requires that: (1) goodwill be allocated to various reporting units of the Company's business to which it relates; (2) the Company estimate the fair value of those reporting units to which the goodwill relates; and (3) the Company determine the book value of those reporting units. If the estimated fair value of reporting units with allocated goodwill is determined to be less than their book value, the Company is required to estimate the fair value of all identifiable assets and liabilities of those reporting units in a manner similar to a purchase price allocation for an acquired business. This requires independent valuation of certain internally developed and unrecognized assets including in-process research and development and developed technology. Once this process is complete, the amount of goodwill impairment, if any, can be determined.

Based on the Company's estimates as of September 27, 2003, there was no impairment of goodwill. However, changes in various circumstances including changes in the Company's market capitalization, changes in the Company's forecasts, and changes in the Company's internal business structure could cause one or more of the Company's reporting units to be valued differently thereby causing an impairment of goodwill. Additionally, in response to changes in the personal computer industry and changes in global or regional economic conditions, the Company may strategically realign its resources and consider restructuring, disposing, or otherwise exiting businesses, which could result in an impairment of property, plant, and equipment, identifiable intangibles, or goodwill.

Warranty Costs

The Company provides currently for the estimated cost for product warranties at the time the related revenue is recognized based on historical experience of failure rates. Each quarter, the Company reevaluates its estimates to assess the adequacy of its recorded warranty liabilities and adjusts the amounts

as necessary. If actual product failure rates or repair costs differ from estimates, revisions to the estimated warranty liability would be required and could negatively affect the Company's results of operations.

Income Taxes

The Company records a tax provision for the anticipated tax consequences of the reported results of operations. In accordance with SFAS No. 109, *Accounting for Income Taxes*, the provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. The Company records a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized.

Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets. In the event that all or part of the net deferred tax assets are determined not to be realizable in the future, an adjustment to the valuation allowance would be charged to earnings in the period such determination is made. Similarly, if the Company subsequently realizes deferred tax assets that were previously determined to be unrealizable, the respective valuation allowance would be reversed, resulting in a positive adjustment to earnings in the period such determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with management's expectations could have a material impact on the Company's results of operations and financial position.

Net Sales

Net sales and Macintosh unit sales by operating segment and net sales and unit sales by product follow (net sales in millions and Macintosh unit sales in thousands):

	2003	Change	2002	Change	2001
Net Sales by Operating Segment:					
Americas net sales (a)	$ 3,181	2 %	$ 3,131	3 %	$ 3,037
Europe net sales	1,309	5 %	1,251	0 %	1,249
Japan net sales	698	(2)%	710	0 %	713
Retail net sales	621	119 %	283	—	19
Other segments net sales (a)	398	8 %	367	6 %	345
Total net sales	$ 6,207	8 %	$ 5,742	7 %	$ 5,363
Unit Sales by Operating Segment:					
Americas Macintosh unit sales	1,620	(6)%	1,728	(2)%	1,768
Europe Macintosh unit sales	684	(5)%	722	(4)%	754
Japan Macintosh unit sales	339	(12)%	386	(2)%	394
Retail Macintosh unit sales	187	103 %	92	—	7
Other segments Macintosh unit sales (a)	182	5 %	173	5 %	164
Total Macintosh unit sales	3,012	(3)%	3,101	0 %	3,087
Net Sales by Product:					
Power Macintosh net sales (b)	$ 1,237	(10)%	$ 1,380	(17)%	$ 1,664
PowerBook net sales	1,299	56 %	831	2 %	813
iMac net sales	1,238	(15)%	1,448	30 %	1,117
iBook net sales	717	(18)%	875	8 %	809
Total Macintosh net sales	4,491	(1)%	4,534	3 %	4,403
Peripherals and other hardware (c)	1,058	57 %	674	74 %	387
Software (d)	362	18 %	307	33 %	230
Service and other sales	296	30 %	227	(34)%	343
Total net sales	$ 6,207	8 %	$ 5,742	7 %	$ 5,363

Unit Sales by Product:					
Power Macintosh unit sales (b)	667	(13)%	766	(18)%	937
PowerBook unit sales	604	69 %	357	3 %	346
iMac unit sales	1,094	(16)%	1,301	8 %	1,208
iBook unit sales	647	(4)%	677	14 %	596
Total Macintosh unit sales	3,012	(3)%	3,101	0 %	3,087
Net sales per Macintosh unit sold (e)	$ 1,491	2 %	$ 1,462	3 %	$ 1,426
iPod unit sales	939	146 %	381	—	—
iPod net sales	$ 345	141 %	$ 143	—	—

Notes:

(a) Other segments consists of Asia Pacific and FileMaker. Certain net sales in 2002 and 2001 related to recent acquisitions and Internet services have been reclassified from Other segments net sales to Americas segment net sales to conform to the 2003 presentation.

(b) Power Macintosh figures include server sales.

(c) Net sales of peripherals and other hardware include sales of iPod, Apple-branded and third-party displays, and other hardware accessories.

(d) Net sales of software include sales of Apple-branded operating system and application software and sales of third-party software.

(e) Net sales per Macintosh unit sold is derived by dividing total Macintosh net sales by total Macintosh unit sales.

Fiscal Year 2003 versus 2002

Net sales increased $465 million or 8% during 2003 compared to 2002 while Macintosh unit sales declined 3% year-over-year to approximately 3 million units in 2003. Several factors have contributed favorably to net sales during 2003 including:

- The Retail segment's net sales grew to $621 million during 2003 from $283 million in 2002, an increase of 119%. While the Company's customers may elect to purchase product from their local Apple Retail store rather than through other preexisting sales channels in the United States, the Company believes that a substantial portion of the Retail segment's net sales is incremental to total net sales. See additional comments below related to the Retail segment under the heading "Segment Operating Performance."

- Net sales of peripherals and other hardware rose $384 million or 57% during 2003 compared 2002, which follows a $287 million or 74% increase in 2002 as compared to 2001. The current year increase was primarily driven by the $202 million, or 141%, year-over-year increase in iPod net sales to $345 million. All of the Company's operating segments experienced substantial increases in iPod net sales and unit sales during 2003. iPod sales during 2003 were favorably affected by the introduction of substantially redesigned new models, which are compatible with both Macintosh and Windows operating systems and by the Company's introduction of its iTunes Music Store for the Macintosh operating system in April 2003. The Company's iPod digital music player is sold by a variety of resellers, many of which do not currently market the Company's Macintosh systems. The Company has expanded this distribution network during 2003, which has contributed to the current year increase in iPod unit sales of 146%.

  In addition to the iPod, the increase in net sales of peripherals and other hardware during 2003 also reflects an overall increase in net sales of other computer accessories including AirPort cards and base stations, which facilitate wireless connectivity; third party digital cameras and printers; and a number of portable computer related accessories.

- Although total Macintosh unit sales were down 3% in 2003, unit sales of the Company's portable systems were relatively strong primarily due to the 69% or 247,000 unit increase in PowerBook unit sales, slightly offset by a 4% or 30,000 unit decrease in iBook unit sales. The increase in PowerBook net sales of $468 million or 56% is due primarily to the success of the Company's new 12-inch, 15-inch and 17-inch models that were introduced during 2003. The decline in iBook consumer portable sales during 2003 is primarily due to a lower average price per unit. Portable systems represented 42% of all Macintosh systems sold in 2003 versus 33% in 2002 and 31% in 2001, which reflects an overall industry trend towards portable systems.

- The Company's average net sales per Macintosh unit sold increased 2% to $1,491 in 2003 as a result of various changes in overall unit mix towards relatively higher-priced PowerBook systems and an increase in direct sales primarily from the Company's retail and online stores, offset by somewhat lower year-over-year pricing on comparable Macintosh systems for most of the Company's Macintosh product lines in response to industry pricing pressure, particularly with the Company's

iBook consumer portable systems. PowerBook and Power Macintosh systems accounted for 42% of total unit sales in 2003 versus 36% in 2002.

- Net sales of software increased $55 million or 18% during 2003 compared to the prior year and reflects higher net sales of Apple-branded application and server software and third-party software. Net sales of Apple-branded application and server software increased due to the introduction of several new software titles during the year including Final Cut Express, iLife, and Keynote, as well as from higher sales of software related to recent acquisitions including PowerSchool and Emagic. Growth in net sales of third-party software during 2003 was particularly strong in the Americas Segment due to strong sales of software by the Company's online store and its Retail segment.

- Service and other sales rose $69 million or 30% during 2003 and results from significant year-over-year increases in net sales associated with AppleCare Protection Plan (APP) extended maintenance and support services, as well as the Company's Internet related services. Increased net sales associated with APP are primarily the result of increasing attach rates over the last several years. Increased net sales associated with Internet services are due to net sales from the iTunes Music Store introduced in April 2003 and increased net sales of the Company's .Mac Internet service.

Offsetting the favorable factors discussed above, the Company's net sales during 2003 were negatively impacted by the following factors:

- Total unit sales of desktop systems fell 15% during 2003 compared to 2002. iMac systems unit sales declined 16% from 2003 to 2002 resulting from a shift in sales away from desktop systems in favor of portables. Also, the current flat panel iMac form factor was in the eighth quarter of its life cycle by the end of 2003 and did not experience significant enhancements until the release of the 20-inch flat-panel iMac in November 2003.

- Unit sales of Power Macintosh systems fell 13% during 2003 compared to 2002. For the first nine months of 2003 compared to the same period in 2002, unit sales of Power Macintosh systems decreased 24%, which is representative of the decline of Power Macintosh systems sales experienced by the Company during recent years and is also believed to be attributable to delays in purchasing pending the release of the Power Mac G5. As expected, this trend reversed in the fourth quarter of 2003 with unit sales increasing 26% during the quarter as compared to the same period in the prior year due largely to the new Power Mac G5, which the Company introduced in June 2003 and began shipping at the end of fiscal 2003. The decline in Power Macintosh sales over the last several years also reflects the shift in sales to portable systems, particularly PowerBooks. In addition, the Company continues to believe that weak economic conditions over the past several years are having a pronounced negative impact on its professional and creative customers. Additionally, some of the Company's professional and creative customers may have delayed upgrades of their systems in anticipation of certain software vendors transitioning their professionally oriented Macintosh software applications to run natively on Mac OS X. Currently there are many applications that run natively on Mac OS X, including Adobe's PhotoShop 7 and QuarkXPress 6; however, there is no assurance that this will result in additional sales of Macintosh systems, particularly Power Macintosh units.

- The Company has continued to experience ongoing weakness in its U.S. education channel during 2003. Net sales and unit sales in U.S. education during 2003 were down 4% and 6%, respectively, as compared to 2002. This decline was due to a decrease in K-12 sales, partially offset by an increase in higher education sales. Net sales declined primarily as a result of a continued shift in mix away from higher priced Power Macintosh and iMac systems towards lower priced eMac and iBook systems, although the Company did experience a significant increase in sales of its PowerBook systems primarily to higher education customers. Portable systems accounted for approximately 43% of total unit sales in the education channel during 2003, as compared to approximately 34% in 2002.

The Company's one-to-one (1:1) learning solutions are a complete solution consisting of an iBook portable system for every student and teacher along with a wireless network connected to a central server. The Company has experienced significant competition in 1:1 learning solutions and, accordingly, has experienced a lower sales price per unit, on average, in these transactions.

The Company believes weakness in its U.S. education channel, particularly K-12, has been caused by multiple factors including funding pressures due to weak economic conditions, large budget deficits in many states, and increased competition particularly for desktop computers. Although the Company has taken steps, and will continue to take steps, to address weakness in the U.S. education channel, it remains difficult to anticipate when and if this negative trend will reverse.

- The personal computer industry in general, and the Company specifically, continue to see relatively soft demand for their products. Sales of professional and consumer oriented Macintosh systems remain far below levels experienced in fiscal 2000 and earlier. Difficult global economic conditions during the past several years exacerbated by the economic and political uncertainties caused by terrorist activities and the associated international responses have clearly had a pronounced negative effect on the overall demand for the Company's products in virtually all of its markets. Further, growth in the overall personal computer industry has slowed due to the high market penetration of personal computers and a lengthening of consumer, creative, and business personal computer upgrade cycles.

Fiscal Year 2002 versus 2001

Net sales increased $379 million or 7% during 2002 compared to 2001, while Macintosh unit sales were relatively flat year-over-year at approximately 3.1 million units. On a geographic basis, performance in the domestic market was relatively strong, especially when considering the performance of the Company's Retail segment, which operated during 2002 exclusively in the United States. However, the European and Japanese markets remained sluggish throughout 2002. The Company's net sales in 2002 were positively influenced by a number of factors.

- First, net sales from software, service, peripherals, and other sources rose $248 million or 26% in 2002 versus 2001. This increase was driven by several factors including a 28% increase in combined third-party and Apple-branded software sales; $143 million in net sales of iPod, the Company's portable digital music player that was introduced in the first half of 2002; a 9% increase in the sale of computer accessories; and a 14% increase in service revenue caused primarily by increased revenue associated with extended maintenance and support contracts. The growth in software revenue was primarily the result of increased sales of third-party software in the Company's retail and online stores and expansion in recent years in the number of Apple-branded software titles.

- Second, overall unit sales of Macintosh portable systems grew by 92,000 units or 10% in 2002 reflecting a general trend in the personal computer market away from desktop systems towards portable systems. During 2002, portable Macintosh systems represented 33% of total systems sales versus 31% in 2001 and 20% in 2000. Growth in this area has been most pronounced for iBook, the Company's education and consumer oriented portable Macintosh system. iBook unit sales increased 14% in 2002 and 9% in 2001.

- Third, the Company's Retail segment grew from 8 stores at the end of 2001 to 40 stores at the end of 2002. The Retail segment's net sales grew from $19 million in 2001 to $283 million in 2002. While the Retail segment may have cannibalized some net sales from the Company's preexisting sales channels in the U.S., the Company believed that a substantial portion of the Retail segment's net sales was incremental to the Company's total net sales. See additional comments below related to the Retail segment under the heading "Segment Operating Performance."

- Fourth, the Company's average unit pricing increased 3% during 2002 as a result of various changes in overall unit mix offset by somewhat lower pricing year-over-year on comparative Macintosh systems. Net sales per Macintosh unit sold during 2002 of $1,462 per unit reflected the shift in mix towards relatively higher-priced portable Macintosh systems and reflected the impact on net sales of the relatively higher-priced new iMac design introduced during 2002. The impact of these changes in mix were offset by the decline in unit sales of relatively higher-priced Power Macintosh systems and by lower pricing on comparative Macintosh systems during 2002 for most of the Company's Macintosh product lines in response to industry pricing pressure.

- Fifth, any comparison of net sales in 2002 versus 2001 must consider the effect of unusually low net sales during the first quarter of 2001. This was attributable to several factors at the beginning of 2001, including continued deterioration in worldwide demand for personal computers, rebate programs and price cuts instituted by the Company during that quarter that cost the Company approximately $138 million, and a plan implemented by the Company during the first quarter of 2001 that reduced substantially the level of inventory in its distribution channels that resulted in a decline in channel inventory of approximately 300,000 units during that quarter.

Offsetting the favorable factors discussed above, the Company's net sales in 2002 were negatively impacted by several notable factors.

- First, unit sales of Power Macintosh systems fell 18% during 2002 as compared to 2001. This followed a 35% decline in Power Macintosh unit sales in 2001 from 2000. The Company believed that weak economic conditions over the past several years had a pronounced negative impact on its professional and creative customers and that many of these customers continued to delay upgrades of their Power Macintosh systems due to the Company's ongoing transition to Mac OS X, its new operating system, and in anticipation of certain software vendors transitioning their Macintosh applications to run natively in Mac OS X. Further, the Company did not experience the anticipated increase in Power Macintosh sales that it expected following the introduction of Adobe's PhotoShop 7 during 2002. Additionally, many professional users may have postponed upgrading their systems until after the introduction of Mac OS X Jaguar released in the fourth quarter of 2002. Others may have delayed upgrading until after the availability of other professionally oriented software applications for Mac OS X such as QuarkXPress.

- Second, despite the overall increase in net sales during 2002 in the Americas, the Company continued to see weakness in its U.S. education channel. Total net sales in this channel fell 15% in 2002 and 4% in 2001. These declines were consistent with industry data that showed the Company losing market share in the U.S. education market in each of the last two fiscal years. The Company believed this weakness was caused by multiple factors, including increased price competition in this price sensitive market from the Company's competitors who sell Windows-based personal computers. Additionally, some of the Company's education customers appeared to be delaying technology purchases due to concerns about the overall impact of the weaker economy on their available funding.

- Third, the personal computer industry in general and the Company specifically experienced soft demand for its products due to adverse global economic conditions, political uncertainties, and a lengthening of consumer, creative, and business personal computer upgrade cycles.

Segment Operating Performance

The Company manages its business primarily on a geographic basis. The Company's reportable operating segments are comprised of the Americas, Europe, Japan, and Retail. The Americas segment includes both North and South America, except for the activities of the Company's Retail segment. The Europe segment includes European countries as well as the Middle East and Africa. The Japan segment includes only Japan, except for the activities of the Company's Retail segment. The Retail segment currently operates

Apple-owned retail stores in the United States and opened its first international store in Tokyo, Japan in the first quarter of 2004. Each reportable operating segment provides similar hardware and software products and similar services. Further information regarding the Company's operating segments may be found in Item 8 of this Form 10-K in the Notes to Consolidated Financial Statements at Note 11, "Segment Information and Geographic Data."

Americas

Net sales in the Americas segment during 2003 increased $50 million or 2% compared to 2002. During 2003 and 2002, the Americas segment represented approximately 51% and 55%, respectively, of the Company's total net sales and represented approximately 54% and 56%, respectively, of total Macintosh unit sales. The results of the Americas segment are similar to the overall results of the Company as they reflect substantially lower unit sales and net sales of Power Macintosh systems and iMac systems, partially offset by increases in unit sales and net sales of PowerBooks. The net sales of the Americas segment, and the Company in total, also reflect substantially higher sales of peripherals, software, and services during 2003 compared to 2002 due primarily to higher sales of iPods and Internet services. The Americas segment has been negatively affected by weakness in its U.S. education channel. As noted above, total net sales and unit sales in the U.S. education channel during 2003 were down 4% and 6%, respectively, compared to the same period in 2002. The Company believes this decline is caused by increased competition in the education market and by a reduction in spending by U.S. educational institutions due to federal and state funding concerns and tax revenue shortfalls resulting from the weak economy. Additionally, some of the decline during 2003 in net sales and unit sales of Macintosh systems in the Americas segment may be the result of the operation of the Company's Retail segment whose net sales, all of which occurred within the U.S., increased significantly during 2003.

Net sales for the Americas segment increased 3% or $94 million in 2002 compared to 2001. The Americas segment was negatively affected by a decline in U.S. education sales in 2002 of $215 million. The Americas segment also experienced a 17% decline in Power Macintosh unit sales. However, outside of the U.S. education channel, unit sales of consumer desktop and portable systems rebounded from the substantial declines experienced in 2001, rising a combined 31% in 2002. Sales of software, peripherals, and accessories were also up in the Americas during 2002. Growth in unit sales of consumer oriented systems during 2002 in the Americas is somewhat attributable to the significantly depressed level of net sales experienced in the first quarter of 2001 as discussed above. However, growth in the Americas was somewhat negatively affected, particularly with respect to consumer-oriented systems, by the significant growth of the Company's Retail segment in the U.S. More than 70% of the Retail segment's Macintosh unit sales during 2002 were for iMacs and iBooks.

Europe

Net sales in Europe increased $58 million or 5% during 2003 as compared to 2002 while Macintosh unit sales declined by 5% during the same period. Europe's operating results were consistent with the trend experienced in the Americas and by the Company as a whole. Europe experienced weakened demand for Power Macintosh, iMac and iBook systems in 2003, partially offset by strong demand for PowerBooks whose net sales increased by 48% or $100 million from 2002. Europe also realized increased sales of peripherals, software, and service, primarily attributable to higher sales of iPods, accessories and APP.

Economic conditions in Europe remained weak throughout 2002, and the overall demand for the Company's products in that region remained flat during 2002 versus 2001. Unit sales in Europe for 2002 reflect relatively stronger demand for consumer-oriented products, particularly iBook whose unit sales increased 27% in 2002, offset by declines in Power Macintosh unit sales.

Japan

Net sales in Japan decreased $12 million or 2% during 2003 as compared to the same period in 2002, the weakest year-to-date performance of any of the Company's operating segments. Japan's Macintosh unit sales were particularly weak in 2003, declining 12%, and were primarily attributable to lower sales of iMac and iBook systems, partially offset by an increase in PowerBook sales as well as higher sales of peripherals and other hardware. Japan's Macintosh unit sales remain significantly below the segment's historic levels due to current economic conditions that remain particularly negative in Japan.

Net sales in Japan remained flat during 2002 versus 2001, with a slight decline in unit sales of 2%. Consistent with the Company's other geographic operating segments, during 2002 Japan showed growth in unit sales of consumer systems and a decline in unit sales of Power Macintosh systems. Japan's iMac unit sales increased 85% in 2002. However, in the case of Japan the increase in iMac unit shipments in 2002 versus 2001 was primarily the result of the unusually depressed level of net sales experienced by the Company in the first quarter of 2001 as discussed above. Additionally, net sales in Japan on a sequential and year-over-year comparative basis generally worsened as 2002 progressed reflecting particularly poor economic conditions in Japan.

Retail

The Company opened 25 new retail stores during 2003, bringing the total number of open stores to 65 as of September 27, 2003, which compares to 40 open stores as of September 28, 2002 and 8 open stores as of September 29, 2001. During the first quarter of fiscal 2004, the Company opened 9 additional stores including its first international store in the Ginza in Tokyo, Japan. The Retail segment's net sales grew to $621 million during 2003 from $283 million in 2002 and from $19 million in 2001. The $338 million or 119% increase in net sales during 2003 reflects the impact from opening 25 new stores in 2003, the full year impact of 2002 store openings, as well as an increase in average revenue per store. Total Macintosh sales increased by approximately $170 million of which $108 million related to year-over-year increases in PowerBook sales. The Retail segment has also contributed strongly to the increases in net sales of peripherals, software and services experienced by the Company during 2003. During 2003, approximately 45% of the Retail segment's net sales came from the sale of Apple-branded and third-party peripherals, software and services as compared to 28% for the Company as a whole. With an average of 54 stores open during 2003, the Retail segment achieved annualized revenue per store of approximately $11.5 million, as compared to approximately $10.2 million based on an average of 28 stores open in 2002.

As measured by the Company's operating segment reporting, the Retail segment improved from a loss of $22 million during 2002 to a loss of $5 million during 2003. This improvement is primarily attributable to the segment's year-over-year increase in net sales, which resulted in higher leverage on occupancy, depreciation and other fixed costs.

Expansion of the Retail segment has required and will continue to require a substantial investment in fixed assets and related infrastructure, operating lease commitments, personnel, and other operating expenses. Capital expenditures associated with the Retail segment since its inception totaled approximately $290 million through the end of fiscal 2003, $92 million of which was incurred during 2003. As of September 27, 2003, the Retail segment had approximately 1,300 employees and had outstanding operating lease commitments associated with retail store space and related facilities of $354 million. The Company would incur substantial costs should it choose to terminate its Retail segment or close individual stores. Such costs could adversely affect the Company's results of operations and financial condition. Investment in a new business model such as the Retail segment is inherently risky, particularly in light of the significant investment involved, the current economic climate, and the fixed nature of a substantial portion of the Retail segment's operating expenses.

Gross Margin

Gross margin for the three fiscal years ended September 27, 2003 are as follows (in millions, except gross margin percentages):

	2003	2002	2001
Net sales	$ 6,207	$ 5,742	$ 5,363
Cost of sales	4,499	4,139	4,128
Gross margin	$ 1,708	$ 1,603	$ 1,235
Gross margin percentage	27.5%	27.9%	23.0%

Gross margin decreased to 27.5% of net sales in 2003 from 27.9% of net sales in 2002. This decline in gross margin reflects relatively aggressive pricing actions on several Macintosh models instituted by the Company beginning in late fiscal 2002 as a result of continued pricing pressure throughout the personal computer industry, lower sales of relatively higher margin Power Macintosh systems during the first three fiscal quarters of 2003, and increased air freight and manufacturing costs associated with the production ramp-up of the new Power Mac G5 and 15-inch PowerBook, both of which began shipping in volume during September 2003. This decline is also attributable to a rise in certain component costs as the year progressed. The aforementioned negative factors affecting gross margins during 2003 were partially offset by the increase in higher margin software and direct sales.

The Company anticipates that its gross margin and the gross margin of the overall personal computer industry will remain under pressure throughout fiscal 2004 in light of weak economic conditions, price competition in the personal computer industry, and potential increases in component pricing. The Company also expects to continue to incur air freight charges on the Power Mac G5 and other products during 2004.

The foregoing statements regarding the Company's expected gross margin during 2004, general demand for personal computers, anticipated industry component pricing, anticipated air freight charges, and future economic conditions are forward-looking. There can be no assurance that current gross margins will be maintained, targeted gross margin levels will be achieved, or current margins on existing individual products will be maintained. In general, gross margins and margins on individual products will remain under significant downward pressure due to a variety of factors, including continued industry wide global pricing pressures, increased competition, compressed product life cycles, potential increases in the cost and availability of raw material and outside manufacturing services, and potential changes to the Company's product mix, including higher unit sales of consumer products with lower average selling prices and lower gross margins. In response to these downward pressures, the Company expects it will continue to take pricing actions with respect to its products. Gross margins could also be affected by the Company's ability to effectively manage product quality and warranty costs and to stimulate demand for certain of its products. The Company's operating strategy and pricing take into account anticipated changes in foreign currency exchange rates over time; however, the Company's results of operations can be significantly affected in the short-term by fluctuations in exchange rates.

The Company orders components for its products and builds inventory in advance of product shipments. Because the Company's markets are volatile and subject to rapid technology and price changes, there is a risk the Company will forecast incorrectly and produce or order from third-parties excess or insufficient inventories of particular products or components. The Company's operating results and financial condition in the past have been and may in the future be materially adversely affected by the Company's ability to manage its inventory levels and outstanding purchase commitments and to respond to short-term shifts in customer demand patterns.

Gross margin increased to 27.9% of net sales in 2002 from 23.0% in 2001. Gross margin in 2001 was unusually low resulting from negative gross margin of 2% experienced in the first quarter of 2001. As a

percentage of net sales, the Company's quarterly gross margins declined during fiscal 2002 from 31% in the first quarter down to 26% in the fourth quarter. This decline resulted from several factors including a rise in component costs as the year progressed and aggressive pricing by the Company across its products lines instituted as a result of continued pricing pressures in the personal computer industry.

Operating Expenses

Operating expenses for the three fiscal years ended September 27, 2003 are as follows (in millions, except for percentages):

	2003	2002	2001
Research and development	$ 471	$ 446	$ 430
Percentage of net sales	8%	8%	8%
Selling, general, and administrative expenses	$ 1,212	$ 1,109	$ 1,138
Percentage of net sales	20%	19%	21%
Restructuring costs	$ 26	$ 30	—
Purchased in-process research and development	—	$ 1	$ 11

Research and Development (R&D)

The Company recognizes that focused investments in R&D are critical to its future growth and competitive position in the marketplace and are directly related to timely development of new and enhanced products that are central to the Company's core business strategy. The Company has historically relied upon innovation to remain competitive. R&D expense amounted to approximately 8% of total net sales during 2003, 2002 and 2001, up substantially from approximately 5% of total net sales in fiscal year 2000 and recent earlier periods. The Company's management believes that maintaining or increasing the pace of innovation and product development is the best way to respond to current economic and market conditions and will continue to position the Company for future growth as conditions improve. R&D expense increased 6% or $25 million to $471 million in 2003 as compared to 2002, which follows a $16 million increase in 2002 as compared to 2001. The overall increase in R&D expense relates primarily to increased headcount and support for new product development activities. R&D spending also included capitalized software development costs of approximately $14.7 million related to the development of Mac OS X Panther in 2003; approximately $13.3 million associated with the development of Mac OS X Jaguar and approximately $6 million associated with the PowerSchool enterprise student information system in 2002; and approximately $5.4 million associated with the development of the original version of Mac OS X in 2001. Further information related to the Company's capitalization of software development costs may be found in Part II, Item 8 of this Form 10-K at Note 1 of Notes to Consolidated Financial Statements.

Selling, General, and Administrative Expense (SG&A)

SG&A increased $103 million or 9% during 2003 as compared to 2002 due primarily to the Company's continued expansion of the Retail segment and increases in headcount. The overall increase was partially offset by a decrease in current year discretionary spending on marketing and advertising and by savings resulting from the 2003 and 2002 restructuring activities described below.

SG&A decreased $29 million or 3% during 2002 as compared to 2001. The decrease in SG&A in 2002 was primarily the result of lower discretionary spending on marketing and advertising expenses, decreased spending related to information systems, and benefits directly related to the Company's restructuring actions in 2002 and 2001. The decreases were partially offset by higher sales expense in 2002 resulting from increased operating expenses associated with expansion of the Company's Retail segment.

Restructuring Actions

During the second quarter of 2003, the Company's management approved and initiated restructuring actions that resulted in recognition of a total restructuring charge of $2.8 million. The primary focus of actions taken in the second quarter were for the most part supplemental to actions initiated in the prior two quarters and focused on further headcount reductions in various sales and marketing functions in the Company's Americas and Europe operating segments and further reductions associated with PowerSchool related activities in the Americas operating segment. The second quarter actions resulted in recognition of severance costs of $2.4 million for termination of 93 employees, 92 of whom were terminated prior to the end of 2003 at a cost of $2.2 million. During the second quarter of 2003, an additional $400,000 was accrued for asset write-offs and lease payments on an abandoned facility in the Americas operating segment. The Company estimates these restructuring actions will reduce quarterly operating expenses by $1.5 million.

During the first quarter of 2003, the Company's management approved and initiated restructuring actions with a total cost of $24 million that resulted in the termination of manufacturing operations at the Company-owned facility in Singapore, further reductions in headcount resulting from the shift in PowerSchool product strategy that took place at the end of fiscal 2002, and termination of various sales and marketing activities in the United States and Europe. These restructuring actions will ultimately result in the elimination of 260 positions worldwide, all but one was eliminated by the end of 2003. The Company estimates these restructuring actions will reduce quarterly operating expenses by $6 million.

During fiscal 2002, the Company recorded total restructuring charges of $30 million related to actions intended to eliminate certain activities and better align the Company's operating expenses with existing general economic conditions and to partially offset the cost of continuing investments in new product development and investments in the Company's Retail operating segment. The Company estimates these restructuring actions will result in reduced quarterly operating expenses of approximately $10 million.

Of the $30 million restructuring charge for fiscal 2002, $6 million was incurred in the fourth quarter of 2002 related to actions designed to reduce headcount costs in corporate operations and sales and to adjust its PowerSchool product strategy. Headcount actions, primarily in corporate operations, sales, and PowerSchool related research and development, resulted in the elimination of approximately 180 positions worldwide at a cost of $1.8 million. The shift in product strategy at PowerSchool included discontinuing development and marketing of a PowerSchool product that resulted in the impairment of previously capitalized development costs associated with the product in the amount of $4.5 million. The remaining charge in 2002 of $24 million was incurred in the first quarter of 2002 and resulted in the elimination of approximately 425 positions worldwide, at a cost of $8 million. Positions were eliminated primarily in the Company's operations, information systems, and administrative functions. In addition, these restructuring actions also included significant changes in the Company's information systems strategy resulting in termination of equipment leases and cancellation of existing projects and activities. Related lease and contract cancellation charges totaled $12 million, and charges for asset impairments totaled $4 million. During the first quarter of 2003, the Company reversed the remaining unused accrual of $600,000.

Purchased In-Process Research and Development (IPR&D)

During the fourth quarter of 2002, the Company acquired Emagic GmbH, a provider of professional software solutions for computer based music production, for approximately $30 million in cash; $551,000 of which was allocated to IPR&D. The amount of the purchase price allocated to IPR&D was expensed upon acquisition, because the technological feasibility of products under development had not been established and no alternative future uses existed. The IPR&D relates primarily to Emagic's Logic series technology and extensions. At the date of the acquisition, the products under development were between 43%-83% complete, and it was expected that the remaining work would be completed during the Company's fiscal 2003 at a cost of approximately $415,000. The remaining efforts, which were completed in 2003, included finalizing user interface design and development, and testing. The fair value of the IPR&D was determined

using the income approach, which reflects the projected free cash flows that will be generated by the IPR&D projects and that are attributable to the acquired technology, and discounting the projected net cash flows back to their present value using a discount rate of 25%.

In May 2001, the Company acquired PowerSchool, Inc., a provider of web-based student information systems for K-12 schools and districts that enables schools to record, access, report, and manage their student data and performance in real-time, and gives parents real-time web access to track their children's progress. Of total purchase consideration of $66.1 million, $10.8 million was allocated to IPR&D and was expensed upon acquisition because the technological feasibility of products under development had not been established and no alternative future uses existed. The IPR&D relates to technologies representing processes and expertise employed to design, develop, and deploy a functioning, scalable web-based student information system for use by K-12 schools. At the date of the acquisition, the PowerSchool product under development was approximately 50% complete, and it was expected that the remaining 50% would be completed during the Company's fiscal 2002 at a cost of approximately $9.25 million. The remaining efforts, which were completed during 2002, included completion of coding, finalizing user interface design and development, and testing. The fair value of the IPR&D was determined using the income approach, which reflects the projected free cash flows that will be generated by the IPR&D projects and that are attributable to the acquired technology, and discounting the projected net cash flows back to their present value using a discount rate of 25%.

Other Income and Expense

Other income and expense for the three fiscal years ended September 27, 2003 are as follows (in millions):

	2003	2002	2001
Gains (losses) on non-current investments, net	$ 10	$ (42)	$ 88
Unrealized loss on convertible securities	$ —	$ —	$ (13)
Interest income	$ 69	$ 118	$ 218
Interest expense	(8)	(11)	(16)
Gains on sales of short term investments, net	21	7	—
Other income (expense), net	(5)	(2)	15
Gain on forward purchase agreement	6	—	—
Interest and other income, net	$ 83	$ 112	$ 217
Total other income and expense	$ 93	$ 70	$ 292

Gains and Losses on Non-current Investments

The Company has held investments in EarthLink Inc. (EarthLink), Akamai Technologies, Inc. (Akamai), ARM Holdings plc (ARM) and certain investments in private companies. These investments have been reflected in the consolidated balance sheets as long term assets within other assets and have been categorized as available-for-sale requiring that they be carried at fair value with unrealized gains and losses, net of taxes, reported in equity as a component of accumulated other comprehensive income. The Company recognizes an impairment charge to earnings in the event a decline in fair value below the cost basis of one of these investments is determined to be other-than-temporary. The Company includes recognized gains and losses resulting from the sale or from other-than-temporary declines in fair value associated with these investments in other income and expense. Further information related to the Company's non-current debt and equity investments may be found in Part II, Item 8 of this Form 10-K at Note 2 of Notes to Consolidated Financial Statements.

During 2003, the Company sold 1,875,000 shares of Akamai stock for net proceeds of approximately $9 million, and a gain before taxes of approximately $8 million. Additionally, the Company sold its remaining investment in ARM stock, 278,000 shares, for net proceeds of approximately $295,000, and a

gain before taxes of $270,000, and sold its remaining investment in EarthLink stock, 6,540,000 shares, for net proceeds of approximately $37 million, and a gain before taxes of $2 million. The fair value of the Company's remaining investment in Akamai as of September 27, 2003, was approximately $5 million.

During 2002, the Company determined that declines in the fair value of certain of these investments were other-than-temporary. As a result, the Company recognized a $44 million charge to earnings to writedown the basis of its investment in EarthLink, a $6 million charge to earnings to writedown the basis of its investment in Akamai, and a $15 million charge to earnings to writedown the basis of its investment in a private company investment. These losses in 2002 were partially offset by the sale of 117,000 shares of EarthLink stock for net proceeds of $2 million and a gain before taxes of $223,000, the sale of 250,000 shares of Akamai stock for net proceeds of $2 million and a gain before taxes of $710,000, and the sale of approximately 4.7 million shares of ARM stock for both net proceeds and a gain before taxes of $21 million.

During 2001, the Company sold a total of approximately 1 million shares of Akamai stock for net proceeds of $39 million and recorded a gain before taxes of $36 million, and sold a total of approximately 29.8 million shares of ARM stock for net proceeds of $176 million and recorded a gain before taxes of $174 million. These gains during 2001 were partially offset by a $114 million charge to earnings that reflected an other-than-temporary decline in the fair value of the Company's investment in EarthLink and an $8 million charge that reflected an other-than-temporary decline in the fair value of certain private company investments.

Unrealized Loss on Convertible Securities

On October 1, 2000, the Company adopted Statement of Financial Accounting Standard (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*. SFAS No. 133 established accounting and reporting standards for derivative instruments, hedging activities, and exposure definition. SFAS No. 133 required the Company to adjust the carrying value of the derivative component of its investment in Samsung to earnings during the first quarter of 2001, the before tax effect of which was an unrealized loss of approximately $13 million.

Interest and Other Income, Net

Net interest and other income decreased $29 million or 26% to $83 million during 2003. The decrease is primarily the result of declining investment yields on the Company's cash and short-term investments resulting from substantially lower market interest rates. The weighted average interest rate earned by the Company on its cash, cash equivalents and short-term investments fell to 1.89% in 2003 compared to 2.85% in 2002. The decrease is offset by the increase of $14 million from the gain on the sales of short term investments from the Company's fixed income portfolio, and the increase of $6 million from the gain on the forward purchase agreement during the fourth quarter of 2003.

Net interest and other income was $112 million in fiscal 2002, compared to $217 million in fiscal 2001. This $105 million or 48% decrease was primarily the result of declining investment yields on the Company's cash and short-term investments resulting from substantially lower market interest rates. The weighted average interest rate earned by the Company on its cash, cash equivalents and short-term investments fell to 2.85% in 2002 compared to 5.38% in 2001.

Provision for Income Taxes

The Company's effective tax rate for 2003 was 26% compared to the higher statutory rate due primarily to research and development credits, a non-taxable gain on stock repurchase and certain undistributed foreign earnings for which no U.S. taxes were provided. As of September 27, 2003, the Company had deferred tax assets arising from deductible temporary differences, tax losses, and tax credits of $452 million before being offset against certain deferred tax liabilities and a valuation allowance for presentation on the Company's consolidated balance sheet. As of September 27, 2003, a valuation allowance of $30 million was

recorded against the deferred tax asset for the benefits of tax losses that may not be realized. The valuation allowance relates principally to the operating loss carryforwards acquired from NeXT and other acquisitions, the utilization of which is subject to certain limitations imposed by the Internal Revenue Code. Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, will be sufficient to fully recover the remaining net deferred tax assets. The Company will continue to evaluate the realizability of the deferred tax assets quarterly by assessing the need for and amount of the valuation allowance.

On April 10, 2003, the Internal Revenue Service (IRS) proposed adjustments to the Company's federal income tax returns for the years 1998 through 2000, and the Company has made certain prepayments thereon. Certain of these adjustments are being contested through the IRS Appeals Office. Substantially all IRS audit issues for years prior to 1998 have been resolved. Management believes that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. Should any issues addressed in the Company's tax audits be resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs.

Cumulative Effects of Accounting Changes

Financial Instruments with Characteristics of Both Liabilities and Equity

On May 15, 2003, the Financial Accounting Standards Board (FASB) issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*. SFAS No. 150 requires issuers to classify as liabilities certain freestanding financial instruments that embody obligations for the issuer and have characteristics of both liabilities and equity. The Company adopted the provisions of SFAS No. 150 on June 29, 2003, which resulted in a favorable cumulative effect type adjustment of approximately $3 million. This adjustment represented the mark-to-market adjustment to fair value for a forward purchase agreement that allowed the Company to acquire 1.5 million shares of its common stock at a price of $16.64 per share. The Company settled this forward purchase agreement in August 2003. The settlement resulted in an additional gain of approximately $6 million, which is included in interest and other income, net.

Accounting for Asset Retirement Obligations

On September 29, 2002, the Company adopted SFAS No. 143, *Accounting for Asset Retirement Obligations*, which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. Net of the related income tax effect of approximately $1 million, adoption of SFAS No. 143 resulted in an unfavorable cumulative-effect type adjustment to net income during 2003 of approximately $2 million. This adjustment represents cumulative depreciation and accretion that would have been recognized through the date of adoption of SFAS No. 143 had the statement been applied to the Company's existing asset retirement obligations at the time they were initially incurred.

Accounting for Derivatives

The adoption of SFAS 133 during 2001 resulted in a favorable cumulative-effect type adjustment of approximately $12 million, net of a related income tax effect of approximately $5 million.

Further information related to the adoption of SFAS Nos. 133, 143 and 150 and the resulting cumulative accounting effects may be found in Part II, Item 8 of this Form 10-K at Note 1 of Notes to Consolidated Financial Statements.

Accounting for Stock-Based Compensation

The Company currently measures compensation expense for its employee stock-based compensation plans using the intrinsic value method prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* and provides pro forma disclosures of the effect on net income and earnings per share as if the fair value-based method had been applied in measuring compensation expense. The Company has elected to follow APB Opinion No. 25 because, as further discussed in Part II, Item 8 of this Form 10-K at Note 1 of the Notes to Consolidated Financial Statements, the alternative fair value accounting provided for under SFAS No. 123, *Accounting for Stock-Based Compensation*, requires use of option valuation models that were not developed for use in valuing employee stock options and employee stock purchase plan shares. Under APB Opinion No. 25, when the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of the grant, no compensation expense is recognized.

The FASB decided on April 22, 2003 to require all companies to expense the value of employee stock options. Companies will be required to measure the cost of employee stock options according to their fair value. The FASB has indicated that it plans to issue in the first quarter of calendar year 2004 an exposure draft of a new accounting standard addressing this matter. Prior to issuance of this exposure draft, the FASB has indicated it will be addressing several significant technical issues. Among other things, the FASB must determine the extent to which the new accounting standard will permit adjustments to recognized expense for actual option forfeitures and actual performance outcomes. This determination will affect the timing and amount of compensation expense recognized. Also, a method to determine the fair value of employee stock options must be established. Current accounting standards require use of an option-pricing model, such as the Black-Scholes formula, to determine fair value and provide guidance on adjusting some of the input factors used in the model. This valuation approach has received significant criticism and may be subject to changes that could have a significant impact on the calculated fair value of employee stock options under the new standard.

At the Company's annual shareholder's meeting on April 24, 2003, shareholders approved a proposal requesting that the Company's Board of Directors (the Board) establish a policy of expensing the value of all future employee stock options issued by the Company. The Board and management appreciate and take seriously the views expressed by the Company's shareholders. As discussed in the Company's Form 10-Q for the period ended March 29, 2003, the Company had decided not to expense the value of employee stock options until the FASB finalizes its new accounting standard on the matter. The Company based this decision on the FASB's announced intention to soon require all companies to expense the value of employee stock options and the FASB's near-term review of technical issues that will play a significant role in determining the fair value of and accounting for employee stock options. The Company monitors progress at the FASB and other developments with respect to the general issue of employee stock compensation. In the future, should the Company expense the value of employee stock options, either out of choice or due to new requirements issued by the FASB, the Company may have to recognize substantially more compensation expense in future periods that could have a material adverse impact on the Company's future results of operations.

Recent Accounting Pronouncements

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities*. FIN 46 clarifies the application of Accounting Research Bulletin No. 51 and applied immediately to any variable interest entities created after January 31, 2003 and to variable interest entities in which an interest is obtained after that date. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after December 15, 2003. The adoption of the provision of FIN 46 related to variable interests created after January 31, 2003 did not have a material impact on the Company's results of operations or financial position. The Company continues to evaluate the provisions of FIN 46, and does not believe that the adoption of the remaining provisions will have a material impact on its results of operations or financial position.

In May 2003, the FASB's Emerging Issues Task Force (EITF) reached consensus on EITF Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*. EITF Issue No. 00-21 provides guidance on how to account for certain arrangements that involve the delivery or performance of multiple products, services, and/or rights to use assets. The provisions of EITF Issue No. 00-21 apply to revenue transactions entered into in fiscal periods beginning after June 15, 2003. Additionally, in August 2003, the EITF reached consensus on EITF Issue No. 03-5, *Applicability of AICPA Statement of Position 97-2, "Software Revenue Recognition," to Non-Software Deliverables in an Arrangement Containing More-than-Incidental Software*. EITF Issue No. 03-5 provides guidance on determining whether non-software deliverables are included within the scope of SOP 97-2, and accordingly, whether multiple element arrangements are to be accounted for in accordance with EITF Issue No. 00-21 or SOP 97-2. The Company currently applies the requirements of SOP No. 97-2 when accounting for all multiple element transactions. The Company does not anticipate the application of either EITF Issue Nos. 00-21 or 03-5 will have a significant impact on its results of operations or financial position.

Liquidity and Capital Resources

The following table presents selected financial information and statistics for each of the last three fiscal years (dollars in millions):

	2003	2002	2001
Cash, cash equivalents, and short-term investments	$ 4,566	$ 4,337	$ 4,336
Accounts receivable, net	$ 766	$ 565	$ 466
Inventory	$ 56	$ 45	$ 11
Working capital	$ 3,530	$ 3,730	$ 3,625
Days sales in accounts receivable (DSO) (a)	41	36	29
Days of supply in inventory (b)	4	4	1
Days payables outstanding (DPO) (c)	82	77	73
Annual operating cash flow	$ 289	$ 89	$ 185

(a) DSO is based on ending net trade receivables and most recent quarterly net sales for each period.

(b) Days supply of inventory is based on ending inventory and most recent quarterly cost of sales for each period.

(c) DPO is based on ending accounts payable and most recent quarterly cost of sales adjusted for the change in inventory.

As of September 27, 2003, the Company's cash, cash equivalents, and short-term investments portfolio totaled $4.566 billion, an increase of $229 million from the end of fiscal 2002. The Company's short-term investment portfolio consists primarily of investments in U.S. Treasury and Agency securities, U.S. corporate securities, and foreign securities. Foreign securities consist primarily of foreign commercial paper, certificates of deposit and time deposits with foreign institutions, most of which are denominated in U.S. dollars. The Company's investments are generally liquid and investment grade.

As a result of declining investment yields on the Company's cash equivalents and short-term investments resulting from substantially lower market interest rates during 2003, the Company has elected to reduce the average maturity of its portfolio to maintain liquidity for future investment opportunities when market interest rates increase. Accordingly, during 2003 the Company increased its holdings in short-term investment grade instruments, both in U.S. corporate and foreign securities, that are classified as cash equivalents and has reduced its holdings in longer-term U.S. corporate securities classified as short-term investments.

Although the Company's cash, cash equivalents, and short-term investments increased in 2003, the Company's working capital at September 27, 2003 decreased by $200 million as compared to the end of

fiscal 2002 due primarily to the current year reclassification of the Company's long-term debt as a current obligation resulting from its scheduled maturity in February 2004.

The primary sources of total cash and cash equivalents in fiscal 2003 were $289 million in cash generated by operating activities and $53 million in proceeds from the issuance of common stock, partially offset by $164 million utilized for capital expenditures and $26 million for the repurchase of common stock.

The Company believes its existing balances of cash, cash equivalents, and short-term investments will be sufficient to satisfy its working capital needs, capital expenditures, debt obligations, stock repurchase activity, outstanding commitments, and other liquidity requirements associated with its existing operations over the next 12 months.

Debt

The Company currently has debt outstanding in the form of $300 million of aggregate principal amount 6.5% unsecured notes that were originally issued in 1994. The notes, which pay interest semiannually, were sold at 99.925% of par, for an effective yield to maturity of 6.51%. The notes, along with approximately $4 million of unamortized deferred gains on closed interest rate swaps, are due in February 2004 and therefore have been classified as current debt as of September 27, 2003. The Company currently anticipates utilizing its existing cash balances to settle these notes when due.

Capital Expenditures

The Company's total capital expenditures were $164 million during fiscal 2003, $92 million of which were for retail store facilities and equipment related to the Company's Retail segment and $72 million of which were primarily for corporate infrastructure, including information systems enhancements and operating facilities enhancements and expansions. The Company currently anticipates it will utilize approximately $160 million for capital expenditures during 2004, approximately $85 million of which is expected to be utilized for further expansion of the Company's Retail segment and the remainder utilized to support normal replacement of existing capital assets and enhancements to general information technology infrastructure.

Stock Repurchase Plan

In July 1999, the Company's Board of Directors authorized a plan for the Company to repurchase up to $500 million of its common stock. This repurchase plan does not obligate the Company to acquire any specific number of shares or acquire shares over any specified period of time.

During the fourth quarter of 2001, the Company entered into a forward purchase agreement to acquire 1.5 million shares of its common stock in September of 2003 at an average price of $16.64 per share for a total cost of $25.5 million. In August 2003, the Company settled this agreement prior to its maturity, at which time the Company's common stock had a fair value of $22.81. Other than this forward purchase transaction, the Company has not engaged in any transactions to repurchase its common stock since fiscal 2000. Since inception of the stock repurchase plan, the Company had repurchased a total of 6.55 million shares at a cost of $217 million. The Company was still authorized to repurchase up to an additional $283 million of its common stock as of September 27, 2003.

Off-Balance Sheet Arrangements

The Company has not entered into any transactions with unconsolidated entities whereby the Company has financial guarantees, subordinated retained interests, derivative instruments or other contingent arrangements that expose the Company to material continuing risks, contingent liabilities, or any other obligation under a variable interest in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to the Company.

Lease Commitments

As of September 27, 2003, the Company had total outstanding commitments on noncancelable operating leases of approximately $600 million, $354 million of which related to the lease of retail space and related facilities. Remaining terms on the Company's existing operating leases range from 1 to 12 years. Subsequent to September 27, 2003, the Company entered into additional operating lease commitments for retail space with future lease commitments totaling $64 million for periods ranging from 10 to 12 years.

Purchase Commitments with Contract Manufacturers and Component Suppliers

The Company utilizes several contract manufacturers to manufacture sub-assemblies for the Company's products and to perform final assembly and test of finished products. These contract manufacturers acquire components and build product based on demand information supplied by the Company, which typically covers periods ranging from 1 to 3 months. The Company also obtains individual components for its products from a wide variety of individual suppliers. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. Such purchase commitments typically cover the Company's forecasted component and manufacturing requirements for periods ranging from 30 to 130 days. As of September 27, 2003, the Company had outstanding third-party manufacturing commitments and component purchase commitments of approximately $848 million.

Indemnifications

The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other licensing agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against itself or an indemnified third-party and, in the opinion of management, does not have a potential liability related to unresolved infringement claims that would have a material adverse effect on its financial condition, liquidity or results of operations.

Factors That May Affect Future Results and Financial Condition

Because of the following factors, as well as other factors affecting the Company's operating results and financial condition, past financial performance should not be considered to be a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

General economic conditions and current economic and political uncertainty could adversely affect the demand for the Company's products and the financial health of its suppliers, distributors, and resellers.

The Company's operating performance depends significantly on general economic conditions. For much of the past several years, demand for the Company's products has been negatively impacted by difficult global economic conditions. Additionally, some of the Company's education customers appear to be delaying technology purchases due to concerns about the overall impact of the weaker economy on their available funding. Continued uncertainty about future economic conditions continues to make it difficult to forecast future operating results. Should global and regional economic conditions fail to improve or continue to deteriorate, demand for the Company's products could continue to be adversely affected, as could the financial health of its suppliers, distributors, and resellers.

War, terrorism or public health issues could disrupt supply, delivery or demand of products which could negatively affect the Company's operations and performance.

War, terrorism or public health issues, whether in the U.S. or abroad, have caused and could continue to cause damage or disruption to international commerce by creating economic and political uncertainties

that may have a strong negative impact on the global economy, the Company, and the Company's suppliers or customers. Although it is impossible to predict the occurrences or consequences of any such events, such events could result in a decrease in demand for the Company's products, make it difficult or impossible to deliver products to its customers, or to receive components from its suppliers, and could create delays and inefficiencies in the Company's supply chain. The Company's operating results and financial condition have been, and in the future may continue to be, adversely affected by these events.

The Company and some of its manufacturing vendors and component suppliers have significant operations in various locations throughout Asia, including locations in mainland China, the Hong Kong Special Administrative Region, and Singapore, all of which were subject to the World Health Organization and Centers for Disease Control and Prevention severe acute respiratory syndrome (SARS) travel advisories at times during the second and third quarters of fiscal 2003. Similar travel advisories were issued for Taiwan, where a significant amount of the Company's portable Macintosh systems and the iPod are assembled. Should the severity of the SARs threat increase or other public health issues arise, the Company could be negatively impacted by the need for more stringent employee travel restrictions, additional limitations in the availability of freight services, governmental actions limiting the movement of products between various regions, delays in production ramps of new products, and disruptions in the operations of the Company's manufacturing vendors and component suppliers.

The market for personal computers and related peripherals and services is highly competitive. If the Company is unable to effectively compete in these markets, its results of operations could be adversely affected.

The personal computer industry is highly competitive and is characterized by aggressive pricing practices, downward pressure on gross margins, frequent introduction of new products, short product life cycles, evolving industry standards, continual improvement in product price/performance characteristics, rapid adoption of technological and product advancements by competitors, price sensitivity on the part of consumers, and a large number of competitors. Over the past several years, price competition in the market for personal computers and related peripherals has been particularly intense. The Company's competitors who sell Windows-based personal computers have aggressively cut prices and lowered their product margins in order to gain or maintain market share in response to the weakness in demand that began in the second half of calendar 2000 for personal computing products. The Company's results of operations and financial condition have been, and in the future may continue to be, adversely affected by these and other industry-wide pricing pressures and downward pressures on gross margins.

The personal computer industry has also been characterized by rapid technological advances in software functionality, hardware performance, and features based on existing or emerging industry standards. Further, as the personal computer industry and its customers place more reliance on the Internet, an increasing number of Internet devices that are smaller and simpler than traditional personal computers may compete for market share with the Company's existing products. Several competitors of the Company have either targeted or announced their intention to target certain of the Company's key market segments, including consumer, education, professional and consumer digital video editing, and design and publishing. Several of the Company's competitors have introduced or announced plans to introduce digital music products that mimic many of the unique design, technical features, and solutions of the Company's products. The Company has a significant number of competitors, many of whom have greater financial, marketing, manufacturing, and technological resources, as well as broader product lines and larger installed customer bases than those of the Company. Additionally, there has been a trend towards consolidation in the personal computer industry that has resulted in larger and potentially stronger competitors in the Company's markets.

The Company is currently the only maker of hardware using the Mac OS. The Mac OS has a minority market share in the personal computer market, which is dominated by makers of computers utilizing Microsoft's Windows operating systems. The Company's future operating results and financial condition

are substantially dependent on its ability to continue to develop improvements to the Macintosh platform in order to maintain perceived design and functional advantages over competing platforms, including Windows.

The Company is currently focused on market opportunities related to digital music distribution and related consumer electronic devices including iPods. The Company faces increasing competition from other companies promoting their own digital music distribution services, free peer-to-peer music services, emerging companies, and larger companies that may have greater resources, including technical and marketing resources, and supplier relationships. There can be no assurance that the Company will be able to provide products and services that effectively compete in these markets. Failure to effectively compete could negatively affect the Company's operating results and financial position.

The Company has higher research and development and selling, general and administrative costs, as a percentage of revenue, than many of its competitors.

The Company's ability to compete successfully and maintain attractive gross margins is heavily dependent upon its ability to ensure a continuing and timely flow of innovative and competitive products and technologies to the marketplace. As a result, the Company incurs higher research and development costs as a percentage of revenue than its competitors who sell personal computers based on other operating systems. Many of these competitors seek to compete aggressively on price and maintain very low cost structures. Further, as a result of the expansion of the Company's Retail segment and costs associated with marketing the Company's brand including its unique operating system, the Company incurs higher selling costs as a percentage of revenue than many of its competitors. If the Company is unable to continue to develop and sell innovative new products with attractive gross margins, its results of operations may be materially adversely affected by its operating cost structure.

The Company must successfully manage frequent product introductions and transitions in order to remain competitive and effectively stimulate customer demand.

Due to the highly volatile nature of the personal computer industry, which is characterized by dynamic customer demand patterns and rapid technological advances, the Company must continually introduce new products and technologies, enhance existing products in order to remain competitive, and effectively stimulate customer demand for new products and upgraded versions of the Company's existing products. The success of new product introductions is dependent on a number of factors, including market acceptance; the Company's ability to manage the risks associated with product transitions, including production ramp issues; the availability of application software for new products; the effective management of inventory levels in line with anticipated product demand; the availability of products in appropriate quantities to meet anticipated demand; and the risk that new products may have quality or other defects in the early stages of introduction. Accordingly, the Company cannot determine in advance the ultimate effect that new products will have on its sales or results of operations.

During 2001, the Company introduced a new client operating system, Mac OS X, and delivered its first major upgrade, Mac OS X version 10.1. Other major upgrades include Mac OS X Jaguar in 2002 and most recently Mac OS X Panther in October 2003. Inability of the Company to provide additional improvements in the performance and functionality of Mac OS X, advance customer acceptance of the new operating system and its upgrades, obtain the continued commitment of software developers to transition existing applications to run on Mac OS X, or create new applications to run on Mac OS X, may have an adverse impact on the Company's operating results and financial condition.

Because orders for components, and in some cases commitments to purchase components, must be placed in advance of customer orders, the Company faces substantial inventory risk.

The Company records a write-down for inventories of components and products that have become obsolete or are in excess of anticipated demand or net realizable value and accrues necessary reserves for cancellation fees of orders for inventories that have been cancelled. Although the Company believes its

inventory and related provisions are adequate, given the rapid and unpredictable pace of product obsolescence in the computer industry, no assurance can be given that the Company will not incur additional inventory and related charges. In addition, such charges have had, and may have, a material effect on the Company's financial position and results of operations.

The Company must order components for its products and build inventory in advance of product shipments. Because the Company's markets are volatile and subject to rapid technology and price changes, there is a risk the Company will forecast incorrectly and produce or order from third parties excess or insufficient inventories of particular products. Consistent with industry practice, components are normally acquired through a combination of formal purchase orders, supplier contracts, and open orders based on projected demand information. Such purchase commitments typically cover the Company's forecasted component and manufacturing requirements for periods ranging from 30 to 130 days. The Company's operating results and financial condition have been in the past and may in the future be materially adversely affected by the Company's ability to manage its inventory levels and respond to short-term shifts in customer demand patterns.

Future operating results are dependent upon the Company's ability to obtain a sufficient supply of components, some of which are in short supply or available only from limited sources.

Although most components essential to the Company's business are generally available from multiple sources, certain key components including microprocessors and ASICs are currently obtained by the Company from single or limited sources. Some key components (including without limitation DRAM, TFT-LCD flat-panel displays, and optical and magnetic disk drives), while currently available to the Company from multiple sources, are at times subject to industry-wide availability and pricing pressures. In addition, new products introduced by the Company often initially utilize custom components obtained from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. In situations where a component or product utilizes new technologies, initial capacity constraints may exist until such time as the suppliers' yields have matured. The Company and other producers in the personal computer industry also compete for various components with other industries that have experienced increased demand for their products. The Company uses some components that are not common to the rest of the personal computer industry including certain microprocessors and ASICs. Continued availability of these components may be affected if producers were to decide to concentrate on the production of components other than those customized to meet the Company's requirements. If the supply of a key component were to be delayed or constrained on a new or existing product, the Company's results of operations and financial condition could be adversely affected.

The Company's ability to produce and market competitive products is also dependent on the ability and desire of IBM and Motorola, the sole suppliers of the PowerPC RISC-based microprocessor for the Company's Macintosh computers, to provide the Company with a sufficient supply of microprocessors with price/performance features that compare favorably to those supplied to the Company's competitors by Intel Corporation and other developers and producers of microprocessors used by personal computers using other operating systems. Further, despite its efforts to educate the marketplace to the contrary, the Company believes that many of its current and potential customers believe that the relatively slower MHz rating or clock speed of the microprocessors it utilizes in its Macintosh systems compares unfavorably to those utilized by other operating systems and translates to slower overall system performance. There have been instances in recent years where the inability of the Company's suppliers to provide advanced PowerPC G4 and G3 microprocessors with higher clock speeds in sufficient quantity has had significant adverse effects on the Company's results of operations. In addition, currently IBM is the Company's sole supplier of the G5 processor used in current Power Macintosh products and Motorola is the sole supplier of the G4 processors. The inability in the future of the Company to obtain microprocessors in sufficient quantities with competitive price/performance features could have an adverse impact on the Company's results of operations and financial condition.

The Company relies on third-party music content, which may not be available to the Company on commercially reasonable terms or at all.

The Company contracts with third parties to offer their music content to customers through the Company's iTunes Music Store. The Company pays substantial fees to obtain the rights to offer to its customers this third-party music. Many of the Company's licensing arrangements with these third-party content providers are short-term in nature and do not guarantee the future renewal of these arrangements at commercially reasonable terms, if at all. Certain parties in the music industry have announced their intent to consolidate their music distribution operations, which could limit the availability and increase the fees required to offer music content to customers through the iTunes Music Store. If the Company is unable to continue to offer a wide variety of music content at reasonable prices with acceptable usage rules, or expand its geographic reach outside the United States, then sales and gross margins of the Company's iTunes Music Store as well as related hardware and peripherals, including iPods, may be adversely affected.

Third-party content providers and artists require that the Company provide certain digital rights management solutions and other security mechanisms. If the requirements from content providers or artists change, then the Company may be required to further develop or license technology to address such new rights and requirements. There is no assurance that the Company will be able to develop or license such solutions at a reasonable cost and in a timely manner, if at all, which could have a materially adverse affect on the Company's operating results and financial position.

The Company is dependent on manufacturing and logistics services provided by third parties, many of whom are located outside of the United States.

Many of the Company's products are manufactured in whole or in part by third-party manufacturers. In addition, the Company has outsourced much of its transportation and logistics management. While outsourcing arrangements may lower the fixed cost of operations, they also reduce the Company's direct control over production and distribution. It is uncertain what effect such diminished control will have on the quality or quantity of the products manufactured, or the flexibility of the Company to respond to changing market conditions. Moreover, although arrangements with such manufacturers may contain provisions for warranty expense reimbursement, the Company may remain at least initially responsible to the ultimate consumer for warranty service in the event of product defects. Any unanticipated product defect or warranty liability, whether pursuant to arrangements with contract manufacturers or otherwise, could adversely affect the Company's future operating results and financial condition.

Final assembly of products sold by the Company is conducted in the Company's manufacturing facilities in Sacramento, California, and Cork, Ireland, and by external vendors in Fremont, California, Fullerton, California, Taiwan, Korea, the Netherlands, the People's Republic of China, and the Czech Republic. Currently, manufacture of many of the components used in the Company's products and final assembly of substantially all of the Company's portable products including PowerBooks, iBooks, and the iPod is performed by third-party vendors in Japan, Taiwan and China. If for any reason manufacturing or logistics in any of these locations is disrupted by regional economic, business, environmental, medical, political, or military conditions or events, the Company's results of operations and financial condition could be adversely affected.

The Company's products, from time to time, experience quality problems that can result in decreased net sales and operating profits.

The Company sells highly complex hardware and software products that can contain defects in design and manufacture. Sophisticated operating system software and applications, such as those sold by the Company, often contain "bugs" that can unexpectedly interfere with the operation of the software. Defects may also occur in components and products the Company purchases from third-parties that may be beyond its control. There can be no assurance that the Company will be able to detect and fix all defects in the hardware and software it sells. Failure to do so could result in lost revenue, loss of reputation, and significant expense to remedy.

The Company's retail initiative has required and will continue to require a substantial investment and commitment of resources and is subject to numerous risks and uncertainties.

Through November 2003, the Company has opened 74 retail stores including its first international store in Tokyo, Japan. The Company's retail initiative has required substantial investment in equipment and leasehold improvements, information systems, inventory, and personnel. The Company has also entered into substantial operating lease commitments for retail space with lease terms ranging from 5 to 15 years. The Company could incur substantial costs should it choose to terminate this initiative or close individual stores. Such costs could adversely affect the Company's results of operations and financial condition. Additionally, a relatively high proportion of the Retail segment's costs are fixed because of depreciation on store construction costs and lease expense. As a result, significant losses would result should the Retail segment experience a decline in sales for any reason.

Certain of the Company's stores have been designed and built to serve as high profile venues that function as vehicles for general corporate marketing, corporate events, and brand awareness. Because of their unique design elements, locations and size, these stores require substantially more investment in equipment and leasehold improvements than the Company's more typical retail stores. The Company has opened four such stores and has one under construction. Because of their location and size, these high profile stores also require the Company to enter into substantially larger operating lease commitments compared to those required for its more typical stores. Current leases on such locations have terms ranging from 10 to 15 years with total commitments per location over the lease terms ranging from $25 million to $50 million. Closure or poor performance of one of these high profile stores could have a particularly significant negative impact on the Company's results of operations and financial condition.

Many of the general risks and uncertainties the Company faces could also have an adverse impact on its Retail segment. Also, many factors unique to retail operations present risks and uncertainties, some of which are beyond the Company's control, that could adversely affect the Retail segment's future results, cause its actual results to differ from those currently expected, and/or have an adverse effect on the Company's consolidated results of operations. Potential risks and uncertainties unique to retail operations that could have an adverse impact on the Retail segment include, among other things, macro-economic factors that have a negative impact on general retail activity; inability to manage costs associated with store construction and operation; lack of consumer acceptance of the Company's retail approach; failure to attract new users to the Macintosh platform; inability to sell third-party hardware and software products at adequate margins; failure to manage relationships with existing retail channel partners; lack of experience in managing retail operations outside the United States; costs associated with unanticipated fluctuations in the value of Apple-branded and third-party retail inventory; and inability to obtain quality retail locations at reasonable cost.

Unit sales of the Company's professionally oriented desktop systems have declined sharply over the past several years negatively impacting net sales and gross margin.

Unit sales of Power Macintosh systems fell 13% during 2003 as compared to 2002 and fell 18% in 2002 from 2001. Power Macintosh unit sales have fallen as a percentage of total Macintosh unit sales from 30% in 2001 to 22% in 2003. The Company believes that weak economic conditions over the past several years are having a pronounced negative impact on its professional and creative customers who are the primary users of such systems. Also, it is likely that many of the Company's current and potential customers, particularly professional and creative customers who are most likely to utilize the Company's Power Macintosh systems, believe that the relatively slower MHz rating or clock speed of the microprocessors it utilizes in its Macintosh systems compares unfavorably to those utilized by other operating systems and translates to slower overall system performance. In addition to the negative impact on net sales, declining sales of Power Macintosh systems also have a negative effect on the Company's overall gross margin because Power Macintosh systems generally have higher individual gross margins than the Company's other Macintosh systems. Continued deterioration in Power Macintosh unit sales could adversely affect the Company's future net sales and gross margin. If future unit sales of Power Macintosh systems fail to

partially or fully recover, it will be difficult for the Company to improve its overall profitability. While the Company has introduced faster Power Macintosh systems utilizing 64-bit PowerPC G5 processors during 2003, there can be no assurance that introduction of such systems will favorably impact net sales either in the short or long term.

The Company faces increasing competition in the U.S. education market.

Sales in the United States to both elementary and secondary schools, as well as for college and university customers, remain a core market for Apple. Net sales in these markets fell to 18% of the Company's total net sales in 2003 from 21% and 26% in 2002 and 2001, respectively. The drop in 2003 reflects declines in both net sales and Macintosh unit sales in these markets of 4% and 6%, respectively, in fiscal 2003 compared to 2002. Additionally, several competitors of the Company have either targeted or announced their intention to target the education market for personal computers, which could also negatively affect the Company's market share. In an effort to regain market share and remain competitive, the Company has been and will continue to pursue 1:1 learning solutions in education. These 1:1 solutions and other strategic sales are generally priced more aggressively and could result in significantly less profitability or even in financial losses, particularly for larger deals. Although the Company believes it has taken certain steps to strengthen its position in the education market, there can be no assurance that the Company will be able to increase or maintain its share of the education market or execute profitably on large strategic arrangements. Failure to do so may have an adverse impact on the Company's operating results and financial condition.

The Company's future operating performance is dependent on the performance of distributors and other resellers of the Company's products.

The Company distributes its products through wholesalers, resellers, national and regional retailers and cataloguers, many of whom distribute products from competing manufacturers. In addition, the Company also sells many of its products and resells certain third-party products in most of its major markets directly to end users, certain education customers, and certain resellers through its online stores around the world. The Company also sells its own products and certain third-party products through its retail stores. Many of the Company's significant resellers operate on narrow product margins and have been negatively affected by current economic conditions. Considerable trade receivables that are not covered by collateral or credit insurance are outstanding with the Company's distribution and retail channel partners. The Company's business and financial results could be adversely affected if the financial condition of these resellers weaken, if resellers within consumer channels were to cease distribution of the Company's products, or if uncertainty regarding demand for the Company's products caused resellers to reduce their ordering and marketing of the Company's products. The Company has invested and will continue to invest in various programs to enhance reseller sales, including staffing selected resellers' stores with Company employees. These programs could require a substantial investment from the Company, while providing no assurance of return or incremental revenue to offset this investment.

Over the past several years, an increasing proportion of the Company's net sales have been made by the Company directly to end-users through its online stores around the world and through its retail stores in the United States. Some of the Company's resellers have perceived this expansion of the Company's direct sales as conflicting with their own business and economic interests as distributors and resellers of the Company's products. Perception of such a conflict could discourage the Company's resellers from investing additional resources in the distribution and sale of the Company's products or lead them to limit or cease distribution of the Company's products. The Company's business and financial results could be adversely affected if expansion of its direct sales to end-users causes some or all of its resellers to cease or limit distribution of the Company's products.

Further information regarding risks associated with Marketing and Distribution may be found in Part I, Item 1 of this Form 10-K under the heading "Markets and Distribution," which information is hereby incorporated by reference.

The Company's business is subject to the risks of international operations.

A large portion of the Company's revenue is derived from its international operations. As a result, the Company's operating results and financial condition could be significantly affected by risks associated with international activities, including economic and labor conditions, political instability, tax laws (including U.S. taxes on foreign subsidiaries), and changes in the value of the U.S. dollar versus the local currency in which the products are sold and goods and services are purchased. The Company's primary exposure to movements in foreign currency exchange rates relate to non-dollar denominated sales in Europe, Japan, Australia, Canada, and certain parts of Asia and non-dollar denominated operating expenses incurred throughout the world. Weaknesses in foreign currencies, particularly the Japanese Yen and the Euro, can adversely impact consumer demand for the Company's products and the U.S. dollar value of the Company's foreign currency denominated sales. Conversely, strengthening in these and other foreign currencies can increase the cost to the Company of product components, negatively affecting the Company's results of operations.

Margins on sales of Apple products in foreign countries, and on sales of products that include components obtained from foreign suppliers, can be adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including tariffs and antidumping penalties.

Derivative instruments, such as foreign exchange forward and option positions, and interest rate swap and option positions have been utilized by the Company to hedge exposures to fluctuations in interest rates and foreign currency exchange rates. The use of such hedging activities may not offset more than a portion of the adverse financial impact resulting from unfavorable movements in either foreign exchange or interest rates.

Further information related to the Company's global market risks may be found in Part II, Item 7A of this Form 10-K under the subheading "Foreign Currency Risk" and may be found in Part II, Item 8 of this Form 10-K at Notes 1 and 2 of Notes to Consolidated Financial Statements, which information is hereby incorporated by reference.

The Company's future performance is dependent upon support from third-party software developers. If third-party software applications cease to be developed or available for the Company's hardware products, then customers may choose not to buy the Company's products.

The Company believes that decisions by customers to purchase the Company's personal computers, as opposed to Windows-based systems, are often based on the availability of third-party software for particular applications such as Microsoft Office. The Company also believes the availability of third-party application software for the Company's hardware products depends in part on third-party developers' perception and analysis of the relative benefits of developing, maintaining, and upgrading such software for the Company's products versus software for the larger Windows market. This analysis is based on factors such as the perceived strength of the Company and its products, the anticipated potential revenue that may be generated, acceptance by customers of Mac OS X, and the costs of developing such software products. To the extent the Company's financial losses in prior years and the minority market share held by the Company in the personal computer market, as well as the Company's decision to end its Mac OS licensing program, have caused software developers to question the Company's prospects in the personal computer market, developers could be less inclined to develop new application software or upgrade existing software for the Company's products and more inclined to devote their resources to developing and upgrading software for the larger Windows market. Moreover, there can be no assurance software developers will continue to develop software for Mac OS X, the Company's operating system, on a timely basis or at all.

In addition, past and future development by the Company of its own software applications and solutions may negatively impact the decision of software developers to develop, maintain, and upgrade similar or competitive software for the Company's products. The Company currently markets and sells a variety of software applications for use by professionals, consumers, and education customers that could influence

the decision of third-party software developers to develop or upgrade Macintosh-compatible software products. Software applications currently marketed by the Company include software for professional film and video editing, professional compositing and visual effects for large format film and video productions, professional music production and music post production, professional and consumer DVD encoding and authoring, consumer digital video and digital photo editing and management, digital music management, desktop-based database management, and high-quality presentations. The Company also markets an integrated productivity application that incorporates word processing, page layout, image manipulation, spreadsheets, databases, and presentations in a single application.

In August 1997, the Company and Microsoft Corporation entered into patent cross license and technology agreements. In addition, for a period of five years through August 2002, and subject to certain limitations related to the number of Macintosh computers sold by the Company, Microsoft was required to make versions of its Microsoft Office and Internet Explorer products for the Mac OS. Although Microsoft has released Microsoft Office and Internet Explorer for Mac OS X, Microsoft is not obligated to produce future versions of its products subsequent to August 2002. While the Company believes its relationship with Microsoft has been and will continue to be beneficial to the Company and to its efforts to increase the installed base for the Mac OS, the Company does compete directly with Microsoft in a number of key areas. Accordingly, Microsoft's interest in producing application software for the Mac OS following expiration of the agreements may be influenced by Microsoft's perception of its interests as the vendor of the Windows operating system. Discontinuance of Microsoft Office and other Microsoft products for the Macintosh platform would have an adverse effect on the Company's net sales and results of operations. In June of 2003, Microsoft stated that it would no longer develop new versions of Internet Explorer for the Mac OS. Microsoft's decision to discontinue development of Internet Explorer for Mac OS X appears to have been influenced in part by the Company's introduction during 2003 of its own web browser, Safari. It is unclear what impact, if any, Microsoft's decision to cease further development of Internet Explorer for Mac OS X will have on the Company. However, if customers chose not to purchase the Company's products because Internet Explorer is not available on the Macintosh platform or should websites fail to provide support for web browsers other than Internet Explorer, the Company's net sales and results of operations could be materially adversely affected.

The Company's business relies on access to patents and intellectual property obtained from third parties, and the Company's future results could be adversely affected if it is alleged or found to have infringed on the intellectual property rights of others.

Many of the Company's products are designed to include intellectual property obtained from third parties. While it may be necessary in the future to seek or renew licenses relating to various aspects of its products and business methods, the Company believes that based upon past experience and industry practice, such licenses generally could be obtained on commercially reasonable terms. However, there can be no assurance that the necessary licenses would be available or available on acceptable terms.

Because of technological changes in the computer industry, current extensive patent coverage, and the rapid rate of issuance of new patents, it is possible certain components of the Company's products and business methods may unknowingly infringe existing patents of others. The Company has from time to time been notified that it may be infringing certain patents or other intellectual property rights of others. Responding to such claims, regardless of their merit, can be time consuming, result in significant expenses, and cause the diversion of management and technical personnel. Several pending claims are in various stages of evaluation. The Company may consider the desirability of entering into licensing agreements in certain of these cases. However, no assurance can be given that such licenses can be obtained on acceptable terms or that litigation will not occur. In the event there is a temporary or permanent injunction entered prohibiting the Company from marketing or selling certain of its products or a successful claim of infringement against the Company requiring it to pay royalties to a third-party, the Company's future operating results and financial condition could be adversely affected. Information regarding claims and litigation involving the Company related to alleged patent infringement and other matters is set forth in

Part I, Item 3 of this Form 10-K. In the opinion of management, the Company does not have a potential liability for damages or royalties from any current legal proceedings or claims related to the infringement of patent or other intellectual property rights of others that would individually or in the aggregate have a material adverse effect on its results of operations, or financial condition. However, the results of such legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of the matters related to infringement of patent or other intellectual property rights of others described in Part I, Item 3 of this Form 10-K or should several of these matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

The Company expects its quarterly revenue and operating results to fluctuate for a variety of reasons.

The Company's profit margins vary among its products and its distribution channels. As a result, the overall profitability of the Company in any given period will depend, in part, on the product, geographic, and channel mix reflected in that period's net sales.

The typical concentration of net sales in the third month of the Company's fiscal quarters can adversely affect the Company's business and operating results.

The Company generally sells more products during the third month of each quarter than it does during either of the first two months, a pattern typical in the personal computer industry. This sales pattern can produce pressure on the Company's internal infrastructure during the third month of a quarter and may adversely impact the Company's ability to predict its financial results accurately. Developments late in a quarter, such as lower-than-anticipated demand for the Company's products, an internal systems failure, or failure of one of the Company's key logistics, components suppliers, or manufacturing partners, can have significant adverse impacts on the Company and its results of operations and financial condition.

The Company's success depends largely on its ability to attract and retain key personnel.

Much of the future success of the Company depends on the continued service and availability of skilled personnel, including its Chief Executive Officer, members of its executive team, and those in technical, marketing and staff positions. Experienced personnel in the information technology industry are in high demand and competition for their talents is intense, especially in the Silicon Valley, where the majority of the Company's employees are located. The Company has relied on its ability to grant stock options as one mechanism for recruiting and retaining this highly skilled talent. Potential accounting regulations requiring the expensing of stock options may impair the Company's future ability to provide these incentives without incurring significant compensation costs. There can be no assurance that the Company will continue to successfully attract and retain key personnel.

The Company is subject to risks associated with the availability and cost of insurance.

The Company has observed rapidly changing conditions in the insurance markets relating to nearly all areas of traditional corporate insurance. Such conditions have resulted in higher premium costs, higher policy deductibles, and lower coverage limits. For some risks, because of cost and/or availability, the Company does not have insurance coverage. For these reasons, the Company is retaining a greater portion of its insurable risks than it has in the past at relatively greater cost.

Business interruptions could adversely affect the Company's future operating results.

The Company's major business operations are subject to interruption by earthquake, fire, power shortages, terrorist attacks and other hostile acts, labor disputes, medical conditions, and other events beyond its control. The majority of the Company's research and development activities, its corporate headquarters, information technology systems, and other critical business operations, including certain component suppliers and manufacturing vendors, are located near major seismic faults. The Company does not carry earthquake insurance for direct quake-related losses. The

Company's operating results and financial

condition could be materially adversely affected in the event of a major earthquake or other natural or manmade disaster.

Failure of the Company's information technology systems and breaches in the security of data could adversely affect the Company's future operating results.

Information technology system failures and breaches of data security could disrupt the Company's ability to function in the normal course of business by potentially causing delays or cancellation of customer orders, impeding the manufacture or shipment of products, or resulting in the unintentional disclosure of customer or Company information. Management has taken steps to address these concerns by its implementation of sophisticated network security and internal control measures. However, there can be no assurance that a system failure or data security breach will not have a material adverse effect on the Company's results of operations.

The Company is exposed to credit risk on its accounts receivables. This risk is heightened as economic conditions worsen.

The Company distributes its products through third-party computer resellers and retailers and directly to certain educational institutions and commercial customers. A substantial majority of the Company's outstanding trade receivables are not covered by collateral or credit insurance. The Company also has non-trade receivables from certain of its manufacturing vendors resulting from the sale by the Company of raw material components to these manufacturing vendors who manufacture sub-assemblies or assemble final products for the Company. While the Company has procedures in place to monitor and limit exposure to credit risk on its trade and non-trade receivables, there can be no assurance that such procedures will be effective in limiting its credit risk and avoiding losses. Additionally, if the global economy and regional economies fail to improve or continue to deteriorate, it becomes more likely that the Company will incur a material loss or losses as a result of the weakening financial condition of one or more of its customers or manufacturing vendors.

The Company is subject to risks associated with environmental regulations.

Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations including, in some instances, the requirement to provide customers the ability to return product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have recently been passed in several jurisdictions in which the Company operates, including various European Union member countries, Japan and California. Although the Company does not anticipate any material adverse effects in the future based on the nature of its operations and the thrust of such laws, there is no assurance that such existing laws or future laws will not have a material adverse effect on the Company's results of operation and financial position.

Changes in accounting rules could adversely affect the Company's future operating results.

Financial statements are prepared in accordance with U.S. generally accepted accounting principles. These principles are subject to interpretation by various governing bodies, including the FASB and the SEC, who interpret and create appropriate accounting regulations. A change from current accounting regulations can have a significant effect on the Company's results of operations and could impact the manner in which the Company conducts business.

Unanticipated changes in the Company's tax rates could affect its future results.

The Company's future effective tax rates could be favorably or unfavorably affected by unanticipated changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of the Company's deferred tax assets and liabilities, or by changes in tax laws or their interpretation. In addition, the Company is subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities. The Company regularly assesses the likelihood of adverse outcomes

resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse effect on its operating results and financial condition.

The Company's stock price may be volatile.

The Company's stock has at times experienced substantial price volatility as a result of variations between its actual and anticipated financial results and as a result of announcements by the Company and its competitors. In addition, the stock market has experienced extreme price and volume fluctuations that have affected the market price of many technology companies in ways that have been unrelated to the operating performance of these companies. These factors, including lack of positive performance in the Company's stock price, as well as general economic and political conditions and investors' concerns regarding the credibility of corporate financial reporting and integrity of financial markets, may materially adversely affect the market price of the Company's stock in the future.

The Company's acquisition activity could disrupt its ongoing business and may present risks not contemplated at the time of the transaction.

The Company has acquired and may continue to acquire companies that have products, services, personnel and technologies that complement the Company's strategic direction and product roadmap. These acquisitions may involve significant risks and uncertainties, including difficulties in incorporating the acquired companies' operations and technologies; distraction of management's attention away from normal business operations; insufficient revenue generation to offset liabilities assumed and expenses associated with acquisition; and unidentified issues not discovered in the Company's due diligence process, including product quality issues and legal contingencies. Acquisitions are inherently risky, and no assurance can be given that the Company's previous or future acquisitions will be successful and will not materially adversely affect business, operating results or financial condition. The Company has generally paid cash for its acquisitions. Should the Company issue its common stock or other equity related purchase rights as consideration in an acquisition, current shareholders' percentage ownership and earnings per share may become diluted.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate and Foreign Currency Risk Management

To ensure the adequacy and effectiveness of the Company's foreign exchange and interest rate hedge positions, as well as to monitor the risks and opportunities of the non-hedge portfolios, the Company regularly reviews its foreign exchange forward and option positions, and its interest rate swap and option positions both on a stand-alone basis and in conjunction with its underlying foreign currency and interest rate related exposures, respectively, from both an accounting and an economic perspective. However, given the effective horizons of the Company's risk management activities and the anticipatory nature of the exposures intended to hedge, there can be no assurance the aforementioned programs will offset more than a portion of the adverse financial impact resulting from unfavorable movements in either foreign exchange or interest rates. In addition, the timing of the accounting for recognition of gains and losses related to mark-to-market instruments for any given period may not coincide with the timing of gains and losses related to the underlying economic exposures and, therefore, may adversely affect the Company's operating results and financial position. The Company adopted SFAS No. 133 as of October 1, 2000. SFAS No. 133 established accounting and reporting standards for derivative instruments, hedging activities, and exposure definition. Management does not believe that ongoing application of SFAS No. 133 will significantly alter the Company's hedging strategies. However, its application may increase the volatility of other income and expense and other comprehensive income.

Interest Rate Risk

While the Company is exposed to interest rate fluctuations in many of the world's leading industrialized countries, the Company's interest income and expense is most sensitive to fluctuations in the general level of U.S. interest rates. In this regard, changes in U.S. interest rates affect the interest earned on the Company's cash, cash equivalents, and short-term investments as well as costs associated with foreign currency hedges.

The Company's fixed income investment policy and strategy is to ensure the preservation of capital, meet liquidity requirements, and optimize return in light of the current credit and interest rate environment. The Company benchmarks its performance by utilizing external money managers to manage a small portion of the aggregate investment portfolio. The external managers adhere to the Company's investment policies and also provide occasional research and market information that supplements internal research used to make credit decisions in the investment process.

During 1994, the Company issued $300 million aggregate principal amount of 6.5% unsecured notes in a public offering registered with the SEC. The notes were sold at 99.925% of par, for an effective yield to maturity of 6.51%. The notes pay interest semiannually and mature on February 15, 2004.

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's investment portfolio and debt obligations and related derivative financial instruments. The Company places its short-term investments in highly liquid securities issued by high credit quality issuers and, by policy, limits the amount of credit exposure to any one issuer. The Company's general policy is to limit the risk of principal loss and ensure the safety of invested funds by limiting market and credit risk. All highly liquid investments with maturities of three months or less are classified as cash equivalents; highly liquid investments with maturities greater than three months are classified as short-term investments. As of September 27, 2003, approximately $629 million of the Company's short-term investments had underlying maturities ranging from 1 and 5 years. As of September 28, 2002, $1.087 billion of the Company's investment portfolio classified as short-term investments had maturities ranging from 1 to 5 years. The remainder all had underlying maturities between 3 and 12 months. Due to liquidity needs, or in anticipation of credit deterioration, or for the purpose of duration management of the Company's investment portfolio, the Company may sell investments prior to their stated maturities. As a result of such activity, the Company recognized net gains of $21 million in 2003 and $7 million in 2002.

In order to provide a meaningful assessment of the interest rate risk associated with the Company's investment portfolio, the Company performed a sensitivity analysis to determine the impact that a change in interest rates would have on the value of the investment portfolio assuming a 100 basis point parallel shift in the yield curve. Based on investment positions as of September 27, 2003, a hypothetical 100 basis point increase in interest rates across all maturities would result in a $12.9 million decline in the fair market value of the portfolio. As of September 28, 2002, a similar 100 basis point shift in the yield curve would have resulted in a $37.7 million decline in fair value. Such losses would only be realized if the Company sold the investments prior to maturity. Except in instances noted above, the Company's policy is to hold investments to maturity.

The Company sometimes enters into interest rate derivative transactions, including interest rate swaps, collars, and floors, with financial institutions in order to better match the Company's floating-rate interest income on its cash equivalents and short-term investments with its fixed-rate interest expense on its debt, and/or to diversify a portion of the Company's exposure away from fluctuations in short-term U.S. interest rates. The Company may also enter into interest rate contracts that are intended to reduce the cost of the interest rate risk management program. The Company entered into no interest rate asset swaps during 2003 or 2002 and had no open interest rate asset swaps at September 27, 2003.

In prior years, the Company had entered into interest rate debt swaps with financial institutions. The interest rate debt swaps, which qualified as accounting hedges, generally required the Company to pay a floating interest rate based on the three- or six-month U.S. dollar LIBOR and receive a fixed rate of interest without exchanges of the underlying notional amounts. These swaps effectively converted the Company's fixed-rate 10-year debt to floating-rate debt and convert a portion of the floating rate investments to fixed rate. Due to prevailing market interest rates, during 2002 the Company entered into and then subsequently closed out debt swap positions realizing a gain of $6 million. During 2001 the Company closed out all of its then existing debt swap positions realizing a gain of $17 million. Both the gains in 2002 and 2001 were deferred, recognized in long-term debt and are being amortized to other income and expense over the remaining life of the debt.

Foreign Currency Risk

Overall, the Company is a net receiver of currencies other than the U.S. dollar and, as such, generally benefits from a weaker dollar and is adversely affected by a stronger dollar relative to major currencies worldwide. Accordingly, changes in exchange rates, and in particular a strengthening of the U.S. dollar, may negatively affect the Company's net sales and gross margins as expressed in U.S. dollars. There is also a risk that the Company will have to adjust local currency product pricing within the time frame of our hedged positions due to competitive pressures when there has been significant volatility in foreign currency exchange rates.

The Company enters into foreign currency forward and option contracts with financial institutions primarily to protect against foreign exchange risks associated with existing assets and liabilities, certain firmly committed transactions, and probable but not firmly committed transactions. Generally, the Company's practice is to hedge a majority of its existing material foreign exchange transaction exposures. However, the Company may not hedge certain foreign exchange transaction exposures due to immateriality, prohibitive economic cost of hedging particular exposures, and limited availability of appropriate hedging instruments. The Company also enters into foreign currency forward and option contracts to offset the foreign exchange gains and losses generated by the re-measurement of certain recorded assets and liabilities denominated in non-functional currencies of its foreign subsidiaries.

In order to provide a meaningful assessment of the foreign currency risk associated with certain of the Company's foreign currency derivative positions, the Company performed a sensitivity analysis using a value-at-risk (VAR) model to assess the potential impact of fluctuations in exchange rates. The VAR model consisted of using a Monte Carlo simulation to generate 3000 random market price paths. The VAR is the maximum expected loss in fair value, for a given confidence interval, to the Company's foreign

exchange portfolio due to adverse movements in rates. The VAR model is not intended to represent actual losses but is used as a risk estimation and management tool. The model assumes normal market conditions. Forecasted transactions, firm commitments, and assets and liabilities denominated in foreign currencies were excluded from the model. Based on the results of the model, the Company estimates with 95% confidence a maximum one-day loss in fair value of $7.5 million as of September 27, 2003 compared to a maximum one-day loss of $3.8 million as of September 28, 2002. Because the Company uses foreign currency instruments for hedging purposes, losses incurred on those instruments are generally offset by increases in the fair value of the underlying exposures.

Actual gains and losses in the future associated with the Company's investment portfolio and derivative positions may differ materially from the sensitivity analyses performed as of September 27, 2003 due to the inherent limitations associated with predicting the changes in the timing and amount of interest rates, foreign currency exchanges rates, and the Company's actual exposures and positions.

Item 8. Financial Statements and Supplementary Data

Index to Consolidated Financial Statements | **Page**

Financial Statements:

All financial statement schedules have been omitted, since the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Consolidated Financial Statements and Notes thereto.

CONSOLIDATED BALANCE SHEETS

(In millions, except share amounts)

	September 27, 2003	September 28, 2002
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 3,396	$ 2,252
Short-term investments	1,170	2,085
Accounts receivable, less allowances of $49 and $51, respectively	766	565
Inventories	56	45
Deferred tax assets	190	166
Other current assets	309	275
Total current assets	5,887	5,388
Property, plant, and equipment, net	669	621
Goodwill	85	85
Acquired intangible assets	24	34
Other assets	150	170
Total assets	$ 6,815	$ 6,298
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	$ 1,154	$ 911
Accrued expenses	899	747
Current debt	304	—
Total current liabilities	2,357	1,658
Long-term debt	—	316
Deferred tax liabilities and other non-current liabilities	235	229
Total liabilities	2,592	2,203
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value; 900,000,000 shares authorized; 366,726,584 and 358,958,989 shares issued and outstanding, respectively	1,926	1,826
Deferred stock compensation	(62)	(7)
Retained earnings	2,394	2,325
Accumulated other comprehensive income (loss)	(35)	(49)
Total shareholders' equity	4,223	4,095
Total liabilities and shareholders' equity	$ 6,815	$ 6,298

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except share and per share amounts)

Three fiscal years ended September 27, 2003	2003	2002	2001
Net sales	$ 6,207	$ 5,742	$ 5,363
Cost of sales	4,499	4,139	4,128
Gross margin	1,708	1,603	1,235
Operating expenses:			
Research and development	471	446	430
Selling, general, and administrative	1,212	1,109	1,138
Restructuring costs	26	30	—
Purchased in-process research and development	—	1	11
Total operating expenses	1,709	1,586	1,579
Operating income (loss)	(1)	17	(344)
Other income and expense:			
Gains (losses) on non-current investments, net	10	(42)	88
Unrealized loss on convertible securities	—	—	(13)
Interest and other income, net	83	112	217
Total other income and expense	93	70	292
Income (loss) before provision for (benefit from) income taxes	92	87	(52)
Provision for (benefit from) income taxes	24	22	(15)
Income (loss) before accounting changes	68	65	(37)
Cumulative effects of accounting changes, net of income taxes	1	—	12
Net income (loss)	$ 69	$ 65	$ (25)
Earnings (loss) per common share before accounting changes:			
Basic	$ 0.19	$ 0.18	$ (0.11)
Diluted	$ 0.19	$ 0.18	$ (0.11)
Earnings (loss) per common share:			
Basic	$ 0.19	$ 0.18	$ (0.07)
Diluted	$ 0.19	$ 0.18	$ (0.07)
Shares used in computing earnings (loss) per share (in thousands):			
Basic	360,631	355,022	345,613
Diluted	363,466	361,785	345,613

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In millions, except share amounts which are in thousands)

	Preferred Stock		Common Stock				
	Shares	Amount	Shares	Amount	Retained Earnings	Deferred Stock Compensation	Accumulated Other Comprehensive Income (Loss)
Balances as of September 30, 2000	76	$ 76	335,677	$ 1,502	$ 2,285	$ —	$ 24
Components of comprehensive loss:							
Net loss	—	—	—	—	(25)	—	—
Change in foreign currency translation	—	—	—	—	—	—	(3
Change in unrealized gain on available-for-sale securities, net of tax	—	—	—	—	—	—	(26
Change in unrealized gain on derivative investments, net of tax	—	—	—	—	—	—	[illegible]
Total comprehensive loss							
Issuance of common stock and assumption of stock options in connection with acquisition	—	—	2,403	66	—	(13)	—
Amortization of deferred stock compensation	—	—	—	—	—	2	—
Common stock issued under stock plans	—	—	3,660	42	—	—	—
Conversion of Series A preferred stock	(76)	(76)	9,182	76	—	—	—
Tax benefit related to stock options	—	—	—	7	—	—	—
Balances as of September 29, 2001	—	$ —	350,922	$ 1,693	$ 2,260	$ (11)	$ (2
Components of comprehensive income:							
Net income	—	—	—	—	65	—	—
Change in foreign currency translation	—	—	—	—	—	—	[illegible]
Change in unrealized gain on available-for-sale securities, net of tax	—	—	—	—	—	—	(1
Change in unrealized gain on derivative investments, net of tax	—	—	—	—	—	—	(1
Total comprehensive income							
Amortization of deferred stock compensation	—	—	—	—	—	4	—
Common stock issued under stock plans	—	—	8,037	105	—	—	—
Tax benefit related to stock options	—	—	—	28	—	—	—
Balances as of September 28, 2002	—	$ —	358,959	$ 1,826	$ 2,325	$ (7)	$ (4
Components of comprehensive income:							
Net income	—	—	—	—	69	—	—
Change in foreign currency translation	—	—	—	—	—	—	31
Change in unrealized gain on available-for-sale securities, net of tax	—	—	—	—	—	—	(1
Change in unrealized gain on derivative investments, net of tax	—	—	—	—	—	—	(
Total comprehensive income							
Amortization of deferred stock compensation	—	—	—	—	—	15	—
Write-off of deferred stock compensation	—	—	—	—	—	5	—
Common stock issued under stock plans	—	—	9,299	128	—	(75)	—
Settlement of forward purchase agreement	—	—	(1,531)	(35)	—	—	—
Tax benefit related to stock options	—	—	—	7	—	—	—
Balances as of September 27, 2003	—	$ —	366,727	$ 1,926	$ 2,394	$ (62)	$ (3

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

Three fiscal years ended September 27, 2003	2003	2002	2001

Cash and cash equivalents, beginning of the year	$ 2,252	$ 2,310	$ 1,191
Operating Activities:			
Net income (loss)	69	65	(25)
Cumulative effects of accounting changes, net of taxes	(1)	—	(12)
Adjustments to reconcile net income (loss) to cash generated by operating activities:			
Depreciation, amortization and accretion	113	114	100
Stock based compensation expense	16	5	2
Non-cash restructuring	12	8	—
Benefit from deferred income taxes	(11)	(34)	(36)
Loss on disposition of property, plant, and equipment	2	7	9
Gains on sales of short-term investments, net	(21)	(7)	—
(Gains) losses on sales of non-current investments, net	(10)	42	(88)
Gain on forward purchase agreement	(6)	—	—
Unrealized loss on convertible securities	—	—	13
Purchased in-process research and development	—	1	11
Changes in operating assets and liabilities:			
Accounts receivable	(201)	(99)	487
Inventories	(11)	(34)	22
Other current assets	(34)	(114)	106
Other assets	(30)	(11)	12
Accounts payable	243	110	(356)
Other liabilities	159	36	(60)
Cash generated by operating activities	289	89	185
Investing Activities:			
Purchases of short-term investments	(2,648)	(4,144)	(4,268)
Proceeds from maturities of short-term investments	2,446	2,846	4,811
Proceeds from sales of short-term investments	1,116	1,254	278
Proceeds from sales of non-current investments	45	25	340
Purchases of property, plant, and equipment	(164)	(174)	(232)
Cash used for business acquisitions	—	(52)	(19)
Other	33	(7)	(18)
Cash generated by (used for) investing activities	828	(252)	892
Financing Activities:			
Proceeds from issuance of common stock	53	105	42
Cash used for repurchase of common stock	(26)	—	—
Cash generated by financing activities	27	105	42
Increase (decrease) in cash and cash equivalents	1,144	(58)	1,119
Cash and cash equivalents, end of the year	$ 3,396	$ 2,252	$ 2,310
Supplemental cash flow disclosures:			
Cash paid during the year for interest	$ 20	$ 20	$ 20
Cash paid for income taxes, net	$ 45	$ 11	$ 42
Noncash transactions:			
Issuance of common stock for conversion of Series A preferred stock	$ —	$ —	$ 76
Issuance of common stock in connection with acquisition	$ —	$ —	$ 66

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1—Summary of Significant Accounting Policies

Apple Computer, Inc. and its subsidiaries (the Company) designs, manufactures and markets personal computers and related software, peripherals and personal computing and communicating solutions. The Company's products include the Macintosh line of desktop and notebook computers, the Mac OS X operating system, the iPod digital music player, and a portfolio of software products and peripherals for education, creative, consumer and business customers. The Company sells its products through its online stores, direct sales force, third-party wholesalers and resellers, and its own retail stores.

Basis of Presentation and Preparation

The accompanying consolidated financial statements include the accounts of the Company. Intercompany accounts and transactions have been eliminated. The preparation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in these consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates. Certain prior year amounts in the consolidated financial statements and notes thereto have been reclassified to conform to the current year presentation.

Typically, the Company's fiscal year ends on the last Saturday of September. Fiscal years 2003, 2002 and 2001 were each 52-week years. However, approximately every six years, the Company reports a 53-week fiscal year to align its fiscal quarters with calendar quarters by adding a week to its first fiscal quarter. All information presented herein is based on the Company's fiscal calendar.

Financial Instruments

Cash Equivalents and Short-term Investments

The Company places its short-term investments in highly liquid securities issued by high credit quality issuers. All highly liquid investments with maturities of three months or less at the date of purchase are classified as cash equivalents; highly liquid investments with maturities greater than three months are classified as short-term investments. Management determines the appropriate classification of its investments in debt and marketable equity securities at the time of purchase and reevaluates such designation as of each balance sheet date. The Company's debt and marketable equity securities have been classified and accounted for as available-for-sale. These securities are carried at fair value, with the unrealized gains and losses, net of taxes, reported as a component of shareholders' equity. The cost of securities sold is based upon the specific identification method.

Non-Current Debt and Equity Investments

The Company has made investments in non-current debt and equity investments of public and privately held companies that have been reflected in the consolidated balance sheets as long-term assets within other assets. They are not categorized as current assets either because, given their nature, they are not readily convertible into cash or because they represent potentially longer-term investments by the Company. Further, the fair value of these investments has been subject to a high degree of volatility. The Company's non-current debt and equity investments have been categorized as available-for-sale requiring that they be carried at fair value with unrealized gains and losses, net of taxes, reported in equity as a component of accumulated other comprehensive income. However, the Company recognizes an impairment charge to earnings in the event a decline in fair value below the cost basis of one of these investments is determined to be other-than-temporary. The Company includes recognized gains and losses resulting from the sale or from other-than-temporary declines in fair value associated with these investments in other income and expense. Occasionally, the Company uses short-term equity derivatives to

manage potential dispositions of non-current debt and equity investments. Any gains or losses associated with such derivatives are recognized currently in other income and expense.

Financial Instruments with Characteristics of Both Liabilities and Equity

On May 15, 2003, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*. SFAS No. 150 requires issuers to classify as liabilities (or assets in some circumstances) certain freestanding financial instruments that embody obligations for the issuer and have characteristics of both liabilities and equity. The Company adopted the provisions of SFAS No. 150 on June 29, 2003, which resulted in a favorable cumulative-effect type adjustment of approximately $3 million. This adjustment related to a forward purchase agreement that allowed the Company to acquire 1.5 million shares of its common stock at an average price of $16.64 per share for a total cost of $25.5 million. The Company settled this forward purchase agreement in August 2003, which resulted in an additional gain of approximately $6 million representing the increase in fair value of the agreement from June 29, 2003 through the settlement date.

Derivative Financial Instruments

On October 1, 2000, the Company adopted SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. SFAS No. 133 establishes accounting and reporting standards for derivative instruments, hedging activities, and exposure definition. SFAS No. 133 requires that all derivatives be recognized as either assets or liabilities at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in fair value will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings. Net of the related income tax effect of approximately $5 million, adoption of SFAS No. 133 resulted in a favorable cumulative-effect type adjustment to net income of approximately $12 million. Net of the related income tax effect of approximately $5 million, adoption of SFAS No. 133 resulted in a favorable cumulative-effect-type adjustment to other comprehensive income of approximately $12 million, all of which was reclassified to earnings during 2001. Management does not believe that ongoing application of SFAS No. 133 will significantly alter the Company's hedging strategies. However, its application may increase the volatility of other income and expense and other comprehensive income.

For derivative instruments that hedge the exposure to variability in expected future cash flows that are attributable to a particular risk and that are designated as cash flow hedges, the net gain or loss on the derivative instrument is reported as a component of other comprehensive income in shareholders' equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. To receive hedge accounting treatment, cash flow hedges must be highly effective in achieving offsetting changes to expected future cash flows on hedged transactions. For derivative instruments that hedge the exposure to changes in the fair value of an asset or a liability or an identified portion thereof that are attributable to a particular risk and that are designated as fair value hedges, the net gain or loss on the derivative instrument as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in earnings in the current period. The net gain or loss on the effective portion of a derivative instrument that is designated as an economic hedge of the foreign currency translation exposure of the net investment in a foreign operation is reported in the same manner as a foreign currency translation adjustment. For forward contracts designated as net investment hedges, the Company excludes changes in fair value relating to changes in the forward carry component from its definition of effectiveness. Accordingly, any gains or losses related to this component are recognized in current

earnings. For derivative instruments not designated as hedging instruments, changes in fair value are recognized in earnings in the current period.

For foreign currency forward contracts designated as cash flow hedges, hedge effectiveness is measured based on changes in the fair value of the contract attributable to changes in the forward exchange rate. Changes in the expected future cash flows on the forecasted hedged transaction and changes in the fair value of the forward hedge are both measured from the contract rate to the forward exchange rate associated with the forward contract's maturity date. For currency option contracts, hedge effectiveness is measured based on changes in the total fair value of the option contract. Hedge effectiveness is assessed by comparing the present value of the cumulative change in expected future cash flows on the hedged transaction to changes in expected cash flow of the option hedge at maturity. The net gains or losses on derivative instruments qualifying as cash flow hedges are reported as components of other comprehensive income in shareholders' equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Any hedge ineffectiveness is recognized in current earnings in other income and expense. For interest rate swap agreements qualifying as fair value hedges, the Company assumes no ineffectiveness because these swaps meet the criteria for accounting under the short-cut method defined in SFAS No. 133.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market. If the cost of the inventories exceeds their market value, provisions are made currently for the difference between the cost and the market value.

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. Depreciation is computed by use of the declining balance and straight-line methods over the estimated useful lives of the assets, which are 30 years for buildings, from 2 to 5 years for equipment, and the shorter of lease terms or 10 years for leasehold improvements. The Company capitalizes eligible costs to acquire or develop internal-use software that are incurred subsequent to the preliminary project stage. Capitalized costs related to internal-use software are amortized using the straight-line method over the estimated useful lives of the assets, which range from 3 to 5 years.

Asset Retirement Obligations

On September 29, 2002, the Company adopted SFAS No. 143, *Accounting for Asset Retirement Obligations*, which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The standard applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the assets. SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset and this additional carrying amount is depreciated over the life of the asset. All of the Company's existing asset retirement obligations are associated with commitments to return property subject to operating leases to original condition upon lease termination. The Company estimated that as of September 29, 2002, gross expected future cash flows of $9.5 million would be required to fulfill these obligations.

As of the date of adoption, the Company recorded a $6 million long-term asset retirement liability and a corresponding increase in leasehold improvements. This amount represents the present value of expected future cash flows associated with returning certain of the Company's leased properties to original condition. The difference between the gross expected future cash flow of $9.5 million and its present value of $6 million at

September 29, 2002, is being accreted over the life of the related leases as an operating expense. Net of the related income tax effect of approximately $1 million, adoption of SFAS No. 143 resulted in an unfavorable cumulative-effect type adjustment to net income during the first quarter of 2003 of approximately $2 million. This adjustment represents cumulative depreciation and accretion that would have been recognized through the date of adoption of SFAS No. 143 had the statement been applied to the Company's existing asset retirement obligations at the time they were initially incurred.

The following table reconciles changes in the Company's asset retirement liability for fiscal 2003 (in millions):

Asset retirement liability recorded at September 29, 2002	$ 5.5
Additional asset retirement obligations recognized	0.5
Accretion recognized	1.2
Asset retirement liability as of September 27, 2003	$ 7.2

Long-Lived Assets Including Goodwill and Other Acquired Intangible Assets

The Company reviews property, plant, and equipment and certain identifiable intangibles, excluding goodwill, for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of these assets is measured by comparison of its carrying amount to future undiscounted cash flows the assets are expected to generate. If property, plant, and equipment and certain identifiable intangibles are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the assets exceeds its fair market value. For the three years ended September 27, 2003, the Company has made no material adjustments to its long-lived assets, except those made in connection with the restructuring actions described in Note 5.

The Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets*, in the first quarter of fiscal 2002. SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually or sooner whenever events or changes in circumstances indicate that they may be impaired. Prior to fiscal 2002, goodwill was amortized using the straight-line method over its estimated useful life. The Company completed its transitional goodwill impairment test as of October 1, 2001, and its annual goodwill impairment tests at August 30, 2003 and August 30, 2002, respectively, and found no impairment. The Company established reporting units based on its current reporting structure. For purposes of testing goodwill for impairment, goodwill has been allocated to these reporting units to the extent it relates to each reporting unit.

SFAS No. 142 also requires that intangible assets with definite lives be amortized over their estimated useful lives and reviewed for impairment in accordance with SFAS No. 144, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of.* The Company is currently amortizing its acquired intangible assets with definite lives over periods ranging from 3 to 10 years.

Foreign Currency Translation

The Company translates the assets and liabilities of its international non-U.S. functional currency subsidiaries into U.S. dollars using exchange rates in effect at the end of each period. Revenue and

expenses for these subsidiaries are translated using rates that approximate those in effect during the period. Gains and losses from these translations are credited or charged to foreign currency translation included in "accumulated other comprehensive income (loss)" in shareholders' equity. The Company's foreign manufacturing subsidiaries and certain other international subsidiaries that use the U.S. dollar as their functional currency remeasure monetary assets and liabilities at exchange rates in effect at the end of each period, and inventories, property, and nonmonetary assets and liabilities at historical rates. Gains and losses from these translations were insignificant and have been included in the Company's results of operations.

Revenue Recognition

Net sales consist primarily of revenue from the sale of products (hardware, software, and peripherals), and extended warranty and support contracts. The Company recognizes revenue pursuant to applicable accounting standards, including Statement of Position (SOP) No. 97-2, *Software Revenue Recognition*, as amended, and Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements*.

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection is probable. Product is considered delivered to the customer once it has been shipped and title and risk of loss have been transferred. For most of the Company's product sales, these criteria are met at the time the product is shipped. For online sales to individuals, for some sales to education customers in the United States, and for certain other sales, the Company defers revenue until the customer receives the product because the Company legally retains a portion of the risk of loss on these sales during transit. If at the outset of an arrangement the Company determines the arrangement fee is not, or is presumed to not be, fixed and determinable, revenue is deferred and subsequently recognized as amounts become due and payable.

Revenue from extended warranty and support contracts is deferred and recognized ratably over the warranty and support periods. These contracts typically include extended phone support, certain repairs, web-based support resources, diagnostic tools, and extend the Company's one-year basic limited parts and labor warranty.

The Company sells software and peripheral products obtained from other companies. The Company establishes its own pricing and retains related inventory risk, is the primary obligor in sales transactions with its customers, and assumes the credit risk for amounts billed to its customers. Accordingly, the Company recognizes revenue for the sale of products obtained from other companies at the gross amount billed.

Revenue on arrangements that include multiple elements such as hardware, software, and services is allocated to each element based on vendor specific objective evidence (VSOE) of the fair value of each element. Allocated revenue for each element is recognized when revenue recognition criteria have been met for each element. VSOE is determined based on the price charged when each element is sold separately.

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end user rebates, and other sales programs and volume-based incentives. The estimated cost of these programs is accrued as a reduction to revenue in the period the Company has sold the product and committed to a plan. The Company also records reductions to revenue for expected future product returns based on the Company's historical experience.

Generally, the Company does not offer specified or unspecified upgrade rights to its customers in connection with software sales or the sale of extended warranty and support contracts. However, a limited number of the Company's software products are available with maintenance agreements that grant customers rights to unspecified future upgrades over the maintenance term on a when and if available basis. Revenue associated with such maintenance is recognized ratably over the maintenance term.

Shipping Costs

The Company's shipping and handling costs are included in cost of sales for all periods presented.

Warranty Expense

The Company provides currently for the estimated cost for product warranties at the time the related revenue is recognized.

Research and Development

Research and development costs are expensed as incurred. Development costs of computer software to be sold, leased or otherwise marketed are subject to capitalization beginning when a product's technological feasibility has been established and ending when a product is available for general release to customers pursuant to SFAS No. 86, *Computer Software to be Sold, Leased, or Otherwise Marketed.* In most instances, the Company's products are released soon after technological feasibility has been established. Therefore, costs incurred subsequent to achievement of technological feasibility are usually not significant, and generally all software development costs have been expensed.

During the third and fourth quarters of 2003, the Company incurred substantial development costs associated with the development of Mac OS X version 10.3 (code-named "Panther"), which enhances the features and functionality of the previous version of Mac OS X, subsequent to achievement of technological feasibility as evidenced by public demonstration and release of a developer beta in June 2003, and prior to release of the final version of the product in the first quarter of 2004. Therefore, during 2003 the Company capitalized approximately $14.7 million of development costs associated with the development of Panther. Amortization of this asset began in the first quarter of 2004 when Panther was shipped and is being recognized on a straight-line basis in accordance with SFAS No. 86 over a 3 year estimated useful life.

During the third and fourth quarters of 2002, the Company incurred substantial development costs associated with the development of Mac OS X version 10.2 (code-named "Jaguar") subsequent to achievement of technological feasibility as evidenced by public demonstration and release of a developer beta in May 2002, and prior to release of the final version of the product in the fourth quarter of 2002. As such, the Company capitalized approximately $13.3 million of development costs associated with development of Jaguar. Amortization of this asset began in the fourth quarter of 2002 when Jaguar was shipped and is being recognized on a straight-line basis in accordance with SFAS No. 86 over a 3 year estimated useful life. In addition, during 2002, the Company also began capitalizing certain costs related to development of its new PowerSchool enterprise student information system. Capitalization of approximately $6 million began upon achievement of technological feasibility in the first quarter of 2002. The final version of the enterprise student information system was released in July 2002.

During 2001 the Company incurred substantial development costs associated with the development of the original version of Mac OS X, subsequent to release of a public beta version of the product and prior to release of the final product version. As a result, the Company capitalized approximately $5.4 million of development costs during 2001 associated with development of Mac OS X. Related amortization is computed by use of the straight-line method in accordance with SFAS No. 86 over a 8 year estimated useful life.

Total amortization related to capitalized software development costs was $5.8 million, $1.2 million and $350,000 in 2003, 2002 and 2001, respectively.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expense was $193 million, $209 million, and $261 million for 2003, 2002, and 2001, respectively.

Restructuring Charges

In June 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 supersedes Emerging Issues Task Force (EITF) Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs To Exit an Activity (Including Certain Costs Associated with a Restructuring)* and requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, as opposed to when management commits to an exit plan. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. This Statement was effective for exit or disposal activities initiated after December 31, 2002. The provisions of SFAS No. 146 were required to be applied prospectively after the adoption date to newly initiated exit activities.

Stock-Based Compensation

The Company measures compensation expense for its employee stock-based compensation plans using the intrinsic value method prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees.* The Company applies the disclosure provisions of SFAS No. 123, *Accounting for Stock-based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-based Compensation—Transition and Disclosure* as if the fair value-based method had been applied in measuring compensation expense. The Company has elected to follow APB Opinion No. 25 because, as discussed below, the alternative fair value accounting provided for under SFAS No. 123 requires use of option valuation models that were not developed for use in valuing employee stock options and employee stock purchase plan shares. Under APB Opinion No. 25, when the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of the grant, no compensation expense is recognized.

As required under SFAS No. 123, the pro forma effects of stock-based compensation on net income and earnings per common share for employee stock options granted and employee stock purchase plan purchases have been estimated at the date of grant and beginning of the period, respectively, using a Black-Scholes option pricing model. For purposes of pro forma disclosures, the estimated fair value of the options and shares is amortized to pro forma net income over the options' vesting period and the shares' plan period.

The Black-Scholes option valuation model was developed for use in estimating the fair value of freely traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected life of options and the Company's expected stock price volatility. Because the Company's employee stock options and employee stock purchase plan shares have characteristics significantly different from those of freely traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in

management's opinion, the existing models do not provide a reliable measure of the fair value of the Company's employee stock options and employee stock purchase plan shares.

For purposes of pro forma disclosures, the estimated fair value of the options and shares is amortized to pro forma net income (loss) over the options' vesting period and the shares' plan period. The Company's pro forma information for each of the last three fiscal years follows (in millions, except per share amounts):

	2003	2002	2001
Net income (loss)—as reported	$ 69	$ 65	$ (25)
Add: Stock-based employee compensation expense included in reported net income (loss), net of tax	15	5	2
Deduct: Stock-based employee compensation expense determined under the fair value based method for all awards, net of tax	(181)	(234)	(373)
Net loss—pro forma	$ (97)	$ (164)	$ (396)
Net income (loss) per common share—as reported			
Basic	$ 0.19	$ 0.18	$ (0.07)

Diluted	$ 0.19	$ 0.18	$ (0.07)
Net loss per common share—pro forma			
Basic	$ (0.27)	$ (0.46)	$ (1.15)
Diluted	$ (0.27)	$ (0.46)	$ (1.15)

Earnings Per Common Share

Basic earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the dilutive potential shares of common stock had been issued. The dilutive effect of outstanding options and restricted stock is reflected in diluted earnings per share by application of the treasury stock method. Dilutive potential shares of common stock related to stock options were excluded from the calculation of diluted loss per common share for fiscal 2001 because their effect would have been antidilutive.

The following table sets forth the computation of basic and diluted earnings per share:

For the Years Ended	September 27, 2003	September 28, 2002	September 29, 2001
Numerator (in millions):			
Income (loss) before accounting changes	$ 68	$ 65	$ (37)
Cumulative effects of accounting changes, net of income taxes	$ 1	$ —	$ 12
Net income (loss)	$ 69	$ 65	$ (25)
Denominator (in thousands):			
Weighted-average shares outstanding	360,631	355,022	345,613
Effect of dilutive options and dilutive restricted stock	2,835	6,763	—
Denominator for diluted earnings (loss) per share	363,466	361,785	345,613
Basic earnings (loss) per share before accounting changes	$ 0.19	$ 0.18	$ (0.11)
Cumulative effects of accounting changes, net of tax	—	—	$ 0.04
Basic earnings (loss) per share after accounting changes	$ 0.19	$ 0.18	$ (0.07)
Diluted earnings (loss) per share before accounting changes	$ 0.19	$ 0.18	$ (0.11)
Cumulative effects of accounting changes, net of tax	—	—	$ 0.04
Diluted earnings (loss) per share after accounting changes	$ 0.19	$ 0.18	$ (0.07)

Options to purchase 50.8 million and 58.0 million shares of common stock were outstanding at the end of 2003 and 2002, respectively, that were not included in the computation of diluted earnings per share for that year because the options' exercise price was greater than the average market price of the Company's common shares for that year and, therefore, the effect would be antidilutive. At September 29, 2001, the Company had options to purchase 97.2 million shares of its common stock outstanding, all of which were excluded from the computation of diluted loss per share for 2001 because the effect would have been antidilutive.

Comprehensive Income

Comprehensive income consists of two components, net income and other comprehensive income. Other comprehensive income refers to revenue, expenses, gains and losses that under generally accepted accounting principles are recorded as an element of shareholders' equity but are excluded from net income. The Company's other comprehensive income is comprised of foreign currency translation adjustments from those subsidiaries not using the U.S. dollar as their functional currency, unrealized gains and losses on marketable securities categorized as available-for-sale, and net deferred gains and losses on certain derivative instruments accounted for as cash flow hedges.

Segment Information

The Company reports segment information based on the "management" approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of the Company's reportable segments. Information about the Company's products, major customers, and geographic areas on a company-wide basis is also disclosed.

Note 2—Financial Instruments

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximate their fair value due to the short maturities of those instruments.

Cash, Cash Equivalents and Short-Term Investments

The following table summarizes the fair value of the Company's cash and available-for-sale securities held in its short-term investment portfolio, recorded as cash and cash equivalents or short-term investments as of September 27, 2003, and September 28, 2002 (in millions):

	September 27, 2003	September 28, 2002
Cash	$ 158	$ 161
U.S. Treasury and Agency securities	87	47
U.S. corporate securities	2,368	1,828
Foreign securities	783	216
Total cash equivalents	3,238	2,091
U.S. Treasury and Agency securities	454	674
U.S. corporate securities	623	1,330
Foreign securities	93	81
Total short-term investments	1,170	2,085
Total cash, cash equivalents, and short-term investments	$ 4,566	$ 4,337

The Company's short-term investment portfolio consists of investments in U.S. Treasury and Agency securities, U.S. corporate securities, and foreign securities. The Company's U.S. corporate securities consist primarily of commercial paper, certificates of deposit, time deposits and corporate debt securities. Foreign securities consist primarily of foreign commercial paper, certificates of deposit and time deposits with foreign institutions, most of which are denominated in U.S. dollars. The Company had net unrealized losses totaling $1 million on its investment portfolio, primarily related to investments with stated maturities greater than 1 year as of September 27, 2003 and net unrealized gains of $20 million on its investment portfolio, primarily related to investments with stated maturities greater than 1 year, as of September 28, 2002. The Company occasionally sells short-term investments prior to their stated maturities. As a result of such sales, the Company recognized net gains of $21 million in 2003 and $7 million in 2002. These net gains were included in interest and other income, net.

As of September 27, 2003, approximately $629 million of the Company's short-term investments had underlying maturities ranging from 1 to 5 years. The remaining short-term investments as of September 27, 2003 had maturities of 3 to 12 months. As of September 28, 2002, approximately $1.087 billion of the Company's short-term investments had underlying maturities ranging from 1 to 5 years. The remaining short-term investments as of September 28, 2002 had maturities of 3 to 12 months.

Accounts Receivable

Trade Receivables

The Company distributes its products through third-party resellers and directly to certain education, consumer, and commercial customers. The Company generally does not require collateral from its customers. However, when possible the Company does attempt to limit credit risk on trade receivables with credit insurance for certain customers in Latin America, Europe and Asia and by arranging with third-

party financing companies to provide flooring arrangements and other loan and lease programs to the Company's direct customers. These credit financing arrangements are directly between the third-party financing company and the end customer. As such, the Company does not assume any recourse or credit risk sharing related to any of these arrangements. However, considerable trade receivables that are not covered by collateral, third-party flooring arrangements, or credit insurance are outstanding with the Company's distribution and retail channel partners. Trade receivables from a single customer, Ingram Micro, Inc., accounted for approximately 10.3% and 10.8% of net accounts receivable as of September 27, 2003, and September 28, 2002, respectively.

The following table summarizes the activity in the allowance for doubtful accounts (in millions):

	2003	2002	2001
Beginning allowance balance	$ 51	$ 51	$ 64
Charged to costs and expenses	4	10	7
Deductions (a)	(6)	(10)	(20)
Ending allowance balance	$ 49	$ 51	$ 51

(a) Represents amounts written off against the allowance, net of recoveries.

Non-Trade Receivables

The Company has non-trade receivables from certain of its manufacturing vendors resulting from the sale of raw material components to these manufacturing vendors who manufacture sub-assemblies or assemble final products for the Company. The Company purchases these raw material components directly from suppliers. These non-trade receivables, which are included in the consolidated balance sheets in other current assets, totaled $184 million and $142 million as of September 27, 2003, and September 28, 2002, respectively. The Company does not recognize any profits on these sales or reflect the sale of these components in its net sales.

Inventory Prepayment

In April 2002, the Company made a $100 million prepayment to an Asian supplier for the purchase of components over the following nine months. In return for this deposit, the supplier agreed to supply the Company with a specified level of components during the three consecutive fiscal quarters ended December 28, 2002. Approximately $53 million of this deposit remained unused as of September 28, 2002 and was reflected in the consolidated balance sheets in other current assets. During the first six months of 2003, the remainder of the deposit balance was fully utilized for the purchase of components. The deposit was unsecured and had no stated interest component. The Company imputed an amount to cost of sales and interest income during each period the deposit was outstanding at a 3.25% interest rate to reflect the economics of this transaction.

Derivative Financial Instruments

The Company uses derivatives to partially offset its business exposure to foreign exchange and interest rate risk. Foreign currency forward and option contracts are used to offset the foreign exchange risk on certain existing assets and liabilities and to hedge the foreign exchange risk on expected future cash flows on certain forecasted revenues and cost of sales. From time to time, the Company enters into interest rate swap agreements to modify the interest rate profile of certain investments and debt. The Company's

accounting policies for these instruments are based on whether the instruments are designated as hedge or non-hedge instruments. The Company records all derivatives on the balance sheet at fair value.

The following table shows the notional principal, net fair value, and credit risk amounts of the Company's foreign currency instruments as of September 27, 2003 and September 28, 2002 (in millions):

	September 27, 2003			September 28, 2002		
	Notional Principal	Fair Value	Credit Risk Amounts	Notional Principal	Fair Value	Credit Risk Amounts
Foreign exchange instruments qualifying as accounting hedges:						
Spot/Forward contracts	$ 464	$ (21)	$ —	$ 462	$ 1	$ 1
Purchased options	$ 512	$ 3	$ 3	$ 196	$ —	$ —
Sold options	$ 645	$ (8)	$ —	$ 392	$ (4)	$ —

Foreign exchange instruments other than accounting

hedges:						
Spot/Forward contracts	$ 445	$ 3	$ 3	$ 302	$ —	$ —
Purchased options	$ 8	$ —	$ —	$ —	$ —	$ —
Sold options	$ 5	$ —	$ —	$ —	$ —	$ —

The notional principal amounts for derivative instruments provide one measure of the transaction volume outstanding as of year-end, and do not represent the amount of the Company's exposure to credit or market loss. The credit risk amount shown in the table above represents the Company's gross exposure to potential accounting loss on these transactions if all counterparties failed to perform according to the terms of the contract, based on then-current currency exchange rates at each respective date. The Company's exposure to credit loss and market risk will vary over time as a function of currency exchange rates.

The estimates of fair value are based on applicable and commonly used pricing models using prevailing financial market information as of September 27, 2003 and September 28, 2002. In certain instances where judgment is required in estimating fair value, price quotes were obtained from several of the Company's counterparty financial institutions. Although the table above reflects the notional principal, fair value, and credit risk amounts of the Company's foreign exchange instruments, it does not reflect the gains or losses associated with the exposures and transactions that the foreign exchange instruments are intended to hedge. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

Foreign Exchange Risk Management

The Company enters into foreign currency forward and option contracts with financial institutions primarily to protect against foreign exchange risk associated with existing assets and liabilities, certain firmly committed transactions and certain probable but not firmly committed transactions. Generally, the Company's practice is to hedge a majority of its existing material foreign exchange transaction exposures. However, the Company may not hedge certain foreign exchange transaction exposures due to immateriality, prohibitive economic cost of hedging particular exposures, or limited availability of appropriate hedging instruments.

In accordance with SFAS No. 133, hedges related to probable but not firmly committed transactions of an anticipatory nature are designated and documented at hedge inception as cash flow hedges and evaluated for hedge effectiveness quarterly. For currency forward contracts, hedge effectiveness is measured based on changes in the total fair value of the contract attributable to changes in the forward exchange rate. Changes in the expected future cash flows on the forecasted hedged transaction and changes in the fair value of the forward hedge are both measured from the contract rate to the forward exchange rate associated with the forward contract's maturity date.

For currency option contracts, hedge effectiveness is measured based on changes in the total fair value of the option contract. Hedge effectiveness is assessed by comparing the present value of the cumulative change in expected future cash flows on the hedged transaction to changes in expected cash flow of the option hedge at maturity. The net gains or losses on derivative instruments qualifying as cash flow hedges are reported as components of other comprehensive income in shareholders' equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Any hedge ineffectiveness is recognized in current earnings in other income and expense.

To protect gross margins from fluctuations in foreign currency exchange rates, the Company's U.S. dollar functional subsidiaries hedge a portion of forecasted foreign currency revenues, and the Company's non-U.S. dollar functional subsidiaries selling in local currencies hedge a portion of forecasted inventory purchases not denominated in the subsidiaries' functional currency. Other comprehensive income associated with hedges of foreign currency revenues is recognized as a component of net sales in the same period as the related sales are recognized, and other comprehensive income related to inventory purchases is recognized as a component of cost of sales in the same period as the related costs are recognized. Typically, the Company hedges portions of its forecasted foreign currency exposure associated with revenues and inventory purchases over a time horizon of 3 to 9 months.

The Company also enters into foreign currency forward and option contracts to offset the foreign exchange gains and losses generated by the re-measurement of certain recorded assets and liabilities in non-functional currencies. Changes in the fair value of these derivatives are recognized in current earnings in other income and expense as offsets to the changes in the fair value of the related assets or liabilities.

The Company may enter into foreign currency forward contracts to offset the translation and economic exposure of a net investment position in a foreign subsidiary. Hedge effectiveness on forwards designated as net investment hedges is measured based on changes in the fair value of the contract attributable to changes in the spot exchange rate. The effective portion of the net gain or loss on a derivative instrument designated as a hedge of the net investment position in a foreign subsidiary is reported in the same manner as a foreign currency translation adjustment. Any residual changes in fair value of the forward contract, including changes in fair value based on the differential between the spot and forward exchange rates, are recognized in current earnings in other income and expense.

As discussed above, the Company enters into foreign currency option contracts as items that provide an offset to the re-measurement of certain recorded assets and liabilities denominated in non-functional currencies. All changes in the fair value of these derivative contracts based on changes in option time value are recorded in current earnings in other income and expense. Due to market movements, changes in option time value can lead to increased volatility in other income and expense.

Derivative instruments designated as cash flow hedges must be de-designated as hedges when it is probable that the forecasted hedged transaction will not occur in the initially identified time period or within a subsequent 2 month time period. Deferred gains and losses in other comprehensive income associated with

such derivative instruments are immediately reclassified into earnings in other income and expense. Any subsequent changes in fair value of such derivative instruments are also reflected in current earnings unless they are re-designated as hedges of other transactions. During 2002, the Company recorded net gains of $2.5 million in other income and expense related to the loss of hedge designation on discontinued cash flow hedges due to changes in the Company's forecast of future net sales and cost of sales and due to prevailing market conditions. During 2001, the Company recorded a net gain of $5.1 million in other income and expense related to the loss of hedge designation on discontinued cash flow hedges due to changes in the Company's forecast of future net sales and cost of sales. No net gains, or losses, of a similar nature were recorded in 2003.

Interest Rate Risk Management

The Company sometimes enters into interest rate derivative transactions, including interest rate swaps, collars, and floors, with financial institutions in order to better match the Company's floating-rate interest income on its cash equivalents and short-term investments with its fixed-rate interest expense on its long-term debt, and/or to diversify a portion of the Company's exposure away from fluctuations in short-term U.S. interest rates.

As of September 30, 2000, the Company had entered into interest rate swaps with financial institutions in order to better match the Company's floating-rate interest income on its cash equivalents and short-term investments with its fixed-rate interest expense on its long-term debt, and to diversify a portion of the Company's exposure away from fluctuations in short-term U.S. interest rates. The interest rate swaps generally required the Company to pay a floating interest rate based on the three- or six-month U.S. dollar LIBOR and receive a fixed rate of interest without exchanges of the underlying notional amounts. These swaps effectively converted the Company's fixed-rate 10-year debt to floating-rate debt and converted a portion of the floating rate investments to fixed rate. The Company assumed no ineffectiveness with regard to the debt interest swaps as each debt interest rate swap met the criteria for accounting under the short-cut method defined in SFAS No. 133 for fair value hedges of debt instruments. Accordingly, no net gains or losses were recorded in income relative to the Company's underlying debt interest rate swaps. During fiscal 2001, the Company closed out all of its existing debt interest rate swap positions due to prevailing market interest rates realizing a gain of $17 million. This gain was deferred, recognized in long-term debt and is being amortized to other income and expense over the remaining life of the debt.

The unrealized loss on the asset swaps as of September 30, 2000, of $5.7 million was deferred and then recognized in income in 2001 as part of the SFAS No. 133 transition adjustment effective on October 1, 2000. The Company closed out all of its existing interest rate asset swaps during 2001 realizing a gain of $1.1 million.

As of September 27, 2003 and September 28, 2002, the Company had no interest rate derivatives outstanding. Due to perceived market risk, the Company entered into interest rate swaps in early 2002. The interest rate swaps required the Company to pay a floating interest rate based on six-month U.S. dollar LIBOR and receive a fixed rate of interest without exchanges of the underlying notional amounts. These swaps effectively converted the Company's fixed-rate 10-year debt to floating-rate debt. The Company assumed no ineffectiveness with regard to the debt interest swaps as each debt interest rate swap met the criteria for accounting under the short-cut method defined in SFAS No. 133 for fair value hedges of debt instruments. Accordingly, no net gains or losses were recorded in income relative to the Company's underlying debt interest rate swaps during fiscal 2002 until the Company closed out the positions in late 2002 due to prevailing market interest rates. Closing the debt interest rate swaps resulted in a realized gain

of $6 million. This gain was deferred, recognized in long-term debt and is being amortized to other income and expense over the remaining life of the debt.

Debt

The Company currently has debt outstanding in the form of $300 million of aggregate principal amount 6.5% unsecured notes that were originally issued in 1994. The notes, which pay interest semiannually, were sold at 99.925% of par, for an effective yield to maturity of 6.51%. The notes, along with approximately $4 million of related unamortized deferred gains on closed interest rate swaps, are due in February of 2004 and therefore have been classified as current debt as of September 27, 2003. As of September 27, 2003 and September 28, 2002, the carrying amount of these notes, including unamortized deferred gains associated with closed debt interest rate swaps, was $304 million and $316 million, respectively, while the fair value was $302 million and $299 million, respectively. The fair value of the notes is based on their listed market values as of September 27, 2003 and September 28, 2002.

Non-Current Debt and Equity Investments and Related Gains and Losses

The Company has held investments in EarthLink, Inc. (EarthLink), Akamai Technologies, Inc. (Akamai), ARM Holdings plc (ARM), and Samsung Electronics Co., Ltd (Samsung). These investments have been reflected in the consolidated balance sheets as long term assets within other assets and have been categorized as available-for-sale requiring that they be carried at fair value with unrealized gains and losses, net of taxes, reported in equity as a component of accumulated other comprehensive income. All realized gains on the sale of these investments have been included in total other income and expense. The combined fair value of these investments held by the Company was $5 million and $39 million as of September 27, 2003 and September 28, 2002, respectively.

EarthLink

In January 2000, the Company invested $200 million in EarthLink, an Internet service provider (ISP). The investment was in EarthLink's Series C Convertible Preferred Stock, which was convertible by the Company after January 4, 2001, into approximately 7.1 million shares of EarthLink common stock. Concurrent with this investment, EarthLink and the Company entered into a multi-year agreement to deliver ISP service to Macintosh users in the United States. Under the terms of the agreement, the Company profits from each new Mac customer that subscribes to EarthLink's ISP service for a specified period of time, and EarthLink is the default ISP in the Company's Internet Setup Software included with all Macintosh computers sold in the United States.

During the first quarter of 2003, the Company sold 2,580,000 shares of EarthLink stock for net proceeds of approximately $13.7 million, an amount that approximated the Company's carrying value of the shares. During the third quarter of 2003, the Company sold all of its remaining holdings in EarthLink, consisting of 3,960,000 shares of stock for net proceeds of approximately $23 million, and a gain before taxes of $2 million.

During the first quarter of 2002, the Company sold 117,000 shares of EarthLink stock for net proceeds of $2 million and a gain before taxes of $223,000. No sales of EarthLink were made in any of the subsequent quarters of fiscal 2002. However, during the fourth quarter of 2002, the Company determined that the then current decline in the fair value of its investment in EarthLink was other-than-temporary. As a result, the Company recognized a $44 million charge to earnings to write-down the basis of its investment in EarthLink to $35 million. This charge was included in gains (losses) on non-current investments, net. As of September 28, 2002, the Company held 6.5 million shares of EarthLink stock valued at $35 million.

During the second quarter of 2001, the Company determined that the decline in the fair value of its investment in EarthLink was other-than-temporary requiring that its cost basis be written down to fair value as a new cost basis and the amount of the write-down be included in earnings. As a result, the Company recognized a $114 million charge to earnings to write-down the basis of its investment in EarthLink to $86 million. This charge was included in gains (losses) on non-current investments, net. During the fourth quarter of 2001, the Company sold a total of approximately 425,000 shares of EarthLink stock for net proceeds of approximately $6 million, recorded a gain before taxes of approximately $800,000, and recognized related income tax of approximately $200,000.

Akamai

In June 1999, the Company invested $12.5 million in Akamai, a global Internet content delivery service. The investment was in the form of convertible preferred stock that converted into 4.1 million shares of Akamai common stock (adjusted for subsequent stock splits) at the time of Akamai's initial public offering in October 1999. Beginning in the first quarter of 2000, the Company categorized its shares in Akamai as available-for-sale.

During the fourth quarter of 2003, the Company sold 1,875,000 shares of Akamai stock for net proceeds of $9 million and a gain before taxes of $8 million. As of September 27, 2003, the Company's remaining investment in Akamai consists of 986,000 shares of Akamai stock valued at $5 million.

During the first quarter of 2002, the Company sold 250,000 shares of Akamai stock for net proceeds of $2 million and a gain before taxes of $710,000. No sales of Akamai were made in any of the subsequent quarters of fiscal 2002. However, during the fourth quarter of 2002, the Company determined that the decline in the fair value of its investment in Akamai was other-than-temporary. As a result, the Company recognized a $6 million charge to earnings to write-down the basis of its investment in Akamai to $3 million. This charge was included in gains (losses) on non-current investments, net. As of September 28, 2002, the Company held 2.9 million shares of Akamai stock valued at $3 million.

During 2001, the Company sold a total of approximately 1 million shares of Akamai stock for net proceeds of approximately $39 million and recorded a gain before taxes of approximately $36 million.

ARM

ARM is a publicly held company in the United Kingdom involved in the design and licensing of high performance microprocessors and related technology.

During the third quarter of 2003, the Company sold all of its remaining holdings in ARM stock, consisting of 278,000 shares for net proceeds of approximately $295,000, and a gain before taxes of $270,000.

During the first quarter of 2002, the Company sold 4.7 million shares of ARM stock for both net proceeds and a gain before taxes of $21 million. No sales of ARM were made in any of the subsequent quarters of fiscal 2002. As of September 28, 2002, the Company held 278,000 shares of ARM stock valued at $578,000.

During 2001, the Company sold a total of approximately 29.8 million shares of ARM stock for net proceeds of approximately $176 million, recorded a gain before taxes of approximately $174 million, and recognized related income tax expense of approximately $52 million.

Samsung

During the fourth quarter of 1999, the Company invested $100 million in Samsung to assist in the further expansion of Samsung's TFT-LCD flat-panel display production capacity. The investment was in the form of three year unsecured bonds, which were convertible into approximately 550,000 shares of Samsung common stock beginning in July 2000. The bonds carried an annual coupon rate of 2% and paid a total yield to maturity of 5% if redeemed at maturity.

Prior to its sale, the Company had categorized its investment in Samsung as available-for-sale requiring that it be carried at fair value with unrealized gains and losses, net of taxes, reported in equity as a component of accumulated other comprehensive income. The fair value of the Company's investment in Samsung was approximately $123 million as of September 30, 2000. With the adoption of SFAS No. 133 on October 1, 2000, the Company was required to account for the conversion option embedded in the Samsung bonds separately from the related debt. The conversion feature was carried at fair value with any changes in fair value recognized in earnings in the period in which they occur. Included in the $17 million gross SFAS No. 133 transition adjustment recorded in earnings during the first quarter of fiscal 2001 was a $23 million favorable adjustment for the restatement to fair value as of October 1, 2000, of the derivative component of the Company's investment in Samsung. To adjust the carrying value of the derivative component of its investment in Samsung to fair value as of December 30, 2000, the Company recognized an unrealized loss of approximately $13 million during the first quarter of 2001. During the second quarter of 2001, the Company sold this investment for book value, including accrued interest, and received net proceeds of approximately $117 million.

Other Strategic Investments

The Company has made additional minority debt and equity investments in several privately held technology companies, which were reflected in the consolidated balance sheets in other assets. These investments were inherently risky because the products and/or markets of these companies were typically not fully developed. During 2002 and 2001, the Company determined that the decline in fair value of certain of these investments was other-than-temporary and, accordingly, recognized a charge to earnings of $15 million and $8 million, respectively. These charges were included in gains (losses) on non-current investments, net. As of September 27, 2003 and September 28, 2002, the Company had no private debt or equity investments reflected in its consolidated balance sheets.

Note 3—Consolidated Financial Statement Details (in millions)

Inventories

	2003	2002
Purchased parts	$ 2	$ 9
Work in process	4	—
Finished goods	50	36
Total inventories	$ 56	$ 45

Other Current Assets

	2003	2002
Vendor non-trade receivables	$ 184	$ 142
Other current assets	125	133
Total other current assets	$ 309	$ 275

Property, Plant, and Equipment

	2003	2002
Land and buildings	$ 350	$ 342
Machinery, equipment, and internal-use software	393	367

Office furniture and equipment	74	67
Leasehold improvements	357	281
	1,174	1,057
Accumulated depreciation and amortization	(505)	(436)
Net property, plant, and equipment	$ 669	$ 621

Other Assets

	2003	2002
Non-current deferred tax assets	$ 60	$ 70
Non-current debt and equity investments	5	39
Capitalized software development costs, net	28	19
Other assets	57	42
Total other assets	$ 150	$ 170

Accrued Expenses

	2003	2002
Deferred revenue	$ 368	$ 240
Accrued marketing and distribution	124	136
Accrued compensation and employee benefits	101	93
Accrued warranty and related costs	67	69
Other current liabilities	239	209
Total accrued expenses	$ 899	$ 747

Interest and Other Income, Net

	2003	2002	2001
Interest income	$ 69	$ 118	$ 218
Interest expense	(8)	(11)	(16)
Gains on sales of short term investments	21	7	—
Other income (expense) net	(5)	(2)	15
Gain on forward purchase agreement	6	—	—
Total interest and other income, net	$ 83	$ 112	$ 217

Note 4—Acquisitions

Goodwill and Other Intangible Assets

The Company is currently amortizing its acquired intangible assets with definite lives over periods ranging from 3 to 10 years. The Company ceased amortization of goodwill at the beginning of fiscal 2002 when it adopted SFAS No. 142.

The following table summarizes the components of gross and net intangible asset balances (in millions):

	September 27, 2003			September 28, 2002		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount

Goodwill (a)	$ 85	—	$ 85	$ 85	—	$ 85
Other acquired intangible assets	5	(5)	—	5	(5)	—
Acquired technology	42	(18)	24	42	(8)	34
Total acquired intangible assets	$ 132	$ (23)	$ 109	$ 132	$ (13)	$ 119

(a) Accumulated amortization related to goodwill of $55 million arising prior to the adoption of SFAS No. 142 has been reflected in the gross carrying amount of goodwill as of September 27, 2003 and September 28, 2002.

Expected annual amortization expense related to acquired technology is as follows (in millions):

Fiscal Years:	
2004	$ 7
2005	5
2006	3
2007	2
Thereafter	7
Total expected annual amortization expense	$ 24

Amortization expense related to acquired intangible assets is as follows (in millions):

	2003	2002	2001
Goodwill amortization	$ —	$ —	$ 16
Other acquired intangible assets amortization	—	1	3
Acquired technology amortization	10	5	2
Total amortization	$ 10	$ 6	$ 21

Net loss and net loss per share adjusted to exclude amortization of goodwill in fiscal periods prior to the adoption of SFAS No. 142 in fiscal 2002 follows (in millions, except per share amounts):

	2001
Net loss, as reported	$ (25)
Add: goodwill amortization	$ 16
Net loss, as adjusted	$ (9)
Basic loss per share, as reported	$ (0.07)
Add: goodwill amortization	$ 0.04
Basic loss per share, as adjusted	$ (0.03)
Diluted loss per share, as reported	$ (0.07)
Add: goodwill amortization	$ 0.04
Diluted loss per share, as adjusted	$ (0.03)

Acquisition of Emagic GmbH

During the fourth quarter of 2002, the Company acquired Emagic GmbH (Emagic), a provider of professional software solutions for computer based music production, for approximately $30 million in cash; $26 million of which was paid immediately upon closing of the deal and $4 million of which was held-back for future payment contingent on continued employment by certain employees that will be allocated to future compensation expense in the appropriate periods over the next 3 years. During fiscal 2003, contingent consideration totaling $1.3 million was paid. The acquisition has been accounted for as a purchase. The portion of the purchase price allocated to purchased in-process research and development (IPR&D) was expensed immediately, and the portion of the purchase price allocated to acquired technology and to tradename will be amortized over their estimated useful lives of 3 years. Goodwill associated with the acquisition of Emagic is not subject to amortization pursuant to the provisions of SFAS No. 142. Total consideration was allocated as follows (in millions):

Net tangible assets acquired	$	2.3
Acquired technology		3.8
Tradename		0.8
In-process research and development		0.5
Goodwill		18.6
Total consideration	$	26.0

The amount of the purchase price allocated to IPR&D was expensed upon acquisition, because the technological feasibility of products under development had not been established and no alternative future uses existed. The IPR&D relates primarily to Emagic's Logic series technology and extensions. At the date of the acquisition, the products under development were between 43%-83% complete, and it was expected that the remaining work would be completed during the Company's fiscal 2003 at a cost of approximately $415,000. The remaining efforts, which were completed in 2003, included finalizing user interface design and development, and testing. The fair value of the IPR&D was determined using an income approach, which reflects the projected free cash flows that will be generated by the IPR&D projects and that are attributable to the acquired technology, and discounting the projected net cash flows back to their present value using a discount rate of 25%.

Acquisition of certain assets of Zayante, Inc., Prismo Graphics, and Silicon Grail

During fiscal 2002 the Company acquired certain technology and patent rights of Zayante, Inc., Prismo Graphics, and Silicon Grail Corporation for a total of $20 million in cash. These transactions have been accounted for as asset acquisitions. The purchase price for these asset acquisitions, except for $1 million identified as contingent consideration which will be allocated to compensation expense over the next 3 years, has been allocated to acquired technology and will be amortized on a straight-line basis over 3 years, except for certain assets acquired from Zayante associated with patent royalty streams that will be amortized over 10 years.

Acquisition of Nothing Real, LLC

During the second quarter of 2002, the Company acquired certain assets of Nothing Real, LLC (Nothing Real), a privately-held company that develops and markets high performance tools designed for the digital image creation market. Of the $15 million purchase price, the Company has allocated $7 million to acquired technology, which will be amortized over its estimated life of 5 years. The remaining $8 million, which has been identified as contingent consideration, rather than recorded as an additional component of the cost of the acquired assets, will be allocated to future compensation expense in the appropriate periods over the next 3 years.

Acquisition of Spruce Technologies, Inc.

In July 2001, the Company acquired Spruce Technologies, Inc. (Spruce), a privately-held company that develops and markets DVD authoring products, for $14.9 million in cash. Goodwill associated with the acquisition of Spruce is not subject to amortization pursuant to the transition provisions of SFAS No. 142. The consolidated financial statements include the operating results of Spruce from the date of acquisition. Total consideration was allocated as follows (in millions):

Net tangible liabilities assumed	$	(0.7)
Identifiable intangible assets		5.9
Goodwill		9.7
Total consideration	$	14.9

Acquisition of PowerSchool, Inc.

In May 2001, the Company acquired PowerSchool, Inc. (PowerSchool), a provider of web-based student information systems for K-12 schools and districts that enable schools to record, access, report, and manage their student data and performance in real-time, and gives parents real-time web access to track their children's progress. The consolidated financial statements include the operating results of PowerSchool from the date of acquisition.

The purchase price of approximately $66.1 million consisted of the issuance of approximately 2.4 million shares of the Company's common stock with a fair value of $61.2 million, the issuance of stock options with a fair value of $4.5 million, and $300,000 of direct transaction costs. The fair value of the common stock options issued was determined using a Black-Scholes option pricing model with the following assumptions: volatility of 67%, expected life of 4 years, dividend rate of 0%, and risk-free rate of 4.73%.

Total consideration was allocated as follows (in millions):

Net tangible assets acquired	$	0.2
Deferred stock compensation		12.8
Identifiable intangible assets		2.6
In-process research and development		10.8
Goodwill		39.7
Total consideration	$	66.1

The amount of the purchase price allocated to IPR&D was expensed upon acquisition, because the technological feasibility of products under development had not been established and no alternative future uses existed. The IPR&D relates to technologies representing processes and expertise employed to design, develop, and deploy a functioning, scalable web-based student information system for use by K-12 schools. At the date of the acquisition, the product under development was approximately 50% complete, and it was expected that the remaining 50% would be completed during the Company's fiscal 2002 at a cost of approximately $9.25 million. The remaining efforts, which were completed in 2002, included completion of coding, finalizing user interface design and development, and testing. The fair value of the IPR&D was determined using an income approach, which reflects the projected free cash flows that will be generated by the IPR&D projects and that are attributable to the acquired technology, and discounting the projected net cash flows back to their present value using a discount rate of 25%. The acquired intangibles are being amortized over their estimated useful lives of 3 years. Deferred stock compensation associated with restricted stock and options is being amortized over the required future vesting period of 3 years.

In the fourth quarter of 2001, an adjustment was made to increase goodwill associated with the acquisition of PowerSchool by $5.9 million due to the identification of previously unidentified loss contingencies that were in existence prior to consummation of the acquisition.

The Company allocated $12.8 million of its purchase consideration for PowerSchool to deferred stock compensation within shareholders' equity. This amount represented the intrinsic value of stock options assumed that vest as future services are provided by employees and related to 445,000 common shares issued contingent on continued employment of certain PowerSchool employee stockholders. Certain PowerSchool employee stockholders were terminated in the first quarter of 2003 resulting in the $5 million recognition of previously deferred stock compensation as part of the Company's first quarter restructuring action. Unamortized PowerSchool related deferred stock compensation of approximately $294,000 remains as of September 27, 2003.

Pro Forma Financial Information

The unaudited pro forma financial information below presents the condensed consolidated financial results of the Company assuming that PowerSchool and Spruce, acquired in 2001, had been acquired at the

beginning of 2001 and includes the effect of amortization of goodwill and other acquired identifiable intangible assets from that date. The impact of the charge for IPR&D associated with the acquisition of PowerSchool has been excluded. This pro forma financial information is presented for informational purposes only and is not necessarily indicative of the results of future operations that would have been achieved had the acquisitions taken place at the beginning of 2001. Pro forma information follows (in millions, except per share amounts):

		2001
Net sales	$	5,370
Net loss	$	(44)
Basic loss per common share	$	(0.13)
Diluted loss per common share	$	(0.13)

Note 5—Restructuring Charges

Fiscal 2003 Restructuring Actions

The Company recorded total restructuring charges of approximately $26.8 million during the year ended September 27, 2003, including approximately $7.4 million in severance costs, a $5.0 million charge to write-off deferred compensation, $7.1 million in asset impairments and a $7.3 million charge for lease cancellations. Of the $26.8 million, nearly all had been spent by the end of 2003, except for approximately $400,000 of severance costs and approximately $4.5 million related to operating lease costs on abandoned facilities. During the third quarter of 2003, approximately $500,000 of the amount originally accrued for lease cancellations was determined to be in excess due to the sublease of a property sooner than originally estimated and an approximately $500,000 shortfall was identified in the severance accrual due to higher than expected severance costs related to the closure of the Company's Singapore manufacturing operations. These adjustments had no net effect on reported operating expense.

During the second quarter of 2003, the Company's management approved and initiated restructuring actions that resulted in recognition of a total restructuring charge of $2.8 million, including $2.4 million in severance costs and $400,000 for asset write-offs and lease payments on an abandoned facility. Actions taken in the second quarter were for the most part supplemental to actions initiated in the prior two quarters and focused on further headcount reductions in various sales and marketing functions in the Company's Americas and Europe operating segments and further reductions associated with PowerSchool-related activities in the Americas operating segment, including an accrual for asset write-offs and lease payments on an abandoned facility. The second quarter actions resulted in the termination of 93 employees, 92 were terminated prior to the end of 2003.

During the first quarter of 2003, the Company's management approved and initiated restructuring actions with a total cost of $24 million that resulted in the termination of manufacturing operations at the Company-owned facility in Singapore, further reductions in headcount resulting from the shift in PowerSchool product strategy that took place at the end of fiscal 2002, and termination of various sales and marketing activities in the United States and Europe. These restructuring actions will ultimately result in the elimination of 260 positions worldwide, all but one of which were eliminated by the end of 2003.

Closure of the Company's Singapore manufacturing operations resulted in severance costs of $1.8 million and costs of $6.7 million to write-off manufacturing related fixed assets, whose use ceased during the first quarter. PowerSchool related costs included severance of approximately $550,000 and recognition of $5 million of previously deferred stock compensation that arose when PowerSchool was acquired by the

Company in 2001 related to certain PowerSchool employee stockholders who were terminated in the first quarter of 2003. Termination of sales and marketing activities and employees, principally in the United States and Europe, resulted in severance costs of $2.8 million and accrual of costs associated with operating leases on closed facilities of $6.7 million. The total net restructuring charge of $23 million recognized during the first quarter of 2003 also reflects the reversal of $600,000 of unused restructuring accrual originally made during the first quarter of 2002.

Except for certain costs associated with operating leases on closed facilities, the Company currently anticipates that all of the remaining accrual for severance costs of approximately $400,000 will be spent by the end of the first quarter of fiscal 2004.

The following table summarizes activity associated with restructuring actions initiated during fiscal 2003 (in millions):

	Employee Severance Benefits	Deferred Compensation Write-off	Asset Impairments	Lease Cancellations	Totals
Total charge	$ 7.4	$ 5.0	$ 7.1	$ 7.3	$ 26.8
Total spending through September 27, 2003	(7.5)	—	—	(2.3)	(9.8)
Total non-cash items	—	(5.0)	(7.1)	—	(12.1)
Adjustments	0.5	—	—	(0.5)	—
Accrual at September 27, 2003	$ 0.4	$ —	$ —	$ 4.5	$ 4.9

Fiscal 2002 Restructuring Actions

During fiscal 2002, the Company recorded total restructuring charges of approximately $30 million related to actions intended to eliminate certain activities and better align the Company's operating expenses with existing general economic conditions and to partially offset the cost of continuing investments in new product development and investments in the Company's Retail operating segment.

During the fourth quarter of 2002, the Company's management approved and initiated restructuring actions with a total cost of approximately $6 million designed to reduce headcount costs in corporate operations and sales and to adjust its PowerSchool product strategy. These restructuring actions resulted in the elimination of approximately 180 positions worldwide at a cost of $1.8 million, all of which were eliminated by September 27, 2003. Eliminated positions were primarily in corporate operations, sales, and PowerSchool related research and development in the Americas operating segment. The shift in product strategy at PowerSchool included discontinuing development and marketing of PowerSchool's PSE product. This shift resulted in the impairment of previously capitalized development costs associated with the PSE product in the amount of $4.5 million.

During the first quarter of 2002, the Company's management approved and initiated restructuring actions with a total cost of approximately $24 million. These restructuring actions resulted in the elimination of approximately 425 positions worldwide at a cost of $8 million. Positions were eliminated primarily in the Company's operations, information systems, and administrative functions. In addition, these restructuring actions also included significant changes in the Company's information systems strategy resulting in termination of equipment leases and cancellation of existing projects and activities. The Company ceased using the assets associated with first quarter 2002 restructuring actions during that same quarter. Related lease and contract cancellation charges totaled $12 million, and charges for asset impairments totaled

$4 million. The first quarter 2002 restructuring actions were primarily related to corporate activity not allocated to operating segments. During the first quarter of 2003, the Company reversed the remaining unused accrual of $600,000.

The following table summarizes activity associated with restructuring actions initiated during fiscal 2002 (in millions):

	Employee Severance Benefits	Asset Impairments	Lease and Contract Cancellations	Totals
Total charge	$ 10	$ 8	$ 12	$ 30
Total spending through September 27, 2003	(10)	—	(11)	(21)
Total non-cash items	—	(8)	—	(8)
Adjustments	—	—	(1)	(1)
Accrual at September 27, 2003	$ —	$ —	$ —	$ —

Note 6—Income Taxes

The provision for income taxes consisted of the following (in millions):

	2003	2002	2001
Federal:			
Current	$ 18	$ 12	$ (20)
Deferred	(7)	(32)	(8)
	11	(20)	(28)
State:			
Current	4	3	—
Deferred	(11)	6	(10)
	(7)	9	(10)
Foreign:			
Current	21	29	21
Deferred	(1)	4	2
	20	33	23
Provision for income taxes	$ 24	$ 22	$ (15)

The foreign provision for income taxes is based on foreign pretax earnings of approximately $250 million, $284 million and $363 million in 2003, 2002, and 2001, respectively. As of September 27, 2003, approximately $2.5 billion of the Company's cash, cash equivalents, and short-term investments are held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries would be subject to U.S. income taxation on repatriation to the United States. The Company's consolidated financial statements fully provide for any related tax liability on amounts that may be repatriated, aside from undistributed earnings of certain of the Company's foreign subsidiaries that are intended to be indefinitely reinvested in operations outside the United States. U.S. income taxes have not been provided on a cumulative total of $822 million of such earnings. It is not practicable to determine the income tax liability that might be incurred if these earnings were to be distributed.

Deferred tax assets and liabilities reflect the effects of tax losses, credits, and the future income tax effects of temporary differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases and are measured using enacted tax rates that apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

As of September 27, 2003 and September 28, 2002, the significant components of the Company's deferred tax assets and liabilities were (in millions):

	2003	2002
Deferred tax assets:		
Accounts receivable and inventory reserves	$ 35	$ 32
Accrued liabilities and other reserves	155	126
Basis of capital assets and investments	47	34
Tax losses and credits	204	125
Other	11	11
Total deferred tax assets	452	328
Less valuation allowance	30	30
Net deferred tax assets	422	298
Deferred tax liabilities:		
Unremitted earnings of subsidiaries	398	293
Available-for-sale securities	—	1
Total deferred tax liabilities	398	294
Net deferred tax asset	$ 24	$ 4

As of September 27, 2003, the Company had operating loss carryforwards for federal tax purposes of approximately $189 million, which expire from 2011 through 2023. A portion of these carryforwards was acquired from NeXT and other acquisitions, the utilization of which is subject to certain limitations imposed by the Internal Revenue Code. The Company also has Federal credit carryforwards and various state and foreign tax loss and credit carryforwards, the tax effect of which is approximately $117 million and which expire between 2004 and 2023. The remaining benefits from tax losses and credits do not expire. As of September 27, 2003, a valuation allowance of $30 million was recorded against the deferred tax asset for the benefits of tax losses that may not be realized. The valuation allowance relates primarily to the operating loss carryforwards acquired from NeXT and other acquisitions. Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax

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planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets.

A reconciliation of the provision for income taxes, with the amount computed by applying the statutory federal income tax rate (35% in 2003, 2002, and 2001) to income (loss) before provision for (benefit from) income taxes, is as follows (in millions):

	2003	2002	2001
Computed expected tax (benefit)	$ 32	$ 30	$ (18)
State taxes, net of federal effect	(4)	7	(7)
Indefinitely invested earnings of foreign subsidiaries	(13)	—	—
Nondeductible executive compensation	5	(1)	—
Stock repurchase	(2)	—	—
Purchase accounting and asset acquisitions	4	3	10
Change in valuation allowance	—	(16)	—
Research & development credit, net	(7)	(8)	(5)
Nondeductible expenses	6	4	3
Other items	3	3	2
Provision for (benefit from) income taxes	$ 24	$ 22	$ (15)
Effective tax rate	26%	25%	30%

On April 10, 2003, the Internal Revenue Service (IRS) completed its audit of the Company's federal income tax returns for the years 1998 through 2000 and proposed certain adjustments. Certain of these adjustments are being contested through the IRS Appeals Office. Substantially all IRS audit issues for years prior to 1998 have been resolved. Management believes that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. Should any issues addressed in the Company's tax audits be resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs.

Note 7—Shareholders' Equity

CEO Restricted Stock Award

On March 19, 2003, the Company entered into an Option Cancellation and Restricted Stock Award Agreement (the Agreement) with Steven P. Jobs, its Chief Executive Officer (CEO). The Agreement cancelled stock option awards for the purchase of 27.5 million shares of the Company's common stock previously granted to Mr. Jobs in 2000 and 2001. Mr. Jobs retained options to purchase 60,000 shares of the Company's common stock granted in August of 1997 in his capacity as a member of the Company's Board of Directors, prior to becoming the Company's CEO. The Agreement replaced the cancelled options with a restricted stock award of 5 million shares of the Company's common stock. The restricted stock award generally vests three years from date of grant. Vesting of some or all of the restricted shares will be accelerated in the event Mr. Jobs is terminated without cause, dies, or has his management role reduced following a change in control of the Company.

The Company has recorded the value of the restricted stock award of $74.75 million as a component of shareholders' equity and is amortizing that amount on a straight-line basis over the 3-year service/vesting period. The value of the restricted stock award was based on the closing market price of the Company's

common stock on the date of the award. Total amortization of approximately $13 million has been included in selling, general, and administrative expense in 2003 and will continue to be included at approximately $6.2 million per quarter through March 2006. The 5 million restricted shares have been included in the calculation of diluted earnings per share utilizing the treasury stock method.

Stock Repurchase Plan

In July 1999, the Company's Board of Directors authorized a plan for the Company to repurchase up to $500 million of its common stock. This repurchase plan does not obligate the Company to acquire any specific number of shares or acquire shares over any specified period of time.

During the fourth quarter of 2001, the Company entered into a forward purchase agreement to acquire 1.5 million shares of its common stock in September of 2003 at an average price of $16.64 per share for a total cost of $25.5 million. In August 2003, the Company settled this agreement prior to its maturity, at which time the Company's common stock had a fair value of $22.81. Other than this forward purchase transaction, the Company has not engaged in any transactions to repurchase its common stock since fiscal 2000. Since inception of the stock repurchase plan, the Company had repurchased a total of 6.55 million shares at a cost of $217 million. The Company was authorized to repurchase up to an additional $283 million of its common stock as of September 27, 2003.

Preferred Stock

In August 1997, the Company and Microsoft Corporation (Microsoft) entered into patent cross license and technology agreements. In addition, Microsoft purchased 150,000 shares of Apple Series A nonvoting convertible preferred stock ("preferred stock") for $150 million. These shares were convertible by Microsoft after August 5, 2000, into shares of the Company's common stock at a conversion price of $8.25 per share. During 2000, 74,250 shares of preferred stock were converted to 9 million shares of the Company's common stock. During 2001, the remaining 75,750 preferred shares were converted into 9.2 million shares of the Company's common stock.

Comprehensive Income

Comprehensive income consists of two components, net income and other comprehensive income. Other comprehensive income refers to revenue, expenses, gains and losses that under generally accepted accounting principles are recorded as an element of shareholders' equity but are excluded from net income. The Company's other comprehensive income consists of foreign currency translation adjustments from those subsidiaries not using the U.S. dollar as their functional currency, unrealized gains and losses on marketable securities categorized as available-for-sale, and net deferred gains and losses on certain derivative instruments accounted for as cash flow hedges.

The following table summarizes the components of accumulated other comprehensive income (loss), net of taxes (in millions):

	2003	2002	2001
Unrealized gains on available-for-sale securities	$ 1	$ 13	$ 30
Unrealized gains (losses) on derivative investments	(16)	(11)	4
Cumulative foreign currency translation	(20)	(51)	(56)
Accumulated other comprehensive income (loss)	$ (35)	$ (49)	$ (22)

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The following table summarizes activity in other comprehensive income related to available-for-sale securities, net of taxes (in millions):

	2003	2002	2001
Change in fair value of available-for-sale securities	$ 11	$ (49)	$ (183)
Adjustment for net (gains) losses realized and included in net income (loss)	(23)	32	(84)
Change in unrealized gain on available-for-sale securities	$ (12)	$ (17)	$ (267)

The tax effect related to the change in unrealized gain on available-for-sale securities was $6 million, $10 million, $157 million for fiscal 2003, 2002, and 2001, respectively. The tax effect on the reclassification adjustment for net gains (losses) included in net income (loss) was $(8) million, $10 million and $35 million for fiscal 2003, 2002, and 2001, respectively.

The following table summarizes activity in other comprehensive income related to derivatives, net of taxes, held by the Company (in millions):

	2003	2002	2001
Changes in fair value of derivatives	$ (24)	$ 4	$ 45
Adjustment for net gains realized and included in net income (loss)	19	(19)	(53)
Cumulative effect of adopting SFAS No. 133	—	—	12
Change in unrealized gain on derivative instruments	$ (5)	$ (15)	$ 4

The tax effect related to the cumulative effect of adopting SFAS No. 133 was $(5) as of September 29, 2001. The tax effect related to the changes in fair value of derivatives was $11 million, $(2) million and $(19) million for fiscal 2003, 2002, and 2001, respectively. The tax effect related to derivative gains (losses) reclassified from other comprehensive income was $(7) million, $8 million and $23 million for fiscal 2003, 2002, and 2001, respectively.

Note 8—Employee Benefit Plans

2003 Employee Stock Option Plan

At the Annual Meeting of Shareholders held on April 24, 2003, the shareholders approved an amendment to the 1998 Executive Officer Stock Plan to change the name of the plan to the 2003 Employee Stock Option Plan (the 2003 Plan), to provide for broad-based grants to all employees in addition to executive officers and other key employees and to prohibit future "repricings" of employee stock options, including 6-months-plus-1-day option exchange programs, without shareholder approval. Based on the terms of individual option grants, options granted under the 2003 Plan generally expire 7 to 10 years after the grant date and generally become exercisable over a period of 4 years, based on continued employment, with either annual or quarterly vesting. The 2003 Plan permits the granting of incentive stock options, nonstatutory stock options, restricted stock, stock appreciation rights, and stock purchase rights.

1997 Employee Stock Option Plan

In August 1997, the Company's Board of Directors approved the 1997 Employee Stock Option Plan (the 1997 Plan), a non-shareholder approved plan for grants of stock options to employees who are not officers of the Company. Options may be granted under the 1997 Plan to employees at not less than the fair market value on the date of grant. Based on the terms of individual option grants, options granted under the 1997

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Plan generally expire 7 to 10 years after the grant date and generally become exercisable over a period of 4 years, based on continued employment, with either annual or quarterly vesting. As a result of shareholder approval of amendments to the 1998 Executive Officer Stock Plan in April 2003, the Company terminated the 1997 Employee Stock Option Plan and cancelled all remaining unissued shares, following the completion of an employee stock option exchange program in October 2003.

Employee Stock Option Exchange Program

On March 20, 2003, the Company announced a voluntary employee stock option exchange program (the Exchange Program) whereby eligible employees, other than executive officers and members of the Board of Directors, had an opportunity to exchange outstanding options with exercise prices at or above $25.00 per share for a predetermined smaller number of new stock options issued with exercise prices equal to the fair market value of one share of the Company's common stock on the day the new awards are issued, which would be at least six months plus one day after the exchange options are cancelled. On April 17, 2003, in accordance with the Exchange Program, the Company accepted and cancelled options to purchase 16,569,193 shares of its common stock. On October 22, 2003, new stock options totaling 6,697,368 shares were issued to employees at an exercise price of $22.76 per share, which is equivalent to the closing price of the Company's stock on that date. No financial or accounting impact to the Company's financial position, results of operations or cash flow was associated with this transaction.

1997 Director Stock Option Plan

In August 1997, the Company's Board of Directors adopted a shareholder approved Director Stock Option Plan (DSOP) for non-employee directors of the Company. Initial grants of 30,000 options under the DSOP vest in three equal installments on each of the first through third anniversaries of the date of grant, and subsequent annual grants of 10,000 options are fully vested at grant.

Rule 10b5-1 Trading Plans

Certain of the Company's executive officers, including Mr. Timothy D. Cook and Mr. Fred D. Anderson, have entered into trading plans pursuant to Rule 10b5-1(c)(1) of the Securities Exchange Act of 1934, as amended. A trading plan is a written document that pre-establishes the amounts, prices and dates (or formula for determining the amounts, prices and dates) of future purchases or sales of Apple stock including the exercise and sale of employee stock options and shares acquired pursuant to the Company's Employee Stock Purchase Plan.

Employee Stock Purchase Plan

The Company has a shareholder approved employee stock purchase plan (the Purchase Plan), under which substantially all employees may purchase common stock through payroll deductions at a price equal to 85% of the lower of the fair market values as of the beginning and end of six-month offering periods. Stock purchases under the Purchase Plan are limited to 10% of an employee's compensation, up to a maximum of $25,000 in any calendar year. In the third quarter of 2003, the Company's shareholders also approved an amendment to the Employee Stock Purchase Plan to increase the number of shares authorized for issuance by 4 million shares. Beginning with the six-month offering period that started on June 30, 2003, the number of shares authorized for issuance is limited to a total of 1 million shares per offering period. During 2003, 2002, and 2001, 2.1 million, 1.8 million and 1.8 million shares, respectively, were issued under the Purchase Plan. As of September 27, 2003, approximately 4.0 million shares were reserved for future issuance under the Purchase Plan.

Employee Savings Plan

The Company has an employee savings plan (the Savings Plan) qualifying as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code. Under the Savings Plan, participating U.S. employees may defer a portion of their pre-tax earnings, up to the Internal Revenue Service annual contribution limit ($12,000 for calendar year 2003). The Company matches 50% to 100% of each employee's contributions, depending on length of service, up to a maximum 6% of the employee's earnings. The Company's matching contributions to the Savings Plan were approximately $21 million, $19 million, and $17 million in 2003, 2002, and 2001, respectively.

Stock Option Activity

A summary of the Company's stock option activity and related information for the years ended September 27, 2003, September 28, 2002 and September 29, 2001 follows (option amounts are presented in thousands):

		Outstanding Options		
	Shares Available for Grant	Number of Shares		Weighted Average Exercise Price
Balance at 9/30/00	11,530	70,758	$	34.01
Additional Options Authorized	27,000	—		—
Options Granted	(34,857)	34,857	$	18.58
Options Cancelled	6,605	(6,605)	$	29.32
Options Exercised	—	(1,831)	$	10.05
Plan Shares Expired	(203)	—		—
Balance at 9/29/01	10,075	97,179	$	29.24
Additional Options Authorized	15,000	—		—
Options Granted	(23,239)	23,239	$	19.89
Options Cancelled	4,737	(4,737)	$	30.98
Options Exercised	—	(6,251)	$	11.99
Plan Shares Expired	(2)	—		—

Balance at 9/28/02	6,571	109,430	$ 28.17
Restricted Stock Granted	(5,000)	—	$ 14.95
Options Granted	(4,179)	4,179	$ 16.38
Options Cancelled	48,443	(48,443)	$ 39.61
Options Exercised	—	(2,154)	$ 14.04
Plan Shares Expired	(5)	—	—
Balance at 9/27/03	45,830	63,012	$ 19.08

Total options outstanding at September 27, 2003 to purchase approximately 63 million shares do not include options to purchase approximately 6.7 million shares that were issued in October 2003 pursuant to the Exchange Program described above.

The options outstanding as of September 27, 2003 have been segregated into six ranges for additional disclosure as follows (option amounts are presented in thousands):

	Options Outstanding			Options Exercisable	
	Options Outstanding as of September 27, 2003	Weighted-Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Options Exercisable as of September 27, 2003	Weighted Average Exercise Price
$0.83-$15.59	11,216	5.49	$ 11.83	8,237	$ 10.83
$15.60-$17.31	11,936	6.41	$ 17.00	7,022	$ 17.07
$17.32-$18.50	17,843	7.04	$ 18.43	11,903	$ 18.43
$18.51-$22.21	14,416	7.88	$ 20.31	6,886	$ 20.27
$22.22-$38.81	5,006	7.49	$ 24.03	2,844	$ 24.29
$38.82-$69.78	2,595	6.28	$ 48.08	1,864	$ 48.11
$0.83-$69.78	63,012	6.84	$ 19.08	38,756	$ 18.75

As of September 28, 2002, the Company had exercisable options to purchase 57.9 million shares outstanding with a weighted average exercise price of $30.85 per share. As of September 29, 2001, the Company had exercisable options to purchase 42.1 million shares outstanding with a weighted average exercise price of $32.15.

Note 9—Stock-Based Compensation

The Company has provided pro forma disclosures in Note 1 of these Notes to Consolidated Financial Statements of the effect on net income (loss) and earnings (loss) per share as if the fair value method of accounting for stock compensation had been used for its employee stock option grants and employee stock purchase plan purchases. These pro forma effects have been estimated at the date of grant and beginning of the period, respectively, using the Black-Scholes option pricing model.

For purposes of the pro forma disclosures provided pursuant to SFAS No. 123, the option awards issued in October 2003 and the awards cancelled as part of the Exchange Program have been accounted for using modification accounting. In accordance with SFAS No. 123, the grant date of the awards issued is the date of acceptance of the exchange offer by participating employees. The cancellation of certain of the Company's Chief Executive Officer's options and replacement with restricted shares in March 2003 is also being accounted for using modification accounting for purposes of the pro forma disclosures provided pursuant to SFAS No. 123.

The assumptions used for each of the last three fiscal years and the resulting estimate of weighted-average fair value per share of options granted during those years are as follows:

	2003	2002	2001
Expected life of stock options	3.5-4 years	4 years	4 years

Expected life of stock purchases		6 months		6 months		6 months
Interest rate—stock options		2.14%-2.45%		2.90%		4.90%
Interest rate—stock purchases		1.10%-1.77%		2.71%		5.97%
Volatility—stock options		40%-63%		64%		66%
Volatility—stock purchases		35%-44%		51%		90%
Dividend yields		0		0		0
Weighted-average fair value of options granted during the year	$	6.63	$	10.11	$	10.15
Weighted-average fair value of stock purchases during the year	$	4.24	$	6.73	$	11.15

For purposes of the pro forma disclosures provided pursuant to SFAS No. 123, the expected volatility assumptions used by the Company prior to the third quarter of 2003 have been based solely on the historical volatility of the Company's common stock over the most recent period commensurate with the estimated expected life of the Company's stock options. Beginning in the third quarter of 2003, the Company has modified this approach to consider other relevant factors including implied volatility in market traded options on the Company's common stock and the impact of unusual fluctuations not reasonably expected to recur on the historical volatility of the Company's common stock. The Company will continue to monitor these and other relevant factors in developing the expected volatility assumption used to value future awards.

Beginning in the third quarter of 2003, the Company shortened its estimate of the expected life of new options granted to its employees from 4 years to 3.5 years. The Company bases its expected life assumption on its historical experience and on the terms and conditions of the stock options it grants to employees. The change in the expected life assumption made during the third quarter of 2003 was the result of the expected impact of shortening the contractual life of new options granted to employees from 10 years to 7 years and changing the vesting provisions of new options granted to employees from 4 year straight-line annual vesting to 4 year straight-line quarterly vesting.

Note 10—Commitments and Contingencies

Lease Commitments

The Company leases various equipment and facilities, including retail space, under noncancelable operating lease arrangements. The Company does not currently utilize any other off-balance-sheet financing arrangements. The major facility leases are for terms of 5 to 10 years and generally provide renewal options for terms of 3 to 5 additional years. Leases for retail space are for terms of 5 to 15 years and often contain multi-year renewal options. As of September 27, 2003, the Company's total future minimum lease payments under noncancelable operating leases were $600 million, of which $354 million related to leases for retail space.

Rent expense under all operating leases, including both cancelable and noncancelable leases, was $97 million, $92 million, and $80 million in 2003, 2002, and 2001, respectively. Future minimum lease

payments under noncancelable operating leases having remaining terms in excess of one year as of September 27, 2003, are as follows (in millions):

Fiscal Years		
2004	$	100
2005		100
2006		83
2007		64
2008		51
Later years		202
Total minimum lease payments	$	600

Accrued Warranty and Indemnifications

The Company offers a basic limited parts and labor warranty on its hardware products. The basic warranty period for hardware products is typically one year from the date of purchase by the end-user. The Company also offers a 90-day basic warranty for Apple software and for Apple service parts used to repair Apple hardware products. The Company provides currently for the estimated cost that may be incurred under its basic limited product warranties at the time related revenue is recognized. Factors considered in determining appropriate accruals for product warranty obligations include the size of the installed base of products subject to warranty protection, historical warranty claim rates, historical and projected cost-per-claim, and knowledge of specific product failures that are outside of the Company's typical experience. The Company assesses the adequacy of its preexisting warranty liabilities and adjusts the amounts as necessary based on actual experience and changes in future expectations.

The following table reconciles changes in the Company's accrued warranties and related costs (in millions):

	2003	2002	2001

Beginning accrued warranty and related costs	$ 69	$ 87	$ 108
Cost of warranty claims	(71)	(79)	(92)
Accruals for product warranties	69	61	71
Ending accrued warranty and related costs	$ 67	$ 69	$ 87

The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other licensing agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against itself or an indemnified third-party and, in the opinion of management, does not have a potential liability related to unresolved infringement claims that would have a material adverse effect on its financial condition, liquidity or results of operations. Therefore, the Company did not record a liability for infringement costs as of either September 27, 2003 or September 28, 2002.

Concentrations in the Available Sources of Supply of Materials and Product

Although certain components essential to the Company's business are generally available from multiple sources, other key components (including microprocessors and application-specific integrated circuits, or ("ASICs")) are currently obtained by the Company from single or limited sources. Some other key components, while currently available to the Company from multiple sources, are at times subject to industry-wide availability and pricing pressures. In addition, the Company uses some components that are not common to the rest of the personal computer industry, and new products introduced by the Company often initially utilize custom components obtained from only one source until the Company has evaluated whether there is a need for and subsequently qualifies additional suppliers. If the supply of a key single-sourced component to the Company were to be delayed or curtailed or in the event a key manufacturing vendor delays shipments of completed products to the Company, the Company's ability to ship related products in desired quantities and in a timely manner could be adversely affected. The Company's business and financial performance could also be adversely affected depending on the time required to obtain sufficient quantities from the original source, or to identify and obtain sufficient quantities from an alternative source. Continued availability of these components may be affected if producers were to decide to concentrate on the production of common components instead of components customized to meet the Company's requirements. Finally, significant portions of the Company's CPUs, logic boards, and assembled products are now manufactured by outsourcing partners, the majority of which occurs in various parts of Asia. Although the Company works closely with its outsourcing partners on manufacturing schedules, the Company's operating results could be adversely affected if its outsourcing partners were unable to meet their production obligations.

Contingencies

Beginning on September 27, 2001, three shareholder class action lawsuits were filed in the United States District Court for the Northern District of California against the Company and its Chief Executive Officer. These lawsuits are substantially identical, and purport to bring suit on behalf of persons who purchased the Company's publicly traded common stock between July 19, 2000, and September 28, 2000. The complaints allege violations of the 1934 Securities Exchange Act and seek unspecified compensatory damages and other relief. The Company believes these claims are without merit and intends to defend them vigorously. The Company filed a motion to dismiss on June 4, 2002, which was heard by the Court on September 13, 2002. On December 11, 2002, the Court granted the Company's motion to dismiss for failure to state a cause of action, with leave to Plaintiffs to amend their complaint within thirty days. Plaintiffs filed their amended complaint on January 31, 2003, and on March 17, 2003, the Company filed a motion to dismiss the amended complaint. The Court heard the Company's motion on July 11, 2003 and dismissed Plaintiff's claims with prejudice on August 12, 2003. Plaintiffs have appealed the ruling.

The Company is subject to certain other legal proceedings and claims that have arisen in the ordinary course of business and have not been fully adjudicated. In the opinion of management, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate have a material adverse effect on its financial condition, liquidity or results of operations. However, the results of legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations including, in some instances, the requirement to provide customers

the ability to return product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have recently been passed in several jurisdictions that the Company operates including various European Union member countries, Japan and California. Although the Company does not anticipate any material adverse affects in the future based on the nature of its operations and the thrust of such laws, there is no assurance that such existing laws or future laws will not have a material adverse effect on the Company's results of operations and financial position.

Note 11—Segment Information and Geographic Data

The Company manages its business primarily on a geographic basis. The Company's reportable segments are comprised of the Americas, Europe, Japan, and Retail. The Americas segment includes both North and South America, except for the activities of the Company's Retail segment. The Europe segment includes European countries as well as the Middle East and Africa. The Japan segment includes only Japan. As of September 27, 2003, the Retail segment currently operates Apple-owned retail stores in the United States. Other operating segments include Asia-Pacific, which includes Australia and Asia except for Japan, and the Company's subsidiary, Filemaker, Inc. Each reportable operating segment provides similar hardware and software products and similar services, and the accounting policies of the various segments are the same as those described in the Summary of Significant Accounting Policies in Note 1, except as described below for the Retail segment.

The Company evaluates the performance of its operating segments based on net sales. The Retail segment's performance is also evaluated based on operating income. Net sales for geographic segments are based on the location of the customers. Operating income for each segment includes net sales to third parties, related cost of sales, and operating expenses directly attributable to the segment. Operating income for each segment excludes other income and expense and certain expenses that are managed outside the operating segments. Costs excluded from segment operating income include various corporate expenses, manufacturing costs not included in standard costs, income taxes, and various nonrecurring charges. Corporate expenses include research and development, corporate marketing expenses, and other separately managed general and administrative expenses including certain corporate expenses associated with support of the Retail segment. The Company does not include intercompany transfers between segments for management reporting purposes. Segment assets exclude corporate assets. Corporate assets include cash, short-term and long-term investments, manufacturing facilities, miscellaneous corporate infrastructure, goodwill and other acquired intangible assets, and retail store construction-in-progress that is not subject to depreciation. Except for the Retail segment, capital expenditures for long-lived assets are not reported to management by segment. Capital expenditures by the Retail segment were $92 million, $106 million, and $92 million in 2003, 2002, and 2001, respectively.

Operating income for all segments except Retail includes cost of sales at standard cost. Certain manufacturing expenses and related adjustments not included in segment cost of sales, including variances between standard and actual manufacturing costs and the mark-up above standard cost for product supplied to the Retail segment, are included in corporate expenses.

To assess the operating performance of the Retail segment several significant items are included in its results for internal management reporting that are not included in results of the Company's other segments. First, cost of sales for the Retail segment includes a mark-up above the Company's standard cost to approximate the price normally charged to the Company's major channel partners in the United States. For the years ended September 27, 2003, September 28, 2002, and September 29, 2001 this resulted in the

recognition of additional cost of sales above standard cost by the Retail segment and an offsetting benefit to corporate expenses of approximately $106 million, $52 million, and $4 million, respectively.

Second, the Retail segment includes in its net sales proceeds from sales of the Company's extended warranty and support contracts and also recognizes related cost of sales based on the amount at which such contracts are normally sold to the Company's resellers operating retail stores in the United States. This treatment is consistent with how the Company's major resellers account for the sales and cost of the Company's extended warranty and support contracts. Because the Company has not yet earned the revenue or incurred the costs associated with the sale of these contracts, an offset to these amounts is recognized in the Americas segment's net sales and cost of sales. For the year ended September 27, 2003, this resulted in the recognition of net sales and cost of sales by the Retail segment, with corresponding offsets in the Americas segment, of $30 million and $20 million, respectively. For the year ended September 28, 2002, this resulted in the recognition of net sales and cost of sales by the Retail segment, with corresponding offsets in the Americas segment, of $8 million and $6 million, respectively. These amounts were insignificant in fiscal 2001.

Third, a portion of the operating expenses associated with certain high profile retail stores are allocated from the Retail segment to corporate marketing expense. Allocation of these expenses reflects the unique nature of these stores which, given their larger size and extraordinary design elements, function as vehicles for general corporate marketing, corporate sales and marketing events, and brand awareness. Allocated operating costs are those in excess of operating costs incurred by one of the Company's more typical retail locations. Stores were open in three such high profile locations in New York, Los Angeles, and Chicago as of September 27, 2003. Expenses allocated to corporate marketing resulting from the operations of these three stores were $6 million and $1 million in fiscal 2003 and 2002, respectively.

Summary information by operating segment follows (in millions):

	2003	2002	2001
Americas:			
Net sales	$ 3,181	$ 3,131	$ 3,037
Operating income	$ 323	$ 278	$ 128
Depreciation, amortization and accretion	$ 5	$ 4	$ 4

Segment assets(a)	$	494	$	395	$	334
Europe:						
Net sales	$	1,309	$	1,251	$	1,249
Operating income	$	130	$	122	$	68
Depreciation and amortization	$	4	$	4	$	6
Segment assets	$	252	$	165	$	137
Japan:						
Net sales	$	698	$	710	$	713
Operating income	$	121	$	140	$	98
Depreciation, amortization and accretion	$	3	$	2	$	2
Segment assets	$	130	$	50	$	44
Retail:						
Net sales	$	621	$	283	$	19
Operating loss	$	(5)	$	(22)	$	(21)
Depreciation, amortization and accretion(b)	$	25	$	16	$	2
Segment assets(b)	$	243	$	141	$	46
Other Segments(c):						
Net sales	$	398	$	367	$	345
Operating income	$	51	$	44	$	24
Depreciation, amortization and accretion	$	2	$	2	$	2
Segment assets	$	78	$	67	$	70

(a) The Americas asset figures do not include fixed assets held in the United States. Such fixed assets are not allocated specifically to the Americas segment and are included in the corporate assets figures below.

(b) Retail segment depreciation and asset figures reflect the cost and related depreciation of its retail stores and related infrastructure. Retail store construction-in-progress, which is not subject to depreciation, is reflected in corporate assets.

(c) Other Segments consists of Asia-Pacific and FileMaker. Certain amounts in prior fiscal periods related to recent acquisitions and Internet services have been reclassified from Other Segments to the Americas segment to conform to the 2003 presentation.

A reconciliation of the Company's segment operating income and assets to the consolidated financial statements follows (in millions):

		2003		2002		2001
Segment operating income	$	620	$	562	$	297
Corporate expenses, net		(595)		(514)		(630)
Purchased in-process research and development		—		(1)		(11)
Restructuring costs		(26)		(30)		—
Consolidated operating income (loss)	$	(1)	$	17	$	(344)
Segment assets	$	1,197	$	818	$	631
Corporate assets	$	5,618	$	5,480	$	5,390
Consolidated assets	$	6,815	$	6,298	$	6,021
Segment depreciation, amortization and accretion	$	39	$	28	$	16
Corporate depreciation, amortization and accretion		74		86		84
Consolidated depreciation, amortization and accretion	$	113	$	114	$	100

A large portion of the Company's net sales is derived from its international operations. Also, a majority of the raw materials used in the Company's products is obtained from sources outside of the United States, and a majority of the products sold by the Company is assembled internationally in the Company's facility in Cork, Ireland or by third-party vendors in Taiwan, Korea, the Netherlands, the People's Republic of China, and the Czech Republic. As a result, the Company is subject to risks associated with foreign operations, such as obtaining governmental permits and approvals, currency exchange fluctuations, currency restrictions, political instability, labor problems, trade restrictions, and changes in tariff and freight charges. No single customer accounted for more than 10% of net sales in 2003, 2002 or 2001.

Net sales and long-lived assets related to operations in the United States, Japan, and other foreign countries are as follows (in millions):

	2003	2002	2001
Net Sales:			
United States	$ 3,627	$ 3,272	$ 2,936
Japan	698	710	713
Other Foreign Countries	1,882	1,760	1,714
Total Net Sales	$ 6,207	$ 5,742	$ 5,363
Long-Lived Assets:			
United States	$ 635	$ 561	$ 498
Japan	19	2	3
Other Foreign Countries	60	69	77
Total Long-Lived Assets	$ 714	$ 632	$ 578

Information regarding net sales by product is as follows (in millions):

	2003	2002	2001
Net Sales:			
Power Macintosh(a)	$ 1,237	$ 1,380	$ 1,664
PowerBook	1,299	831	813
iMac	1,238	1,448	1,117
iBook	717	875	809
Total Macintosh Net Sales	$ 4,491	$ 4,534	$ 4,403
Peripherals and other hardware(b)	1,058	674	387
Software(c)	362	307	230
Service and other Net Sales	296	227	343
Total Net Sales	$ 6,207	$ 5,742	$ 5,363

(a) Power Macintosh figures include server sales.

(b) Net sales of peripherals and other hardware include sales of iPod, Apple-branded and third-party displays, and other hardware accessories.

(c) Net sales of software include sales of Apple-branded operating system and application software and sales of third-party software.

Note 12—Related Party Transactions and Certain Other Transactions

During the first quarter of 2000, the Company's Board of Directors approved a special executive bonus for the Company's Chief Executive Officer for past services in the form of an aircraft with a total cost to the Company of approximately $90 million, the majority of which was not tax deductible. Approximately half of the total charge was for the cost of the aircraft. The other half represented all other costs and taxes associated with the bonus. In the fourth quarter of 2002, all significant work and payments associated with the aircraft were completed. Of the original $90 million accrual, $2.4 million remained unspent at the end of fiscal 2002 and was reversed.

In March 2002, the Company entered into a Reimbursement Agreement with its Chief Executive Officer, Mr. Steven P. Jobs, for the reimbursement of expenses incurred by Mr. Jobs in the operation of his private plane when used for Apple business. The Reimbursement Agreement is effective for expenses incurred by Mr. Jobs for Apple business purposes since he took delivery of the plane in May 2001. The Company recognized a total of $404,000 in expenses pursuant to the Reimbursement Agreement during fiscal 2003. For fiscal 2002, the Company recognized a total of $1,168,000 in expenses pursuant to the Reimbursement Agreement related to expenses incurred by Mr. Jobs during 2001 and 2002. All expenses recognized pursuant to the Reimbursement Agreement have been included by the Company in selling, general, and administrative expenses.

In connection with a relocation assistance package, the Company loaned Mr. Ronald B. Johnson, Senior Vice President, Retail, $1.5 million for the purchase of his principal residence. The loan is secured by a deed of trust and is due and payable in May 2004. Under the terms of the loan, Mr. Johnson agreed that should he exercise any of his stock options prior to the due date of the loan, he would pay the Company an amount equal to the lesser of (1) an amount equal to 50% of the total net gain realized from the exercise

of the options; or (2) $375,000 multiplied by the number of years between the exercise date and the date of the loan. Mr. Johnson repaid $750,000 of this loan in fiscal 2003. The remaining $750,000 is due and payable in May 2004.

Mr. Jerome York, a member of the Board of Directors of the Company, is a member of an investment group that purchased MicroWarehouse, Inc. (MicroWarehouse) in January 2000. Until September 7, 2003, he also served as its Chairman, President and Chief Executive Officer. MicroWarehouse is a reseller of computer hardware, software and peripheral products, including products made by the Company. On September 8, 2003, CDW Corporation (CDW), acquired selected North American assets of MicroWarehouse. MicroWarehouse subsequently filed for Chapter 11 bankruptcy protection in the United States. MicroWarehouse accounted for 2.4%, 3.3%, and 2.9% of the Company's net sales in fiscal 2003, 2002 and 2001, respectively. Trade receivables from MicroWarehouse were $9.9 million and $20.9 million as of September 27, 2003, and September 28, 2002, respectively. The Company has provided what it believes to be an adequate allowance on the outstanding receivable based on the Company's secured interest position in selected MicroWarehouse assets and the expected payments to unsecured creditors. Sales to MicroWarehouse and related trade receivables were generally subject to the same terms and conditions as those with the Company's other resellers. In addition, the Company purchases miscellaneous equipment and supplies from MicroWarehouse. Total purchases amounted to approximately $2.3 million, $2.9 million, and $3.4 million in fiscal 2003, 2002, and 2001, respectively.

Note 13—Selected Quarterly Financial Information (Unaudited)

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
	(Tabular amounts in millions, except per share amounts)			
2003				
Net sales	$ 1,715	$ 1,545	$ 1,475	$ 1,472
Gross margin	$ 456	$ 428	$ 418	$ 406
Net income (loss)	$ 44	$ 19	$ 14	$ (8)
Earnings (loss) per common share:				
Basic	$ 0.12	$ 0.05	$ 0.04	$ (0.02)
Diluted	$ 0.12	$ 0.05	$ 0.04	$ (0.02)
2002				
Net sales	$ 1,443	$ 1,429	$ 1,495	$ 1,375
Gross margin	$ 381	$ 391	$ 409	$ 422
Net income (loss)	$ (45)	$ 32	$ 40	$ 38
Earnings (loss) per common share:				
Basic	$ (0.13)	$ 0.09	$ 0.11	$ 0.11
Diluted	$ (0.13)	$ 0.09	$ 0.11	$ 0.11

Basic and diluted earnings (loss) per share are computed independently for each of the quarters presented. Therefore, the sum of quarterly basic and diluted per share information may not equal annual basic and diluted earnings (loss) per share.

Net income during the fourth and third quarters of 2003 included after-tax net gains related to non-current investments of $5 million and $1 million, respectively. Net income for the fourth quarter also included settlement of the Company's forward purchase agreement resulting in a gain of $6 million and a favorable cumulative-effect type adjustment related to the adoption of SFAS 150 of $3 million. Net income (loss)

during the second and first quarters of 2003 included restructuring charges, net of tax, of $2 million and $18 million, respectively. Net loss for the first quarter of 2003 included an after-tax unfavorable cumulative-effect type adjustment for the adoption of SFAS No.143 of $2 million.

Net loss for the fourth quarter of 2002 included the following items, net of tax: the write-down of certain equity investments totaling $49 million; a restructuring charge of $4 million; an in-process research and development charge of approximately $1 million; and the reversal of a portion of a previous executive compensation expense resulting in a favorable impact of $2 million. Net income for the first quarter of 2002 included a restructuring charge, net of tax, of $18 million. Net income during the first quarter of 2002 also included gains, net of tax, of $17 million related to non-current investments.

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Shareholders
Apple Computer, Inc.:

We have audited the accompanying consolidated balance sheets of Apple Computer, Inc. and subsidiaries as of September 27, 2003 and September 28, 2002, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended September 27, 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Apple Computer, Inc. and subsidiaries as of September 27, 2003 and September 28, 2002, and the results of their operations and their cash flows for each of the years in the three-year period ended September 27, 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for asset retirement obligations and for financial instruments with characteristics of both liabilities and equity in 2003, changed its method of accounting for goodwill in 2002, and changed its method of accounting for hedging activities in 2001.

/s/ KPMG LLP

Mountain View, California
October 14, 2003

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A. Controls and Procedures

Based on an evaluation under the supervision and with the participation of the Company's management, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934, as amended (*Exchange Act*)) were effective as of September 27, 2003 to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

There were no significant changes in the Company's internal control over financial reporting identified in management's evaluation during the fourth quarter of fiscal 2003 that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

PART III

Item 10. Directors and Executive Officers of the Registrant

Directors

Listed below are the Company's six directors whose terms expire at the next annual meeting of shareholders.

Name	Position With the Company	Age	Director Since
William V. Campbell	Director	63	1997
Millard S. Drexler	Director	59	1999
Albert Gore, Jr.	Director	56	2003
Steven P. Jobs	Director and Chief Executive Officer	48	1997
Arthur D. Levinson	Director	53	2000
Jerome B. York	Director	65	1997

William V. Campbell has been Chairman of the Board of Directors of Intuit, Inc. *("Intuit")* since August 1998. From September 1999 to January 2000, Mr. Campbell acted as Chief Executive Officer of Intuit. From April 1994 to August 1998, Mr. Campbell was President and Chief Executive Officer and a director of Intuit. From January 1991 to December 1993, Mr. Campbell was President and Chief Executive Officer of GO Corporation. Mr. Campbell also serves on the board of directors of Opsware, Inc.

Albert Gore, Jr. has served as a Senior Advisor to Google, Inc. and Vice Chairman of Metropolitan West Financial LLC since 2001. He is a visiting professor at the University of California Los Angeles, Fisk University and Middle Tennessee State University. Mr. Gore was inaugurated as the 45th Vice President of the United States in 1993. He was re-elected in 1996 and served for a total of eight years as President of the Senate, a member of the cabinet and the National Security Council, and as the leader of a wide range of Administration initiatives including environmental policy, technology, science, communications and government cost reduction.

Millard S. Drexler has been Chairman and Chief Executive Officer of J. Crew Group, Inc. since March 2003. Previously, Mr. Drexler was Chief Executive Officer of Gap Inc. from 1995 and President from 1987 until September 2002. Mr. Drexler was also a member of the Board of Directors of Gap Inc. from November 1983 until October 2002.

Steven P. Jobs is one of the Company's co-founders and currently serves as its Chief Executive Officer. Mr. Jobs is also the Chairman and Chief Executive Officer of Pixar Animation Studios. In addition, Mr. Jobs co-founded NeXT Software, Inc. (*"NeXT"*) and served as the Chairman and Chief Executive Officer of NeXT from 1985 until 1997 when NeXT was acquired by the Company.

Arthur D. Levinson, Ph.D. has been President, Chief Executive Officer and a director of Genentech Inc. (*"Genentech"*) since July 1995. Dr. Levinson has been Chairman of the Board of Directors of Genentech since September 1999. He joined Genentech in 1980 and served in a number of executive positions, including Senior Vice President of R&D from 1993 to 1995.

Jerome B. York has been Chief Executive Officer of Harwinton Capital Corporation, a private investment company which he controls, since September 2003. From January 2000 until September 2003, Mr. York was Chairman and Chief Executive Officer of MicroWarehouse, Inc., a reseller of computer hardware, software and peripheral products. From September 1995 to October 1999, he was Vice Chairman of Tracinda Corporation. From May 1993 to September 1995 he was Senior Vice President and Chief Financial Officer of IBM Corporation, and served as a member of IBM's Board of Directors from January 1995 to August 1995. Previously his career was in the automotive industry, with his last position being Executive Vice President-Finance and Chief Financial Officer and a member of the Board of Directors of Chrysler Corporation. Mr. York is also a director of Tyco International Ltd. and Metro-Goldwyn-Mayer, Inc.

Role of the Board; Corporate Governance Matters

It is the paramount duty of the Board of Directors to oversee the Chief Executive Officer and other senior management in the competent and ethical operation of the Company on a day-to-day basis and to assure that the long-term interests of the shareholders are being served. To satisfy this duty, the directors take a proactive, focused approach to their position, and set standards to ensure that the Company is committed to business success through maintenance of the highest standards of responsibility and ethics.

Members of the Board bring to the Company a wide range of experience, knowledge and judgment. These varied skills mean that good governance depends on far more than a "check the box" approach to standards or procedures. The governance structure in the Company is designed to be a working structure for principled actions, effective decision-making and appropriate monitoring of both compliance and performance. The key practices and procedures of the Board are outlined in the Corporate Governance Guidelines available on the Company's website at www.apple.com/investor.

Board Committees

The Board has a standing Compensation Committee, a Nominating and Corporate Governance Committee (*"Nominating Committee"*) and an Audit and Finance Committee (*"Audit Committee"*).

The Compensation Committee is primarily responsible for reviewing the compensation arrangements for the Company's executive officers, including the Chief Executive Officer, and for administering the Company's stock option plans. Members of the Compensation Committee are Messrs. Campbell, Drexler, Gore and Dr. Levinson.

The Nominating Committee assists the Board in identifying qualified individuals to become directors, determines the composition of the Board and its committees, monitors the process to assess Board effectiveness and helps develop and implement the Company's corporate governance guidelines. Members of the Nominating Committee are Messrs. Campbell, Drexler, Gore and Dr. Levinson.

The Audit Committee is primarily responsible for overseeing the services performed by the Company's independent auditors and internal audit department, evaluating the Company's accounting policies and its system of internal controls and reviewing significant financial transactions. Consistent with the Nasdaq audit committee structure and membership requirements, the Audit Committee is comprised of three members: Messrs. Campbell, York and Dr. Levinson. Because of Mr. York's affiliation with MicroWarehouse, (see Item 13. Certain Relationships and Related Transactions), he is deemed to be a "non-independent" director. As permitted under the Nasdaq requirements, the Board carefully considered Mr. York's affiliation with MicroWarehouse as well as his accounting and financial expertise and determined that it is in the best interest of the Company and its shareholders that he continue to serve as a member of the Audit Committee. Both Mr. Campbell and Dr. Levinson are independent directors.

The Audit, Compensation and Nominating Committees operate under written charters adopted by the Board. These charters are available on the Company's website at www.apple.com/investor.

Audit Committee Financial Expert

While more than one member of the Company's Audit Committee qualifies as an "audit committee financial expert" under Item 401(h) of Regulation S-K, Mr. William V. Campbell, the Committee chairperson, is the designated audit committee financial expert. Mr. Campbell is considered "independent" as the term is used in Item 7(d)(3)(iv) of Schedule 14A under the Exchange Act.

Code of Ethics

The Company has a code of ethics that applies to all of the Company's employees, including its principal executive officer, principal financial officer and principal accounting officer. A copy of this code, "Ethics: The Way We Do Business Worldwide" is available on the Company's website at *www.apple.com/investor* and is filed as an exhibit to this annual report on Form 10-K. The Company intends to disclose any

changes in or waivers from its code of ethics by posting such information on its website or by filing a Form 8-K.

Executive Officers

The following sets forth certain information regarding executive officers of the Company. Information pertaining to Mr. Jobs, who is both a director and an executive officer of the Company, may be found in the section entitled **"Directors."**

Fred D. Anderson, Executive Vice President and Chief Financial Officer (age 59), joined the Company in April 1996. Prior to joining the Company, Mr. Anderson was Corporate Vice President and Chief Financial Officer of Automatic Data Processing, Inc., a position he held from August 1992 to March 1996. Mr. Anderson also serves as a director of eBay Inc. and E.piphany, Inc.

Timothy D. Cook, Executive Vice President, Worldwide Sales and Operations (age 43), joined the Company in February 1998. Prior to joining the Company, Mr. Cook held the position of Vice President, Corporate Materials for Compaq Computer Corporation (*"Compaq"*). Previous to his work at Compaq, Mr. Cook was the Chief Operating Officer of the Reseller Division at Intelligent Electronics. Mr. Cook also spent 12 years with IBM, most recently as Director of North American Fulfillment.

Nancy R. Heinen, Senior Vice President, General Counsel and Secretary (age 47), joined the Company in September 1997. Prior to joining the Company, Ms. Heinen held the position of Vice President, General Counsel and Secretary of the Board of Directors at NeXT from February 1994 until the acquisition of NeXT by the Company in February 1997.

Ronald B. Johnson, Senior Vice President, Retail (age 45), joined the Company in January 2000. Prior to joining the Company, Mr. Johnson spent 16 years with Target Stores, most recently as Senior Merchandising Executive.

Peter Oppenheimer, Senior Vice President of Finance and Corporate Controller (age 41), joined the Company in July 1996. Mr. Oppenheimer also served with the Company in the position of Vice President and Corporate Controller and as Senior Director of Finance for the Americas. Prior to joining the Company, Mr. Oppenheimer was CFO of one of the four business units for Automatic Data Processing, Inc. (*"ADP"*). Prior to joining ADP, Mr. Oppenheimer spent six years in the Information Technology Consulting Practice with Coopers and Lybrand.

Jonathan Rubinstein, Senior Vice President, Hardware Engineering (age 47), joined the Company in February 1997. Before joining the Company, Mr. Rubinstein was Executive Vice President and Chief Operating Officer of FirePower Systems Incorporated, from May 1993 to August 1996. Mr. Rubinstein also serves as a member of the Board of Directors of Immersion Corporation.

Philip W. Schiller, Senior Vice President, Worldwide Product Marketing (age 43), rejoined the Company in 1997. Prior to rejoining the Company, Mr. Schiller was Vice President of Product Marketing at Macromedia, Inc. from December 1995 to March 1997 and was Director of Product Marketing at FirePower Systems, Inc. from 1993 to December 1995. Prior to that, Mr. Schiller spent six years at the Company in various marketing positions.

Bertrand Serlet, Ph.D., Senior Vice President, Software Engineering (age 42), joined the Company in February 1997 upon the Company's acquisition of NeXT. At NeXT, Dr. Serlet held several engineering and managerial positions, including Director of Web Engineering. Prior to NeXT, from 1985 to 1989, Dr. Serlet worked as a research engineer at Xerox PARC.

Sina Tamaddon, Senior Vice President, Applications (age 46), joined the Company in September 1997. Mr. Tamaddon has also served with the Company in the position of Senior Vice President Worldwide Service and Support, and Vice President and General Manager, Newton Group. Before joining the Company, Mr. Tamaddon held the position of Vice President, Europe with NeXT from September 1996

through March 1997. From August 1994 to August 1996, Mr. Tamaddon held the position of Vice President, Professional Services with NeXT.

Avadis Tevanian, Jr., Ph.D., Senior Vice President, Chief Software Technology Officer (age 42), joined the Company in February 1997 upon the Company's acquisition of NeXT. Dr. Tevanian served with the Company in the position of Senior Vice President, Software Engineering from 1997 to July 2003. With NeXT, Dr. Tevanian held several positions, including Vice President, Engineering, from April 1995 to February 1997. Prior to April 1995, Dr. Tevanian worked as an engineer with NeXT and held several management positions.

Item 11. Executive Compensation

Information Regarding Executive Compensation

The following table summarizes compensation information for the last three fiscal years for (i) Mr. Jobs, Chief Executive Officer and (ii) the four most highly compensated executive officers other than the Chief Executive Officer who were serving as executive officers of the Company at the end of the fiscal year (collectively, the "*Named Executive Officers*").

SUMMARY COMPENSATION TABLE

		Annual Compensation		Long-Term Compensation		
Name and Principal Position	Fiscal Year	Salary ($)	Bonus ($)	Restricted Stock Award ($)	Securities Underlying Options* (#)	All Other Compensation ($)
Steven P. Jobs	2003	1	—	74,750,000(1)	—	—
Chief Executive Officer	2002	1	2,268,698(2)		7,500,000(1)	1,302,795(2)
	2001	1	43,511,534(2)		—	40,484,594(2)
Fred D. Anderson	2003	656,631	—	—	—	11,450(3)
Executive Vice President and Chief	2002	656,631	—	—	—	11,000(3)
Financial Officer	2001	657,039	—	—	1,000,000	7,312(3)
Timothy D. Cook	2003	617,673	—	—	—	9,929(3)
Executive Vice President, Worldwide	2002	563,829	—	—	—	8,025(3)
Sales and Operations	2001	452,219	500,000	—	1,000,000	7,875(3)
Ronald B. Johnson	2003	452,404	1,500,000	—	—	—
Senior Vice President, Retail	2002	452,404	—	—	300,000	—
	2001	452,429	—	—	300,000	—
Avadis Tevanian, Jr. Ph.D	2003	456,731	—	—	—	11,962(3)
Senior Vice President, Chief Software	2002	492,212	—	—	—	10,700(3)
Technology Officer	2001	460,873	500	—	1,000,000	10,200(3)

(1) In March 2003, Mr. Jobs voluntarily cancelled all of his outstanding options, excluding those granted to him in his capacity as a director. In March 2003, the Board awarded Mr. Jobs five million restricted shares of the Company's Common Stock which generally vest in full on the third anniversary of the grant date.

(2) In December 1999, Mr. Jobs was given a special executive bonus for past services as the Company's interim Chief Executive Officer, in the form of an aircraft with a total cost to the Company of approximately $90,000,000. Because the aircraft was transferred to Mr. Jobs in 2001, the amount of approximately $43.5 million paid by the Company during fiscal year 2001 towards the purchase of the plane and the related tax assistance of approximately $40.5 million was reported as income to Mr. Jobs. In fiscal 2002, approximately $2.27 million paid by the Company towards the purchase of the plane and approximately $1.3 million in related tax assistance was reported as income to Mr. Jobs.

(3) Consists of matching contributions made by the Company in accordance with the terms of the 401(k) plan.

Option Grants in Last Fiscal Year

There were no options granted to the Named Executive Officers during fiscal year 2003.

Options Exercised and Year-End Option Holdings

The following table provides information about stock option exercises by the Named Executive Officers during fiscal year 2003 and stock options held by each of them at fiscal year-end.

AGGREGATED OPTION EXERCISES IN THE LAST FISCAL YEAR AND FISCAL YEAR-END OPTION VALUES

			Number of Securities Underlying Unexercised Options at Fiscal Year-End (#)		Value of Unexercised In-the-Money Options at Fiscal Year-End ($) (1)	
Name	Shares Acquired on Exercise (#)	Value Realized ($)	Exercisable	Unexercisable	Exercisable	Unexercisable
Steven P. Jobs	—	—	60,000(2)	—	$ 551,400	—
Fred D. Anderson	—	—	1,150,000	800,000	$ 4,134,125	$ 2,952,000
Timothy D. Cook	—	—	800,000	800,000	$ 2,952,000	$ 2,952,000
Ronald B. Johnson	—	—	1,181,250	618,750	$ 451,687	$ 205,312
Avadis Tevanian, Jr.	—	—	1,600,000	800,000	$ 9,636,522	$ 2,952,000

(1) Market value of securities underlying in-the-money options at the end of fiscal year 2003 (based on $20.69 per share, the closing price of Common Stock on the Nasdaq National Market on September 27, 2003), minus the exercise price.

(2) Includes 60,000 options granted to Mr. Jobs in his capacity as a director pursuant to the 1997 Director Stock Option Plan. In March 2003, Mr. Jobs voluntarily cancelled all of his outstanding options, excluding those granted to him in his capacity as a director.

Director Compensation

The form and amount of director compensation is determined by the Board after a review of recommendations made by the Nominating Committee. The current practice of the Board is that a substantial portion of a director's annual retainer be equity-based. In 1998, shareholders approved the 1997 Director Stock Option Plan (the "*Director Plan*") and 800,000 shares were reserved for issuance thereunder. Pursuant to the Director Plan, the Company's non-employee directors are granted an option to acquire 30,000 shares of Common Stock upon their initial election to the Board ("*Initial Options*"). The Initial Options vest and become exercisable in three equal annual installments on each of the first through third anniversaries of the grant date. On the fourth anniversary of a non-employee director's initial election to the Board and on each subsequent anniversary thereafter, the director will be entitled to receive an option to acquire 10,000 shares of Common Stock ("*Annual Options*"). Annual Options are fully vested and immediately exercisable on their date of grant. As of the end of the fiscal year, there were options for 370,000 shares outstanding under the Director Plan. Since accepting the position of CEO, Mr. Jobs is no longer eligible for grants under the Director Plan. Directors also receive a $50,000 annual retainer paid in quarterly increments. Directors do not receive any additional consideration for serving on committees or as committee chairperson.

Compensation Committee Interlocks and Insider Participation

The current members of the Compensation Committee are Messrs. William V. Campbell, Millard S. Drexler, Albert Gore, Jr. and Dr. Arthur B.

Levinson, none of whom are employees of the Company and all of whom are considered "independent" directors under the applicable NASDAQ rules. At the beginning of the fiscal year, Mr. Jerome B. York served on the Committee until his resignation in November 2002 at which time Mr. Drexler was appointed as a member of the Committee. No person who

was an employee of the Company in fiscal year 2003 served on the Compensation Committee. No executive officer of the Company (i) served as a member of the compensation committee (or other board committee performing similar functions or, in the absence of any such committee, the board of directors) of another entity, one of whose executive officers served on the Company's Compensation Committee, (ii) served as a director of another entity, one of whose executive officers served on the Company's Compensation Committee, or (iii) served as a member of the compensation committee (or other board committee performing similar functions or, in the absence of any such committee, the board of directors) of another entity, one of whose executive officers served as a director of the Company.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth certain information as of October 31, 2003 (the "*Table Date*") with respect to the beneficial ownership of the Company's Common Stock by (i) each person the Company believes beneficially holds more than 5% of the outstanding shares of Common Stock; (ii) each director; (iii) each Named Executive Officer listed in the Summary Compensation Table under the heading "**Executive Compensation;**" and (iv) all directors and executive officers as a group. On the Table Date, 367,490,665 shares of Common Stock were issued and outstanding. Unless otherwise indicated, all persons named as beneficial owners of Common Stock have sole voting power and sole investment power with respect to the shares indicated as beneficially owned.

Security Ownership of Directors, Nominees and Executive Officers

Name of Beneficial Owner	Shares of Common Stock Beneficially Owned(1)	Percent of Common Stock Outstanding
Lord, Abbett & Co.	34,864,239(2)	9.49%
Steven P. Jobs	5,060,002(3)	1.38%
Fred D. Anderson	1,152,672(4)	*
William V. Campbell	90,502(5)	*
Timothy D. Cook	804,334(6)	*
Millard S. Drexler	90,000(7)	*
Albert Gore, Jr	—	*
Ronald B. Johnson	1,204,334(8)	*
Arthur D. Levinson	231,600(9)	*
Avadis Tevanian, Jr.	1,601,252(10)	*
Jerome B. York	110,000(5)	*
All executive officers and directors as a group (16 persons)	14,715,373	4.00%

(1) Represents shares of Common Stock held and/or options held by such individuals that were exercisable at the Table Date or within 60 days thereafter.

(2) Based on a Form 13F-HR filed October 22, 2003 by Lord, Abbett & Co., 767 Fifth Avenue, New York, NY 10153.

(3) Includes 60,000 shares of Common Stock which Mr. Jobs has the right to acquire by exercise of stock options.

(4) Includes 1,150,000 shares of Common Stock which Mr. Anderson has the right to acquire by exercise of stock options.

(5) Includes 90,000 shares of Common Stock which Messrs. Campbell and York each have the right to acquire by exercise of stock options.

(6) Includes 800,000 shares of Common Stock which Mr. Cook has the right to acquire by exercise of stock options.

(7) Includes 70,000 shares of Common Stock which Mr. Drexler has the right to acquire by exercise of stock options.

(8) Includes 1,200,000 shares of Common Stock which Mr. Johnson has the right to acquire by exercise of stock options.

(9) Includes 1,400 shares of Common Stock which Dr. Levinson holds indirectly and 30,000 shares of Common Stock which Dr. Levinson has the right to acquire by exercise of stock options.

(10) Includes 1,600,000 shares of Common Stock which Dr. Tevanian has the right to acquire by exercise of stock options.

* Represents less than 1% of the issued and outstanding shares of Common Stock on the Table Date.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires the Company's officers and directors, and persons who own more than ten percent of a registered class of the Company's equity securities, to file reports of securities ownership and changes in such ownership with the Securities and Exchange Commission ("*SEC*"). Officers, directors and greater than ten percent shareholders also are required by rules promulgated by the SEC to furnish the Company with copies of all Section 16(a) forms they file.

Based solely upon a review of the copies of such forms furnished to the Company or written representations that no Forms 5 were required, the Company believes that all Section 16(a) filing requirements were met during fiscal year 2003, except that Messrs. Campbell and York each filed one Form 4 late under the new two-day reporting requirements.

Equity Compensation Plan Information

The following table sets forth certain information, as of September 27, 2003, concerning shares of common stock authorized for issuance under all of the Company's equity compensation plans.

	(a) Number of Securities to be Issued Upon Exercise of Options	(b) Weighted Average Exercise Price of Outstanding Options	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by shareholders	19,507,624	$ 18.75	29,142,907(1)
Equity compensation plans not approved by shareholders	43,343,560	$ 19.29	20,689,245(2)
Total equity compensation plans (3)	62,851,184	$ 19.12	49,832,152(2)

(1) This number includes 4,002,123 shares of common stock reserved for issuance under the Employee Stock Purchase Plan, 310,000 shares available for issuance under the 1997 Director Stock Option Plan and 24,830,784 shares available for issuance under the 2003 Employee Stock Plan. It does not include shares under the 1990 Stock Option Plan which was terminated in 1997. No new options can be granted under the 1990 Stock Option Plan.

(2) On October 22, 2003, the Company granted 6,697,368 shares under the 1997 Employee Stock Option Plan (the "1997 Plan") pursuant to the stock option exchange program (see Part II, Item 8 of this

Form 10-K in the Notes to Consolidated Financial Statements at Note 8, under the heading "Employee Stock Option Exchange Program"). Following that grant, the Company terminated the 1997 Plan, its only non-shareholder approved equity plan. All remaining unissued shares in that plan were cancelled and no new options can be granted under that plan.

(3) This table does not include 160,975 outstanding options assumed in connection with mergers with and acquisitions of the companies which originally established those plans. These assumed options have a weighted average exercise price of $3.69 per share. No additional options may be granted under those assumed plans.

Arrangements with Named Executive Officers

Change In Control Arrangements—Stock Options

In the event of a "change in control" of the Company, all outstanding options under the Company's stock option plans, except the Director Plan, will, unless otherwise determined by the plan administrator, become exercisable in full, and will be cashed out at an amount equal to the difference between the applicable "change in control price" and the exercise price. The Director Plan provides that upon a "change in control" of the Company, all unvested options held by non-employee directors will automatically become fully vested and exercisable and will be cashed out at an amount equal to the difference between the applicable "change in control price" and the exercise price of the options. A "change in control" under these plans is generally defined as (i) the acquisition by any person of 50% or more of the combined voting power of the Company's outstanding securities or (ii) the occurrence of a transaction requiring shareholder approval and involving the sale of all or substantially all of the assets of the Company or the merger of the Company with or into another corporation.

In addition, options granted to the Named Executive Officers generally provide that in the event there is a "change in control," as defined in the Company's stock option plans, and if in connection with or following such "change in control," their employment is terminated without "Cause" or if they should resign for "Good Reason," those options outstanding that are not yet vested and exercisable as of the date of such "change in control" shall become fully vested and exercisable. Generally, "Cause" is defined to include a felony conviction, willful disclosure of confidential information or willful and continued failure to perform his or her employment duties. "Good Reason" includes resignation of employment as a result of a substantial diminution in position or duties, or an adverse change in title or reduction in annual base salary.

Item 13. Certain Relationships and Related Transactions

In connection with a relocation assistance package, the Company loaned Mr. Johnson (Senior Vice President, Retail) $1,500,000 for the purchase of his principal residence. The loan is secured by a deed of trust and is due and payable in May 2004. Under the terms of the loan, Mr. Johnson agreed that should he exercise any of his stock options prior to the due date of the loan, he would pay the Company an amount equal to the lesser of (1) an amount equal to 50% of the total net gain realized from the exercise of the options; or (2) $375,000 multiplied by the number of years between the exercise date and the date of the loan. The largest amount of the indebtedness outstanding on this loan during fiscal year 2003 was $1,500,000. Mr. Johnson repaid the Company $750,000 during the fiscal year and the amount remaining on the loan is $750,000.

Mr. Jerome York, a member of the Board of Directors of the Company, is a member of an investment group that purchased MicroWarehouse, Inc. ("*MicroWarehouse*") in January 2000. Until September 2003, he served as its Chairman, President and Chief Executive Officer. MicroWarehouse is a reseller of computer hardware, software and peripheral products, including products made by the Company. During fiscal year 2003, MicroWarehouse accounted for 2.4% of the Company's net sales. The Company also purchased products from MicroWarehouse for its own internal use.

In March 2002, the Company entered into a Reimbursement Agreement with its Chief Executive Officer, Mr. Steven P. Jobs, for the reimbursement of expenses incurred by Mr. Jobs in the operation of his private plane when used for Apple business. The Reimbursement Agreement is effective for expenses incurred by Mr. Jobs for Apple business purposes since he took delivery of the plane in May 2001. During 2003, the Company recognized a total of $403,766 in expenses pursuant to this reimbursement agreement related to expenses incurred by Mr. Jobs during 2003.

Item 14. Principal Accountant Fees and Services

The following table sets forth the fees paid to the Company's independent auditor, KPMG LLP, during fiscal years 2003 and 2002.

Audit and Non-Audit Fees

	2003	2002
Audit Fees	$ 3,028,000(1)	$ 2,635,000
Audit-Related Fees	$ 144,600(2)	$ 140,000
Tax Fees	$ 1,017,100(3)	$ 1,055,000
All Other Fees	$ —	$ 75,000
Total	$ 4,189,700	$ 3,905,000

(1) Audit fees relate to professional services rendered in connection with the audit of the Company's annual financial statements, quarterly review of financial statements included in the Company's Forms 10-Q, and audit services provided in connection with other statutory and regulatory filings.

(2) Audit-related fees include professional services related to the audit of the Company's financial statements, consultation on accounting standards or transactions, and audits of employee benefit plans.

(3) Tax fees include $901,500 for professional services rendered in connection with tax compliance and preparation relating to the Company's expatriate program, tax audits and international tax compliance; and $115,600 for tax consulting and planning services relating to interest computations and international tax changes. The Company does not engage KPMG to perform personal tax services for its executive officers.

Policy on Audit Committee Pre-Approval of Audit and Non-Audit Services Performed by the Independent Auditors

Prior to the enactment of the Sarbanes-Oxley Act of 2002 (the "*Act*"), the Company adopted an auditor independence policy that banned its auditors from performing non-financial consulting services, such as information technology consulting and internal audit services. This auditor policy also mandates that an annual budget for both audit and non-audit services be approved by the Audit Committee in advance, and that the Audit Committee be provided with quarterly reporting on actual spending. This policy also mandates that no auditor engagements for non-audit services may be entered into without the express approval of the Audit Committee.

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PART IV

Item 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K.

(a) Items Filed as Part of Report:

1. Financial Statements

   The financial statements of the Company filed as part of this report on Form 10-K are set forth in the Index to Consolidated Financial Statements under Part II, Item 8 of this Form 10-K.

2. Financial Statement Schedules

   All financial statement schedules have been omitted, since the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Consolidated Financial Statements and Notes thereto under Part II, Item 8 of this Form 10-K.

3. Exhibits

		Incorporated by Reference		
Exhibit Number	**Exhibit Description**	**Form**	**Filing Date**	**Filed herewith**
3.1	Restated Articles of Incorporation, filed with the Secretary of State of the State of California on January 27, 1988.	S-3	7/27/88	
3.2	Amendment to Restated Articles of Incorporation, filed with the Secretary of State of the State of California on May 4, 2000.	10-Q	5/11/00	
3.3	By-Laws of the Company, as amended through March 19, 2003.	10-Q	5/13/03	
4.2	Indenture dated as of February 1, 1994, between the Company and Morgan Guaranty Trust Company of New York.	10-Q	4/01/94	
4.3	Supplemental Indenture dated as of February 1, 1994, among the Company, Morgan Guaranty Trust Company of New York, as resigning trustee, and Citibank, N.A., as successor trustee.	10-Q	4/01/94	
4.5	Form of the Company's 6 1/2% Notes due 2004.	10-Q	4/01/94	
4.8	Registration Rights Agreement, dated June 7, 1996 among the Company and Goldman, Sachs & Co. and Morgan Stanley & Co. Incorporated.	S-3	8/28/96	
4.9	Certificate of Determination of Preferences of Series A Non-Voting Convertible Preferred Stock of Apple Computer, Inc.	10-K	9/26/97	
10.A.3	Apple Computer, Inc. Savings and Investment Plan, as amended and restated effective as of October 1, 1990.	10-K	9/27/91	
10.A.3-1	Amendment of Apple Computer, Inc. Savings and Investment Plan dated March 1, 1992.	10-K	9/25/92	

10.A.3-2	Amendment No. 2 to the Apple Computer, Inc. Savings and Investment Plan.	10-Q	3/28/97	
10.A.5	1990 Stock Option Plan, as amended through November 5, 1997.	10-Q	12/26/97	

10.A.6	Apple Computer, Inc. Employee Stock Purchase Plan, as amended through April 24, 2003.	S-8	6/24/03	
10.A.8	Form of Indemnification Agreement between the Registrant and each officer of the Registrant.	10-K	9/26/97	
10.A.43	NeXT Computer, Inc. 1990 Stock Option Plan, as amended.	S-8	3/21/97	
10.A.49	1997 Employee Stock Option Plan, as amended through October 19, 2001.	10-K	9/28/02	
10.A.50	1997 Director Stock Option Plan.	10-Q	3/27/98	
10.A.51	2003 Employee Stock Option Plan, as amended through April 24, 2003.	10-Q	6/28/03	
10.A.52	Reimbursement Agreement.	10-Q	6/29/02	
10.A.53	Option Cancellation and Restricted Stock Award Agreement	10-Q	6/28/03	
10.B.18	Custom Sales Agreement effective October 21, 2002 between the Registrant and International Business Machines Corporation.			X
14.1	Code of Ethics of the Company			X
21	Subsidiaries of Apple Computer, Inc.			X
23.1	Independent Auditors' Consent			X
31.1	Rule13a-14(a) / 15d-14(a) Certification of Chief Executive Officer			X
31.2	Rule13a-14(a) / 15d-14(a) Certification of Chief Financial Officer			X
32.1	Section 1350 Certification of Chief Executive and Chief Financial Officer			X

(b) Reports on Form 8-K

The Company filed a current report on Form 8-K on October 15, 2003, to reference and furnish as exhibits a press release and data sheet issued to the public by the Company on October 15, 2003.

The Company filed a current report on Form 8-K on July 16, 2003, to reference and furnish as exhibits a press release and data sheet issued to the public by the Company on July 16, 2003.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, this 18th day of December 2003.

APPLE COMPUTER, INC.

By: /s/ FRED D. ANDERSON

Fred D. Anderson
Executive Vice President and
Chief Financial Officer

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Steven P. Jobs and Fred D. Anderson, jointly and severally, his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this Annual Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Name	Title	Date
/s/ STEVEN P. JOBS STEVEN P. JOBS	Chief Executive Officer and Director (Principal Executive Officer)	December 18, 2003
/s/ FRED D. ANDERSON FRED D. ANDERSON	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	December 18, 2003
/s/ PETER OPPENHEIMER PETER OPPENHEIMER	Senior Vice President of Finance and Corporate Controller (Principal Accounting Officer)	December 18, 2003
/s/ WILLIAM V. CAMPBELL WILLIAM V. CAMPBELL	Director	December 18, 2003
/s/ MILLARD S. DREXLER MILLARD S. DREXLER	Director	December 18, 2003
/s/ ALBERT GORE, JR. ALBERT GORE, JR.	Director	December 18, 2003
/s/ ARTHUR D. LEVINSON ARTHUR D. LEVINSON	Director	December 18, 2003
/s/ JEROME B. YORK JEROME B. YORK	Director	December 18, 2003

QuickLinks

EXHIBIT 3

10-K 1 a2147337z10-k.htm 10-K
QuickLinks -- Click here to rapidly navigate through this document

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended September 25, 2004

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ______________ to ______________

Commission file number 0-10030

APPLE COMPUTER, INC.
(Exact name of registrant as specified in its charter)

CALIFORNIA (State or other jurisdiction of incorporation or organization)	**942404110** (I.R.S. Employer Identification No.)
1 Infinite Loop **Cupertino, California** (Address of principal executive offices)	**95014** (Zip Code)

Registrant's telephone number, including area code: **(408) 996-1010**

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, no par value
(Titles of classes)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities

Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference to Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ☒ No ☐

The aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant, as of March 27, 2004, was approximately $8,336,330,708 based upon the closing price reported for such date on the NASDAQ National Market. For purposes of this disclosure, shares of Common Stock held by persons who hold more than 5% of the outstanding shares of Common Stock and shares held by executive officers and directors of the registrant have been excluded because such persons may be deemed to be affiliates. This determination of executive officer or affiliate status is not necessarily a conclusive determination for other purposes.

402,057,856 shares of Common Stock Issued and Outstanding as of November 19, 2004

PART I

The Business section and other parts of this Annual Report on Form 10-K ("Form 10-K") contain forward-looking statements that involve risks and uncertainties. Many of the forward-looking statements are located in "Management's Discussion and Analysis of Financial Condition and Results of Operations." Forward-looking statements can also be identified by words such as "anticipates," "expects," "believes," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and the Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Factors That May Affect Future Results and Financial Condition" under Part II, Item 7 of this Form 10-K. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Item 1. Business

Company Background

Apple Computer, Inc. ("Apple" or the "Company") was incorporated under the laws of the State of California on January 3, 1977. The Company designs, manufactures and markets personal computers and related software, services, peripherals and networking solutions. The Company also designs, develops and markets a line of portable digital music players along with related accessories and services including the online distribution of third-party music and audio books. The Company's products and services include the Macintosh line of desktop and notebook computers, the iPod digital music player, the Xserve server and Xserve RAID storage products, a portfolio of consumer and professional software applications, the Mac OS X operating system, the online iTunes Music Store, a portfolio of peripherals that support and enhance the Macintosh and iPod product lines, and a variety of other service and support offerings. The Company sells its products worldwide through its online stores, its own retail stores, its direct sales force, and third-party wholesalers, resellers and value added resellers. In addition, the Company sells a variety of third-party products that are compatible with the Company's Macintosh and iPod product lines, including computer printers and printing supplies, storage devices, computer memory, digital video and still cameras, personal digital assistants, iPod accessories, and various other computing products and supplies through its online and retail stores. The Company's fiscal year ends on the last Saturday of September. Unless otherwise stated, all information presented in this Form 10-K is based on the Company's fiscal calendar.

Business Strategy

Apple is committed to bringing the best personal computing and music experience to students, educators, creative professionals, businesses and consumers around the world through its innovative hardware, software, peripherals and Internet offerings. The Company's business strategy leverages its unique ability, through the design and development of its own operating system, hardware and many software applications and technologies, to bring to its customers around the world meaningful new products and solutions with superior ease-of-use, seamless integration and innovative industrial design. The Company believes continual investment in research and development is critical to facilitate innovation of new and improved products and technologies. Besides updates to its existing line of personal computers and related software, services, and peripherals, the Company continues to capitalize on the convergence of digital consumer electronics and the computer by creating product innovations like the iPod and iTunes Music Store. The Company has also invested in new product areas such as rack-mount servers, RAID storage systems and wireless technologies. The Company's strategy also includes expanding its distribution network to effectively reach more of its targeted customers.

Digital Hub

The Company believes personal computing is in an era in which the personal computer functions for both professionals and consumers as the digital hub for advanced new digital devices such as the Company's iPod digital music players, personal digital assistants, cellular phones, digital still and movie cameras, CD and DVD players, and other consumer electronic devices. The attributes of the personal computer, including its ability to run complex applications, possess a high quality user interface, contain large and relatively inexpensive storage, and easily connect to the Internet in multiple ways and at varying speeds, can individually add value to these devices and interconnect them as well. Apple is the only company in the personal computer industry that controls the design and development of the entire personal computer—from the hardware and operating system to sophisticated applications. Apple provides innovative industrial design, intuitive ease-of-use, and built-in networking, graphics, and multimedia capabilities. Thus, the Company is uniquely positioned to offer integrated digital hub products and solutions.

Apple develops products and technologies that adhere to many industry standards in order to provide an optimized user experience through interoperability with peripherals and devices from other companies. Apple has played a role in the development, enhancement, promotion, and/or use of numerous of these industry standards, many of which are discussed below.

Expanded Distribution

The Company believes a high quality buying experience with knowledgeable salespersons, who can convey the value of the Company's products and services, is critical to attracting and retaining customers. As such, in addition to expanding its indirect distribution channels, the Company has expanded its product distribution strategy to include its own retail locations, Apple online stores worldwide, and the Apple Sales Consultant Program. The Company sells many of its products and resells certain third-party products in most of its major markets directly to consumers, education customers, and businesses through its retail stores in the U.S. and internationally, or through one of its online stores around the world. The Company has also invested in programs like the Apple Sales Consultant Program, which is designed to enhance reseller sales by the placement of Apple badged employees at selected third-party reseller locations. The Company believes enabling a direct interface with its targeted end customer provides an efficient means to effectively demonstrate the advantages of the Company's Macintosh and other products over those of its competitors. For certain of its consumer electronic products, including the iPod product family, the Company has also significantly expanded the points of distribution in order to make available its products at locations where its customers shop.

Since inception of its retail initiative in 2001, the Company has opened 84 retail stores in the U.S. and 2 international stores in Tokyo and Osaka, Japan through the end of fiscal year 2004. During the first quarter of 2005, the Company anticipates opening 14 additional stores, and expects to exit the calendar year at approximately 100 stores. The Company has typically located its stores at high traffic locations in quality shopping malls and urban shopping districts. Approximately half of the stores expected to open during the first quarter of 2005 are in the new "mini" store design, which is the Company's smallest store format to date, allowing them to be placed in a variety of new locations to introduce the Company's products to even more customers. The Company also opened its third international store in London, England during the first quarter of 2005.

One of the goals of the retail initiative is to bring new customers to the Company and expand its installed base through sales to both first time personal computer buyers and those switching to the Macintosh platform from competing operating system platforms. By operating its own stores and building them in desirable high traffic locations, the Company is able to better control the customer retail experience and attract new Apple customers. The stores are designed to simplify and enhance the presentation and marketing of personal computing products. To that end, retail store configurations have evolved into various sizes in order to accommodate market demands. The stores employ experienced and knowledgeable personnel who provide product advice and certain hardware support services. The stores offer a wide selection of third-party hardware and software products selected to complement the Company's own products. Additionally, the stores provide a forum in which the Company is able to present entire computing solutions to users in areas such as digital photography, digital video, music, children's software, and home and small business computing. Apple retail stores host customer events and free classes, including the popular "Getting Started" class, and have brought back the concept of customer service with innovations like the Genius Bar.

Education

For more than 25 years, the Company has focused on the use of technology in education and has been committed to delivering tools to help educators teach and students learn. The Company believes effective integration of technology into classroom instruction can result in higher levels of student achievement, especially when used to support collaboration, information access, and the expression and representation of student thought and ideas. The Company creates solutions that enable new modes of curriculum delivery, better ways of conducting research, and opportunities for professional development of faculty, students, and staff. A range of products and services is designed by the Company to help schools maximize their investments in technology. This is manifested in many of the Company's products and services that are designed to meet the needs of education customers, including the eMac™ and the iBook®, video editing solutions, wireless networking capabilities, student information systems, one-to-one learning solutions, and high-quality curriculum and professional development solutions.

Creative Professionals

Creative professionals constitute one of the Company's most important markets for both hardware and software products. This market is also important to many third-party developers who provide Macintosh compatible hardware and software solutions. Creative customers utilize the Company's products for a variety of creative activities including digital video and film production and editing; digital video and film special effects, compositing, and titling; digital still photography; graphic design, publishing, and print production; music performance and production; audio production and sound design; and web design, development and administration.

The Company designs its high-end hardware solutions, including servers, desktops, and portable Macintosh systems, to incorporate the power, expandability, and features desired by creative professionals. Additionally, the Company's operating system, Mac OS X, incorporates powerful graphics and audio technologies and features developer tools to optimize system and application performance when running powerful creative solutions provided by the Company or third-party developers. The Company also offers various software solutions to meet the needs of its creative customers, many of which are described below.

Business Organization

The Company manages its business primarily on a geographic basis. The Company's reportable operating segments are comprised of the Americas, Europe, Japan, and Retail. The Americas segment includes both North and South America, except for the activities of the Company's Retail segment. The Europe segment includes European countries as well as the Middle East and Africa. The Japan segment includes only Japan and excludes revenue from the Company's own retail stores in Japan, which is included in the Company's Retail segment. The Retail segment currently operates Apple-owned retail stores in the U.S., Japan and England. Other operating segments include Asia-Pacific, which includes Australia and Asia except for Japan, and the Company's subsidiary, FileMaker, Inc. Each reportable geographic operating segment provides similar hardware and software products and similar services. Further information regarding the Company's operating segments may be found in Part II, Item 7 of this Form 10-K under the heading "Segment Operating Performance," and in Part II, Item 8 of this Form 10-K in the Notes to Consolidated Financial Statements at Note 11, "Segment Information and Geographic Data."

Hardware Products

The Company offers a range of personal computing products including desktop and notebook personal computers, related devices and peripherals, and various third-party hardware products. All of the Company's Macintosh® products utilize PowerPC® RISC-based microprocessors. The Company's entire line of Macintosh systems, excluding servers and storage systems, features the Company's Mac OS® X

Version 10.3 "Panther" and iLife® suite of software for digital photography, music, movies, and music creation.

Power Mac®

The Power Mac line of desktop personal computers is targeted at business and professional users and is designed to meet the speed, expansion and networking needs of the most demanding Macintosh user. Powered by the PowerPC G5 processor, the Power Mac G5 utilizes 64-bit processing technology for memory expansion up to 8GB, and advanced 64-bit computation while also running existing 32-bit applications natively. The Power Mac G5 product line comes in four processor configurations—single 1.8GHz, dual 1.8GHz, dual 2.0GHz and dual 2.5GHz. All Power Mac G5 desktops feature a SuperDrive™ and either the NVIDIA GeForceFX 5200 Ultra or the ATI Radeon 9600 XT graphics card. In addition, all Power Mac G5 desktops deliver connectivity and high-performance input/output (I/O), including Gigabit Ethernet, FireWire® 800 and FireWire 400 ports, USB 2.0 ports, optical digital audio input and output, built-in support for 54 Mbps AirPort® Extreme wireless networking, and optional Bluetooth connectivity.

Xserve® and Xserve RAID Storage System

Xserve, the Company's first rack-mount server product, was designed for simple setup and remote management of intensive I/O applications such as digital video, high-resolution digital imagery, and large databases. In January 2004, the Company announced Xserve G5, which is available with either a single or dual 2.0 GHz PowerPC G5 processor. Xserve G5 includes a system controller with up to 8GB of PC3200 error correcting code memory; three hot-plug Serial ATA drive modules that deliver up to 750GB of storage; and dual on-board Gigabit Ethernet for high-performance networking. In January 2004, the Company also introduced its Xserve RAID storage system, a 3U high-availability rack storage system, along with support for Windows and Linux-based computing environments. In October 2004, the Company updated its Xserve RAID storage system to deliver 5.6 terabytes of storage capacity and also expanded support for heterogeneous environments. The dual independent RAID controllers with 512MB cache per controller offer sustained throughput of over 380MBps—high enough to support two streams of uncompressed 10-bit HD video editing using protected RAID level 5.

PowerBook®

The PowerBook family of portable computers is designed to meet the mobile computing needs of professionals and advanced consumer users. In April 2004, the Company updated its PowerBook G4 notebooks with faster PowerPC G4 processors. Both the 15-inch and 17-inch PowerBook G4 offer up to a 1.5 GHz PowerPC G4 processor, an available SuperDrive and the ATI Mobility Radeon 9700 graphics processor. The 12-inch PowerBook G4 features a 1.33 GHz PowerPC processor, an available SuperDrive, and NVIDIA GeForce FX Go5200 graphics. Every PowerBook G4 notebook comes with built-in AirPort Extreme wireless networking, an internal Bluetooth module for wireless connectivity, as well as a full complement of I/O ports including Firewire 400, USB 2.0., a built-in 56K v.92 modem and Ethernet (10/100BASE-T), for connectivity to a wide range of peripherals. The 15-inch and 17-inch PowerBook G4 models also include built-in Gigabit Ethernet and Firewire 800.

iMac®

The iMac line of desktop computers is targeted to consumer and education markets. In August 2004, the Company introduced the iMac® G5, featuring the PowerPC G5 processor and a design that integrates the entire computer into the flat panel display. The line offers 17- or 20-inch active matrix widescreen LCDs and PowerPC G5 processors running up to 1.8 GHz. The 17-inch models come with either a 1.8 GHz PowerPC G5 processor and a SuperDrive, or a 1.6 GHz PowerPC G5 processor and a Combo drive. The 20-inch model has a 1.8 GHz PowerPC G5 processor and a SuperDrive. The iMac G5 offers up to a 600 MHz front-side bus, 400 MHz DDR memory expandable to 2GB, AGP 8X graphics and 7200 rpm Serial ATA drives holding up to 250GB. The iMac G5 comes standard with NVIDIA graphics with dedicated video memory. The iMac G5 desktops offer a total of five USB ports (three USB 2.0) and two

FireWire® 400 ports, an optional internal Bluetooth module, a built-in antenna and card slot to support an optional AirPort Extreme Card for 54 Mbps 802.11g wireless networking, and also includes built-in Ethernet (10/100BASE-T) and a 56K V.92 modem.

eMac™

The eMac, which is targeted primarily at the Company's education and consumer customers, features a PowerPC G4 processor, a high resolution 17-inch flat cathode ray tube display, and preserves the all-in-one compact design of the original iMac favored by many of the Company's education and consumer customers. In April 2004, the Company updated its eMac, which now has a suggested retail price starting at $799 and is available with a SuperDrive for a suggested retail price starting at $999. The eMac offers PowerPC G4 processors running at up to 1.25 GHz, 333 MHz DDR memory, ATI Radeon graphics and USB 2.0 connectivity to peripherals.

iBook®

The iBook is designed to meet the portable computing needs of education and consumer users. In October 2004, the Company upgraded its iBook® G4 line to include faster PowerPC G4 processors running up to 1.33 GHz, built-in AirPort Extreme 54 Mpbs 802.11g wireless networking and an available slot-load SuperDrive. The 12-inch model features a 1.2 GHz PowerPC G4 processor and a slot-load Combo drive, while the 14-inch models include a 1.33GHz G4 processor and either a Combo or SuperDrive optical drive. All iBook G4 models offer a full complement of I/O ports including FireWire 400, USB 2.0, a built-in 56K v.92 modem and Ethernet (10/100BASE-T), as well as an optional internal wireless Bluetooth module, for connectivity to a wide range of peripherals.

Music Products and Services

The Company offers its iPod® line of digital music players and related accessories to Macintosh and Windows users. The Company also provides an online service to distribute third-party music and audio books through its iTunes® Music Store. Net sales of iPods and other music products and services generated year-over-year revenue growth of 316% and accounted for 19% of the Company's total net sales in fiscal 2004.

iPod®

In July 2004, the Company introduced the fourth generation of the iPod, the Company's portable digital music player, featuring Apple's patent pending click wheel, which combines a touch-sensitive wheel with five push buttons for one handed navigation, and up to 12 hours of battery life. The iPod features Apple's patent pending Auto-Sync technology that automatically downloads an entire digital music library onto the iPod and keeps it up-to-date whenever it is plugged into a Macintosh or Windows computer using FireWire or USB. The iPod also features Shuffle Songs, which randomly plays songs in a selected playlist or across the entire library. All iPods work with Apple's iTunes digital music management software on either a Macintosh or Windows computer. The iPod is available in 20GB and 40GB models.

The iPod's functionality extends beyond playing music and listening to audio books. Other key capabilities include data storage, calendar and contact information utility, and a selection of games. With the addition of third-party iPod peripherals, the capabilities of certain iPods can be enhanced to include voice recording and photo downloading directly from certain digital cameras. Along with the iPod, the Company has developed a seamless end-to-end music solution with the Company's iTunes software and the iTunes Music Store®, a service that consumers may use to purchase third-party music and audio books over the Internet.

The Company has entered into a strategic alliance with Hewlett-Packard Company (HP), which provides for a HP-branded digital music player based on the iPod, the preinstallation of iTunes software on HP's consumer PCs and notebooks and access to the iTunes Music Store. The Company has also entered into an alliance with BMW Group for the BMW iPod Adapter, a device that offers seamless integration of the iPod and certain BMW automobiles in North America. In addition, the Company formed an alliance with

Founder Technology Group Corporation, a supplier of PCs to the Chinese market, that provides for the preinstallation of iTunes on all Founder Technology Windows-based PCs. A similar alliance was formed with Synnex Technology International Corporation, a Taiwan-based wholesaler and distributor of personal computers, for the preinstallation of iTunes on its Windows-based laptop and desktop PCs.

In October 2004, the Company introduced the iPod U2 Special Edition as part of a strategic alliance with the musical band, U2, and Universal Music Group. The U2 iPod holds up to 5,000 songs, features a black enclosure with a red click wheel and custom engraving of U2 band member signatures.

iPod® photo

In October 2004, the Company introduced iPod® photo. The iPod photo holds digital photos alongside the music library and displays them on its high-resolution color screen, which allows users to scroll through the photo library almost instantly using iPod's patent pending click wheel. iPod photo can auto sync music and photos with a Macintosh or Windows-based computer. The iPod photo also allows users to simultaneously play music and view photo slideshows on the iPod, as well as on televisions and projectors. The iPod photo comes in 40GB or 60GB models and has an extended battery life that gives users up to 15 hours of music playback or up to 5 hours of slideshows. The iPod photo can hold up to 25,000 digital photos or 15,000 digital songs.

iPod® mini

In January 2004, the Company introduced the iPod mini. Smaller and lighter than the iPod, the iPod mini has storage capacity of 4GB and holds up to 1,000 songs, utilizes the patent pending click wheel and is encased in an anodized aluminum case available in a selection of five colors: silver, gold, pink, blue or green. The iPod mini retains the same user interface as the iPod and works seamlessly with the Company's iTunes Music Store® and the iTunes software for buying, managing and listening to digital music on either a Macintosh or Windows-based computer.

iTunes Music Store®

The Company's iTunes Music Store, available for both Windows-based and Macintosh computers, is an online music download store that allows customers to find, purchase, and download third-party digital music and audio books. Users can easily search the contents of the music store catalog to locate works by title, artist, or album, or browse the entire contents of the store by genre and artist. Users can also listen to a free 30-second preview of any song in the store. Since April 2003, the iTunes Music Store has been available to U.S. customers. A similar store became available in the U.K., France and Germany in June 2004 and was followed by the October 2004 launch of an English language music store covering nine additional European countries. The Company has also announced its intention to open an iTunes Music Store in Canada during fiscal 2005.

The iTunes Music Store is fully integrated directly into the latest version of the iTunes software, allowing customers to preview, purchase, download, organize, share, and transfer their digital music to an iPod using a single software application. Further discussion on the iTunes software may be found below under the heading "Software Products and Computer Technologies." Requiring no subscription fee, the iTunes Music Store with iTunes software offers customers a broad range of personal rights to the third-party content they have purchased, including playing songs on up to five personal computers, burning a single song onto CDs an unlimited number of times, burning the same playlist up to seven times, listening to their music on an unlimited number of iPods, and using songs in certain media applications such as iPhoto, iMovie, and iDVD. The iTunes Music Store also features availability of audio books for purchase directly from the iTunes Music Store.

Additional features currently available within the U.S. iTunes Music Store include gift certificates that can be sent via e-mail, prepaid gift cards, an "allowance" feature that enables users to automatically deposit funds into an iTunes Music Store account every month; and "Radio Charts," a feature that allows users to search and buy the top songs played on radio stations in major U.S. markets.

Peripheral Products

The Company sells certain associated Apple-branded computer hardware peripherals, including iSight™ digital video cameras, and a range of high quality flat panel TFT active-matrix digital color displays. The Company also sells a variety of third-party Macintosh compatible hardware products directly to end users through both its retail and online stores, including computer printers and printing supplies, storage devices, computer memory, digital video and still cameras, personal digital assistants, and various other computing products and supplies.

iSight™

The Company's iSight digital video camera enables video conferencing over broadband. iSight is a small, portable aluminum alloy camera with all audio, video and power provided by a single FireWire cable. iSight is designed to be center-mounted on the top of a computer screen and uses its integrated tilt and rotate mechanism to easily position the camera for natural, face-to-face video conferencing.

iSight features an autofocusing autoexposure F/2.8 lens which captures high-quality pictures and full-motion video. With its on-board processor, iSight automatically adjusts color, white balance, sharpness and contrast to provide high-quality images with accurate color reproduction in most lighting conditions. iSight also includes a dual-element microphone that suppresses ambient noise for clear digital audio.

Displays

In June 2004, the Company announced a family of widescreen flat panel displays featuring the 30-inch Apple Cinema HD Display, a widescreen active-matrix LCD with 2560-by-1600 pixel resolution, a 23-inch widescreen Apple Cinema Display with 1920-by-1200 pixel resolution and a 20-inch widescreen Apple Cinema Display with 1680-by-1050 pixel resolution. The displays feature dual FireWire and dual USB 2.0 ports built into the display and use the industry standard DVI interface for a pure digital connection with the Company's latest Power Mac and PowerBook systems. The Cinema Displays feature an aluminum design with a very thin bezel, suspended by an aluminum stand that allows viewing angle adjustment.

Software Products and Computer Technologies

The Company offers a range of software products for education, creative, consumer and business customers, including Mac OS X, the Company's proprietary operating system software for the Macintosh; server software and related solutions; professional application software; and consumer, education and business oriented application software.

Operating System Software

The Company released Mac OS X version 10.3 (code-named "Panther"), the Company's current version of Mac OS X, in October 2003. Panther incorporates features including a new version of Finder™; Exposé™, a way to organize windows and instantly see all open windows at once; FileVault, a feature that secures the contents of a home directory with 128-bit AES encryption; iChat AV; and enhanced support for use on Windows-based networks.

In June 2004, the Company previewed Mac OS X version 10.4 (code-named "Tiger"), the fifth major version of Mac OS X that is expected to ship in the first half of calendar 2005. Tiger will contain new features including Spotlight, a new way to instantly find any file, document or information on a Macintosh created by any application on the Macintosh; Safari™ RSS, a new version of Apple's web browser that incorporates instant access to Really Simple Syndication (RSS) data feeds on the web; Dashboard, a new way to instantly access "Widgets," a new collection of desktop mini application accessories, including a datebook, stock ticker, calculator, address book and iTunes controller; and a new version of iChat instant messaging client with multi-person audio and video conferencing in a 3D interface.

Server Software and Server Solutions

In October 2003, the Company began shipping the current version of its server operating system, Mac OS X Server version 10.3 (code-named "Panther Server"). This release integrates open source and open standards server software with easy-to-use management tools that make it easy to serve Macintosh, Windows and Linux clients. Features in Panther Server include Server Admin tool for easily setting up multiple servers; Open Directory 2 for hosting scalable LDAP directory and Kerberos authentication services; Samba 3 for providing login and home directory support for Windows clients; and the JBoss application server for running powerful J2EE applications.

In June 2004, the Company previewed Mac OS X Server version 10.4 (code-named "Tiger Server"), the next major release of the Company's UNIX-based server operating system that deploys open source solutions for Macintosh, Windows and Linux clients. Tiger Server includes native support for 64-bit applications; iChat Server to deploy private, encrypted communications within an organization; and migration tools to make it easy to upgrade from legacy Windows servers to Mac OS X Server.

In June 2004, the Company introduced Apple Remote Desktop™ 2, the second generation of the Company's asset management, software distribution and help desk support software. Along with improvements in screen sharing performance, Apple Remote Desktop 2 includes more than 50 features for centrally managing Mac OS X systems. Apple Remote Desktop 2 can perform a wide range of desktop management tasks such as installing operating system and application software, running hardware and software inventory reports and executing commands on one or more remote Mac OS X systems on the network. Remote software installation tools allow IT professionals to install single or multiple software packages immediately or at specific dates and times. Comprehensive hardware and software reports based on more than 200 system information attributes allow administrators to keep track of their Mac OS X systems. In addition, built-in real-time screen sharing enables help desk professionals to provide online assistance by observing and controlling the desktops of any remote Macintosh or Virtual Network Computing-enabled computer, including Windows and Linux systems.

Xsan, the Company's enterprise-class Storage Area Network (SAN) file system, was introduced as a beta version in April 2004 and is expected to be available for general release in the Fall of 2004. Xsan is a 64-bit cluster file system for Mac OS X that enables organizations to consolidate storage resources and provide multiple computers with concurrent file-level read/write access to shared volumes over Fibre Channel. Advanced features such as metadata controller failover and Fibre Channel multipathing ensure high availability; file-level locking allows multiple systems to read and write concurrently to the same volume which is ideal for complex workflows; bandwidth reservation provides for effective ingestion of bandwidth-intensive data streams, such as high resolution video; and flexible volume management results in more efficient use of storage resources. Since Xsan is interoperable with ADIC's StorNext File System, it can be used in heterogeneous environments that include Windows, UNIX and Linux server operating system platforms.

Professional Application Software

Final Cut Pro® HD, the latest version of the Company's video editing software, was introduced in April 2004 and features real-time performance of high-quality native DVCPRO HD, a high-definition video format, in addition to real-time support for digital video (DV) and standard definition (SD) formats. Final Cut Pro HD supports native DVCPRO HD editing with no recompression or image degradation and enables HD preview monitoring through the computer's DVI display output via the Digital Cinema Desktop feature. Final Cut Pro HD's support of native DVCPRO HD makes media conversion unnecessary, preserving the full quality of the camera original. Final Cut Pro HD includes precision, non-modal editing and trimming tools; powerful interface customization features; advanced real-time color correction and image control; and enhanced audio editing capabilities with multi-track audio mixing and multi-channel audio output.

In April 2004, the Company announced DVD Studio Pro® 3, the latest version of the Company's professional DVD authoring application. DVD Studio Pro 3 features Alpha Transitions, which are QuickTime® based movie transitions that may be used as segues between DVD menus and as DVD slide show transitions, and a new Graphical View for easy visualization of a project's entire flow in a storyboard environment. Graphical View makes it easy to see the relationships between menus, tracks, slideshows, stories and scripts. DVD Studio Pro 3 also includes Compressor 1.2, the latest version of the Company's digital media encoding and compression software that provides high-quality constant and variable bit rate MPEG-2 encoding. In addition to DV and SD, DVD Studio Pro 3 now provides the ability to scale HD and encode directly to MPEG-2 all in one step.

In August 2004, the Company began shipping Motion, a motion graphic design and production application. Motion features interactive animation of text, graphics and video, with real-time previewing of multiple filters and particle effects. Motion introduces "Behaviors," a procedural animation technology that allows for the adding of natural looking movement to type and graphics, such as gravity and wind, without the use of complex keyframes. Motion's "Interactive Dashboard" gives users access to a contextual, semi-transparent floating palette that provides the tools and slider parameters for objects being manipulated on screen. Motion's "Project Pane" allows users to view and manage all filters, Behaviors, masks and other properties applied to all objects and layers of objects within a project.

In August 2004, the Company introduced Production Suite, which combines the latest versions of Final Cut Pro HD, DVD Studio Pro 3 and Apple Motion into a software suite for film and video production that delivers real-time production tools in one comprehensive and integrated package. Production Suite provides an integrated workflow environment where content that is updated in one of the applications in the suite is automatically updated in the other applications.

Shake® 3.5, an upgrade of the Company's compositing and visual effects software designed for large format film and video productions was introduced in April 2004. Shake 3.5 features shape-based morphing and warping tools for advanced compositing and "shape shifting" special effects. Morphing and warping further enhance Shake's visual effects tools, including layering, tracking, rotoscoping, painting and color correction. Shake 3.5 also improves upon the Shake Qmaster network render manager that can now handle distributed rendering tasks for both Shake and Alias Systems Corp.'s Maya product, allowing for distribution of rendering tasks across a cluster of servers or computers.

Logic® Pro 7, introduced by the Company in September 2004 is actively used by musicians around the world and by professionals in music production, film scoring, and audio post-production facilities. It combines digital music composition, notation and audio production facilities in one comprehensive product and includes software instruments such as Sculpture, a component-modeling based synthesizer; UltraBeat, a drum synthesizer with built-in step sequencer; and digital signal processing (DSP) plug-ins including Guitar Amp Pro, a full-featured guitar amplifier simulator. Along with over 100 workflow enhancements, mastering plug-ins and support for Apple Loops, Logic Pro 7 debuts distributed audio processing, a technology which allows audio pros to tap into a number of Macintosh systems to expand available DSP power via an Ethernet network.

Consumer, Education and Business Oriented Application Software

In January 2004, the Company introduced iLife® '04, the next generation suite of its digital lifestyle applications, which features iPhoto®, iMovie®, iDVD®, iTunes® software, and introduced GarageBand™, a music creation software application. All of these iLife applications come preinstalled on the Company's Macintosh systems, excluding servers and storage systems. Burning DVDs with iDVD requires a Macintosh system configured with a SuperDrive.

iTunes® software, available for both Macintosh and Windows-based computers, lets users create and manage their own digital music library. iTunes organizes music using searching, browsing and playlist features and supports automatic synchronization with the music stored on an iPod. iTunes supports AAC and MP3 encoding from audio CDs, provides the ability to burn custom playlists to CDs and MP3 CDs, and allows for music sharing between networked computers. In October 2004, the Company's newest version, iTunes 4.7, included support for copying photos to an iPod photo. Since April 2003, the Company's iTunes software has been integrated with the Company's iTunes Music Store® to facilitate the sale of third-party music and audio books. Further discussion of the iTunes Music Store may be found above under the heading "Music Products and Services."

iMovie® is the Company's consumer digital video editing software for creation of home and classroom movies. iMovie 4 features an enhanced user interface, improved audio editing capabilities, enhanced controls for titling and transitions, and added special effects. Users may edit and trim audio and video clips in the enhanced timeline with click-and-drag editing and even select and edit multiple clips simultaneously. With graphical audio waveforms and live audio scrubbing, users can locate specific edit points in audio tracks, and alignment guides make it easy to precisely sync video and audio.

iDVD® is consumer oriented software that makes it easy to turn iMovie files, QuickTime files and digital pictures into DVDs that can be played on most consumer DVD players. iDVD simplifies DVD authoring by including professionally designed themes and drag-and-drop simplicity. iDVD® 4 includes themes and professional effects that allow users to use photos and movies as buttons, backgrounds and menus. Movies from iMovie, photos from iPhoto and music from either iTunes or GarageBand can be added directly to a DVD via the media browser, and enhanced photo slideshows can include cinematic transitions and iTunes playlists. The DVD Map provides an overview of an entire DVD project and instant accessibility to all project elements.

GarageBand™, the Company's consumer oriented music creation software, allows users to play, record and create music using a simple interface. With GarageBand, recorded performances, digital audio and looping tracks can be arranged and edited to create songs. GarageBand comes with more than 50 software instruments, pre-recorded audio loops for making complete songs or backing tracks, pro-quality effects presets for mixing, and vintage amplifier sounds for the guitar. The Company also offers three different Jam Packs, which provide additional software instruments and loops that enhance the use of GarageBand to create and record music.

iPhoto® is consumer oriented digital photo software that makes it easy to import, edit, save, share, and print digital photos, as well as organize and manage an entire digital photo collection containing thousands of photos. Users are able to view their photos in full-screen; use the slide show feature accompanied by their favorite music; automatically create custom web pages of their photos; email photos to friends and family; order professionally-processed prints and enlargements online; or easily design and order custom-printed, linen-covered hard bound photo books online. Customers in numerous countries can order prints, enlargements, and photo books directly from within iPhoto. iPhoto® 4 has features that allow users to scroll through thousands of photos in seconds to easily find a particular photo, contains Smart Albums which automatically organizes photos based on date, keyword or the user's own rating, and has controls for rotating, rating and deleting photos.

Final Cut® Express, based on Final Cut Pro, enables small business users, educators, students and advanced hobbyists to perform professional-quality digital video editing. In January 2004, the Company introduced Final Cut Express 2, which features RT Extreme for real-time compositing and effects, an enhanced user interface, real-time color correction tools and enhanced audio editing capabilities.

Logic® Express 7, introduced by the Company in September 2004, is a streamlined version of Logic Pro 7 that provides a basic set of professional tools to compose and produce music for students, educators and advanced hobbyists. Logic Express 7 comes with support for projects from GarageBand offering users a smooth migration path to high-end audio production.

Keynote™ is the Company's presentation software that gives users the ability to create high-quality presentations. Designed to be easy to use, Keynote includes professionally designed themes, advanced typography, professional-quality image resizing, animated charts and tables that can be created quickly, and cinematic-quality transitions. Keynote imports and exports PowerPoint, QuickTime, and PDF files to simplify the creation and sharing of presentations.

AppleWorks® 6.2 is an integrated productivity application that incorporates word processing, page layout, image manipulation, spreadsheets, databases and presentations in a single application. Intended to be an easy-to-use product for the Company's consumer and education customers, AppleWorks makes it simple to create professional-looking documents in the classroom and at home.

FileMaker, Inc., a wholly owned subsidiary of the Company, develops, publishes, and distributes desktop-based database management application software for either a Macintosh or Windows-based computer. The FileMaker® Pro database software and related products offer relational databases and desktop-to-web publishing capabilities. In March 2004, the Company introduced FileMaker Pro 7 with new architecture and enhancements in ease-of-use, customizability and developer productivity. FileMaker Pro 7 has been redesigned using a modern, streamlined relational architecture, which enables users to simplify information management by storing multiple tables within a single file and includes the relationships graph feature which presents a visual "map" of the database and lets users create and modify relationships with a simple click and drag tool. FileMaker Pro 7 has also expanded its data capacity to 8 terabytes per file or 4,000 times the former limit.

Internet Software, Integration, and Services

Apple's Internet strategy is focused on delivering seamless integration with and access to the Internet throughout the Company's product lines. The Company's Internet products and technologies adhere to many industry standards in order to provide an optimized user experience through interoperability. An easy to use Internet Setup Assistant is included with the Mac OS.

Safari™

Safari, the Company's Mac OS X compatible web browser, is capable of loading web pages rapidly. Safari uses the advanced interface technologies underlying Mac OS X and includes built-in Google search; SnapBack™ to instantly return to search results; a way to name, organize and present bookmarks; tabbed browsing; and automatic "pop-up" ad blocking. The Company also released a software development kit that allows developers to embed the Safari HTML rendering engine directly into their applications.

Quicktime®

QuickTime, the Company's multimedia software for either a Macintosh or Windows-based computer, features streaming of live and stored video and audio over the Internet and playback of high-quality audio and video on computers. QuickTime 6 includes the Instant-On Streaming feature that eliminates buffer delays and provides users with the ability to quickly and easily scrub through streaming media content to locate and instantly view specific sections. In addition, QuickTime 6 running on Mac OS X now supports JPEG 2000, the next generation JPEG standard that allows users to capture still images in a higher quality and smaller file size than ever before. QuickTime 6 also includes AAC, the standard MPEG-4 audio format. AAC is the next generation professional-quality audio format that delivers superior sound quality with reduced file sizes.

The Company also offers several other QuickTime products, including QuickTime Pro, a suite of software tools that allows creation and editing of Internet-ready audio and video files and allows a user to add special effects and other features to QuickTime movies; QuickTime Streaming Server which facilitates the broadcasting of streaming digital video; and QuickTime Broadcaster that allows users to quickly and easily produce professional-quality live events for online delivery.

.Mac™

The Company's .Mac offering is a suite of Internet services that for an annual fee provides Macintosh users with powerful Internet tools. .Mac features email service with IMAP, POP or web-based access and 125MB of storage, iDisk Internet storage capacity of an additional 125MB, and hosting for personalized homepages and shared digital photo albums. Also included with .Mac is McAfee's Virex anti-virus software and Backup, a personal back-up solution allowing users to archive data to their Internet storage, CD, or DVD.

Wireless Connectivity and Networking

AirPort Extreme®

AirPort Extreme, introduced in January 2003, is the Company's next generation of Wi-Fi wireless networking technology. AirPort Extreme is based on the 802.11g standard, which supports speeds up to 54 Mbps, and is fully compatible with most Wi-Fi devices which use the 802.11b standard. AirPort Extreme Base Stations can serve up to 50 Macintosh and Windows users simultaneously, provide wireless bridging to extend the range beyond just one base station, and support USB printer sharing to allow multiple users to wirelessly share USB printers connected directly to the base station.

AirPort® Express

In June 2004, the Company introduced AirPort® Express, the first 802.11g mobile base station that can be plugged directly into the wall for wireless Internet connections and USB printing. Airport Express also features analog and digital audio outputs that can be connected to a stereo and AirTunes™ music networking software which works with iTunes, giving users a way to wirelessly stream iTunes music from their Macintosh or Windows-based computer to any room in the house. AirPort Express features a single piece design weighing 6.7 ounces.

Other Connectivity and Networking Solutions

Mac OS X includes capabilities for Bluetooth technology. Bluetooth is an industry standard for wirelessly connecting computers and peripherals that supports transmission of data at up to 1 Mbps within a range of approximately 30 feet. The Company's Bluetooth technology for Mac OS X lets customers wirelessly share files between Macintosh systems, synchronize and share contact information with Palm-OS based PDAs, and access the Internet through Bluetooth-enabled cell phones. A Bluetooth USB adaptor can Bluetooth-enable any USB-based Macintosh computer running in Mac OS X version 10.1.4 or higher.

The Company's zero configuration networking technology is based on open Internet Engineering Task Force (IETF) Standard Protocols such as IP, ARP and DNS and is built into Mac OS X. This technology uses industry standard networking protocols and zero configuration technology to automatically discover and connect devices over any IP network, including Ethernet or 802.11-based wireless networks like the Company's AirPort products. The source code for this technology also includes software to support UNIX, Linux, and Windows-based systems and devices. Major developers such as Canon, Epson, Hewlett-Packard, Lexmark, Philips, Sybase, World Book and Xerox have announced support for this zero configuration networking technology in a broad range of products including network printers, consumer electronics, enterprise database management and educational applications. The Company has made the source code for this technology freely available to developers for use in their network-enabled devices or software applications.

The Company developed FireWire® technology, also referred to as IEEE 1394, which is a high-speed serial I/O technology for connecting digital devices such as digital camcorders and cameras to desktop and portable computers. With its high data-transfer speed and "hot plug-and-play" capability, FireWire has become an established cross-platform industry standard for both consumers and professionals and is the data interface of choice for today's digital video and audio devices, as well as external hard drives and other high-speed peripherals. FireWire is currently included on all Macintosh systems and is a data transfer technology utilized by iPod.

Product Support and Services

AppleCare® offers a range of support options for Apple customers. These options include assistance that is built into software products, printed and electronic product manuals, online support including comprehensive product information as well as technical assistance, and the AppleCare Protection Plan. The AppleCare Protection Plan is a fee-based service that typically includes three years of phone support and hardware repairs, dedicated web-based support resources, and user diagnostic tools.

Specialized Education Products and Services

The Company offers a variety of unique services and products to its education customers, including a separate online store for education customers offering special education price lists and promotions; special financing programs for K-12 and higher education students, faculty, and staff; a special edition of its productivity software suite, AppleWorks, that is compatible for both Macintosh and Windows-based computers; Wireless Mobile Labs that allows teachers and students to share iBook computers, a printer, and a wireless network/Internet connection stored on a cart for mobility between classrooms; and three special Digital Media Studio solutions designed for education, including one that is integrated into a mobile cart. Additionally, the Company offers one-to-one (1:1) learning solutions, which are a complete solution typically consisting of an iBook portable system for every student and teacher along with a wireless network connected to a central server.

The Company's PowerSchool® software product is a web-based student information system for K-12 schools and school districts. PowerSchool software products give school administrators and teachers the ability to easily and cost-effectively manage student records and give parents real-time access to track their children's performance via the Internet. PowerSchool offers the option of remote hosting with an application service provider model.

Markets and Distribution

The Company's customers are primarily in the education, creative, consumer, and business markets. Apple customers are attracted to Macintosh computers for a variety of reasons, including the reduced amount of training resulting from the Macintosh computer's intuitive ease of use, advanced graphics capabilities, industrial design features of the Company's hardware products, and ability of Macintosh computers to network and communicate with other computer systems and environments. Apple personal computers were first introduced to education customers in the late 1970s. Over 16% of the Company's net sales in 2004 were through its U.S. education channel, including sales to elementary and secondary schools, higher education institutions and individual customers.

The Company distributes its products through wholesalers, resellers, national and regional retailers and cataloguers. No individual customer accounted for more than 10% of net sales in 2004, 2003 or 2002. The Company also sells many of its products and resells certain third-party products in most of its major markets directly to consumers, education customers, and businesses through its retail stores in the U.S. and internationally, or through one of its online stores around the world. Total direct and indirect sales transacted through the Company's online stores totaled approximately $3.9 billion, $2.9 billion, and $2.4 billion for fiscal years 2004, 2003 and 2002, respectively.

Competition

The Company is confronted by aggressive competition in all areas of its business. The market for the design, manufacture, and sale of personal computers and related software and peripheral products is highly competitive. This market continues to be characterized by rapid technological advances in both hardware and software development, which have substantially increased the capabilities and applications of these products, and have resulted in the frequent introduction of new products and significant price, feature, and performance competition. Over the past several years, price competition in the market for personal computers has been particularly intense. The Company's competitors who sell personal computers based on other operating systems have aggressively cut prices and lowered their product margins to gain or maintain market share. The Company's results of operations and financial condition have been, and in the future may continue to be, adversely affected by these and other industry-wide downward pressures on gross margins.

The principal competitive factors in the market for personal computers include relative price/performance, product quality and reliability, design innovation, availability of software, product features, marketing and distribution capability, service and support, availability of hardware peripherals, and corporate reputation. Further, as the personal computer industry and its customers place more reliance on the Internet, an increasing number of Internet devices that are smaller, simpler, and less expensive than traditional personal computers may compete for market share with the Company's existing products.

The Company is currently taking and will continue to take steps to respond to the competitive pressures being placed on its personal computer sales as a result of innovations in competing platforms. The Company's future operating results and financial condition are substantially dependent on its ability to continue to develop improvements to the Macintosh platform in order to maintain perceived functional and design advantages over competing platforms.

The Company's initial success with the development of an end-to-end music offering, which includes the iTunes software, iTunes Music Store and iPod digital music player, has already encouraged significant competition in this area from other companies, many of whom have greater financial, marketing, and manufacturing resources than those of the Company. The Company anticipates that competition will intensify requiring the Company to respond as hardware, software and content providers work more collaboratively to offer integrated products that compete against the Company's offerings. The Company believes it maintains a competitive advantage by more effectively integrating the entire end-to-end music solution, including the hardware (iPod), software (iTunes) and distribution of third-party music content (iTunes Music Store).

Raw Materials

Although most components essential to the Company's business are generally available from multiple sources, certain key components (including microprocessors and application-specific integrated circuits ("ASICs")) are currently obtained by the Company from single or limited sources. Some other key components, while currently available to the Company from multiple sources, are at times subject to industry wide availability constraints and pricing pressures. In addition, the Company uses some components that are not common to the rest of the personal computer and consumer electronics industries, and new products introduced by the Company often initially utilize custom components obtained from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. If the supply of a key or single-sourced component to the Company were to be delayed or curtailed or in the event a key manufacturing vendor delays shipments of completed products to the Company, the Company's ability to ship related products in desired quantities and in a timely manner could be adversely affected. The Company did experience such delays during fiscal 2004, which resulted in the constrained availability of certain products. The Company's business and financial performance could also be adversely affected depending on the time required to obtain sufficient quantities from the original source, or to identify and obtain sufficient quantities from an alternative source. Continued availability of these components may be affected if producers were to decide to concentrate on the production of common components instead of components customized to meet the Company's requirements. The Company attempts to mitigate these potential risks by working closely with these and other key suppliers on product introduction plans, strategic inventories, coordinated product introductions, and internal and external manufacturing schedules and levels. Consistent with industry practice, the Company acquires components through a combination of formal purchase orders, supplier contracts, and open orders based on projected demand information. Such purchase commitments typically cover the Company's requirements for periods ranging from 30 to 130 days.

The Company believes there are several component suppliers and manufacturing vendors whose loss to the Company could have a material adverse effect upon the Company's business and financial position. At this time, such vendors include Agere Systems, Inc., Ambit Microsystems Corporation, ASUSTeK Corporation, ATI Technologies, Inc., Broadcom Corporation, Freescale Semiconductor, Inc. (formerly the Semiconductor Products Segment of Motorola, Inc.), Hitachi Global Storage Technologies, Hon Hai Precision Industry Co., Ltd., IBM Corporation, International Display Technology, Inventec Appliances Corporation, LG. Phillips Co., Ltd., Matsushita, Mitsubishi Electric Corporation, NVIDIA Corp., Portal Player, Inc., Quanta Computer, Inc., Samsung Electronics, Synaptics, Inc., and Toshiba Corporation.

Research and Development

Because the personal computer industry is characterized by rapid technological advances, the Company's ability to compete successfully is heavily dependent upon its ability to ensure a continuing and timely flow of competitive products and technology to the marketplace. The Company continues to develop new products and technologies and to enhance existing products in the areas of hardware and peripherals, consumer electronic products, system software, applications software, networking and communications software and solutions, and the Internet. The Company may expand the range of its product offerings and intellectual property through licensing and/or acquisition of third-party business and technology. The Company's research and development expenditures totaled $489 million, $471 million, and $446 million in 2004, 2003, and 2002, respectively.

Patents, Trademarks, Copyrights and Licenses

The Company currently holds rights to patents and copyrights relating to certain aspects of its computer systems, iPods, peripherals and software. In addition, the Company has registered, and/or has applied to register, trademarks and service marks in the U.S. and a number of foreign countries for "Apple," the Apple logo, "Macintosh," and numerous other trademarks and service marks. Although the Company believes the ownership of such patents, copyrights, trademarks and service marks is an important factor in its business and that its success does depend in part on the ownership thereof, the Company relies primarily on the innovative skills, technical competence, and marketing abilities of its personnel.

Many of the Company's products are designed to include intellectual property obtained from third-parties. While it may be necessary in the future to seek or renew licenses relating to various aspects of its products and business methods, the Company believes that, based upon past experience and industry practice, such licenses generally could be obtained on commercially reasonable terms; however, there is no guarantee that such licenses could be obtained at all. Because of technological changes in the computer industry, current extensive patent coverage, and the rapid rate of issuance of new patents, it is possible certain components of the Company's products and business methods may unknowingly infringe existing patents of others. The Company has from time to time been notified that it may be infringing certain patents or other intellectual property rights of others.

Foreign and Domestic Operations and Geographic Data

The U.S. represents the Company's largest geographic marketplace. Approximately 59% of the Company's net sales in fiscal 2004 came from sales to customers inside the U.S. Final assembly of products sold by the Company is conducted in the Company's manufacturing facility in Cork, Ireland, and by external vendors in Fremont, California, Fullerton, California, Taiwan, Korea, the Netherlands, the People's Republic of China, and the Czech Republic. Currently, manufacture of many of the components used in the Company's products and final assembly of substantially all of the Company's portable products including PowerBooks, iBooks, and the iPod are performed by third-party vendors in Taiwan and China. Margins on sales of Apple products in foreign countries, and on sales of products that include components obtained from foreign suppliers, can be adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including tariffs and antidumping penalties.

Information regarding financial data by geographic segment is set forth in Part II, Item 8 of this Form 10-K in the Notes to Consolidated Financial Statements at Note 11, "Segment Information and Geographic Data."

Seasonal Business

The Company has historically experienced increased net sales in its first and fourth fiscal quarters, compared to other quarters in its fiscal year, due to seasonal demand related to the holiday season and the school year, respectively. Past performance should not be considered a reliable indicator of the Company's future net sales or financial performance.

Warranty

The Company offers a basic limited parts and labor warranty on its hardware products. The basic warranty period for hardware products is typically one year from the date of purchase by the end-user. The Company also offers a 90-day basic warranty for Apple service parts used to repair Apple hardware products. In addition, consumers may purchase extended service coverage on most Apple hardware products in all of the Company's major markets.

Backlog

In the Company's experience, the actual amount of product backlog at any particular time is not a meaningful indication of its future business prospects. In particular, backlog often increases in anticipation of or immediately following new product introductions because of over-ordering by dealers anticipating shortages. Backlog often is reduced once dealers and customers believe they can obtain sufficient supply. Because of the foregoing, backlog should not be considered a reliable indicator of the Company's ability to achieve any particular level of revenue or financial performance.

Environmental Laws

Compliance with federal, state, local, and foreign laws enacted for the protection of the environment has to date had no material effect on the Company's capital expenditures, earnings, or competitive position. In the future, these laws could have a material adverse affect on the Company.

Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations including, in some instances, the requirement that the Company provide consumers with the ability to return to the Company product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have recently been passed in several jurisdictions in which the Company operates, including various European Union member states, Japan and California. In the future, these laws could have a material adverse affect on the Company.

Employees

As of September 25, 2004, Apple and its subsidiaries worldwide had 11,695 employees and an additional 1,731 temporary employees and contractors.

Available Information

The Company's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available on its website at http://www.apple.com/investor when such reports are available on the U.S. Securities and Exchange Commission (SEC) website. The public may read and copy any materials filed by the Company with the SEC at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at http://www.sec.gov. The contents of these websites are not incorporated into this filing. Further, the Company's references to the URLs for these websites are intended to be inactive textual references only.

Item 2. Properties

The Company's headquarters are located in Cupertino, California. The Company has manufacturing facilities in Cork, Ireland. As of September 25, 2004, the Company leased approximately 3.3 million square feet of space, primarily in the U.S., and to a lesser extent, in Europe, Japan, and the Asia Pacific region. The major facility leases are for terms of 5 to 10 years and generally provide renewal options for terms of 2 to 5 additional years. Leased space includes 660,000 square feet of retail space, a majority of which is in the U.S. Lease terms for retail space range from 5 to 16 years, the majority of which are for 10 years, and often contain multi-year renewal options.

The Company owns its manufacturing facility in Cork, Ireland, which has approximately 352,000 square feet. The Cork facility also houses a customer support call center. The Company also owns a 752,000 square-foot facility in Sacramento, California, which has a customer support call center and is used for warehousing and distribution. In addition, the Company owns approximately 942,000 square feet of facilities located in Cupertino, California, used for research and development and corporate functions. Outside the U.S., the Company owns additional facilities totaling approximately 169,000 square feet.

The Company believes its existing facilities and equipment are well maintained and in good operating condition. The Company has invested in internal capacity and strategic relationships with outside manufacturing vendors, and therefore believes it has adequate manufacturing capacity for the foreseeable future. The Company continues to make investments in capital equipment as needed to meet anticipated demand for its products.

Item 3. Legal Proceedings

The Company is subject to various legal proceedings and claims that are discussed below. The Company is also subject to certain other legal proceedings and claims that have arisen in the ordinary course of business and which have not been fully adjudicated. In the opinion of management, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate have a material adverse effect on its financial condition, liquidity or results of operations. However, the results of legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected. The Company settled certain matters in 2004, which did not individually or in the aggregate have a material impact on the Company's results of operations.

Antor Media Corporation v. Apple Computer, Inc., et al.

Plaintiff Antor Media filed this action on September 5, 2003 in the United States District Court in the Eastern District of Texas alleging infringement by the Company and other defendants of U.S. patent 5,754,961 relating to a "Method and Apparatus for Transmitting Information Recorded on Information Storage Means from a Central Server to Subscribers via a High Data Rate Digital Telecommunications Network." The complaint seeks unspecified damages and other relief. The Company has answered the complaint, denying all allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims requesting declaratory judgment for non-infringement and invalidity. Trial is set for March 2005. The Court held a Markman hearing on September 16, 2004 but has not yet issued a ruling.

Apple Corps Ltd. v. Apple Computer, Inc.; Apple Computer, Inc. v. Apple Corps Ltd.

Plaintiff Apple Corps filed this action on July 4, 2003 in the High Court of Justice, Chancery Division, in London alleging that the Company has breached a 1991 agreement that resolved earlier trademark litigation between the parties regarding use of Apple marks. Plaintiff seeks an injunction, unspecified damages and other relief. The Company filed a motion on October 13, 2003, challenging jurisdiction in the UK, but the Court denied the motion on April 7, 2004. The Company filed an appeal of the Court's decision but subsequently withdrew the appeal and is preparing its defense in this matter.

On October 8, 2003, the Company filed a lawsuit in the United States District Court for the Northern District of California requesting a declaratory judgment that the Company has not breached the 1991 agreement. Apple Corps challenged jurisdiction in the California case but the Court denied that challenge on March 25, 2004. Apple Corps subsequently prevailed on a motion to stay the California case during the pendency of the UK action. The Company has dismissed the California lawsuit without prejudice.

Cagney v. Apple Computer, Inc.

Plaintiff filed this purported class action on January 9, 2004 in Los Angeles County Superior Court, alleging improper collection of sales tax in transactions involving mail-in rebates. The complaint alleges violations of California Civil Code Section 17200 (unfair competition) and seeks unspecified damages and other relief. The Company was served on January 21, 2004, and filed an answer on February 20, 2004, denying all allegations and asserting numerous affirmative defenses. The Company is investigating these allegations. The Company filed a motion to disqualify Plaintiff's counsel, which the Court denied. The Company filed a petition for a writ of mandate with respect to this ruling and the Court of Appeal has issued an order to show cause as to why the writ should not issue. Plaintiffs lead counsel subsequently withdrew. The hearing on the show cause order is scheduled for January 29, 2005. The Company also has obtained an opinion on the tax issue from the State Board of Equalization.

Compression Labs, Inc. v. Apple Computer, Inc., et al.; Apple v. Compression Labs, Inc., et al.

Plaintiff Compression Labs, Inc. filed this patent infringement action on April 22, 2004 against the Company and twenty-seven other defendants in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement of U.S. patent 4,698,672. Plaintiff alleges that the Company infringes the patent by complying with the JPEG standard as defined by CCITT Recommendation T.81 entitled "Information Technology—Digital Compression and Coding of Continuous Tone Still Images—Requirements and Guidelines." Plaintiff seeks unspecified damages and other relief. The Company is investigating this claim. Defendants have filed a motion to dismiss or, in the alternative, to transfer the case to Delaware. The case is in discovery and trial is expected in October 2005. On July 2, 2004, the Company and several other defendants in the Texas action filed a lawsuit in the United States District Court in Delaware requesting declaratory judgment of noninfringement, invalidity, implied license and unenforceability with respect to the '672 patent. Additional actions regarding this patent have been filed in other jurisdictions. A petition has been filed with the Panel on Multi-District Litigation (MDL), seeking coordination and transfer of all of these cases to one court for pre-trial proceedings.

Craft v. Apple Computer, Inc. (filed December 23, 2003, Santa Clara County Superior Court); *Chin v. Apple Computer, Inc.* (filed December 23, 2003, San Mateo County Superior Court); *Hughes v. Apple Computer, Inc.* (filed December 23, 2003, Santa Clara County Superior Court); *Westley v. Apple Computer, Inc.* (filed December 26, 2003, San Francisco County Superior Court); *Keegan v. Apple Computer, Inc.* (filed December 30, 2003, Alameda County Superior Court); *Wagya v. Apple Computer, Inc.* (filed February 19, 2004, Alameda County Superior Court); *Yamin v. Apple Computer, Inc.* (filed February 24, 2004, Los Angeles County Superior Court); *Kieta v. Apple Computer, Inc.* (filed July 8, 2004, Alameda County Superior Court)

Eight separate plaintiffs filed purported class action cases in various California courts alleging misrepresentations by the Company relative to iPod battery life. The complaints include causes of action for violation of California Civil Code Section 17200 (unfair competition), the Consumer Legal Remedies Action ("CLRA") and claims for false advertising, fraudulent concealment and breach of warranty. The complaints seek unspecified damages and other relief. The Company is investigating these claims. The cases have been consolidated in San Mateo County and Plaintiffs have filed a consolidated complaint.

In addition, a similar complaint relative to iPod battery life, *Mosley v. Apple Computer, Inc.* was filed in Westchester County, New York on June 23, 2004 alleging violations of New York General Business Law Sections 349 (unfair competition) and 350 (false advertising). The Company removed the case to Federal Court and Plaintiff filed a motion for remand, which the Court has not yet decided.

Davis v. Apple Computer, Inc.

Plaintiff filed this purported class action in San Francisco County Superior Court on December 5, 2002, alleging that the Company engaged in unfair and deceptive business practices relating to its AppleCare Extended Service and Warranty Plan. Plaintiff asserts causes of action for violation of the California Business and Professions Code §17200 and §17500, breach of the Song-Beverly Warranty Act, intentional misrepresentation and concealment. Plaintiff requests unspecified damages and other relief. The Company filed a demurrer and motion to strike which were granted, in part, and Plaintiff filed an amended complaint. The Company filed an answer on April 17, 2003 denying all allegations and asserting numerous affirmative defenses. Plaintiff subsequently amended its complaint. On October 29, 2003, the Company filed a motion to disqualify Plaintiff's counsel in his role as counsel to the purported class and to the general public. The Court granted the motion, but allowed Plaintiff to retain substitute counsel. Plaintiff did engage new counsel for the general public, but not for the class. The Company moved to disqualify Plaintiff's new counsel and to have the Court dismiss the general public claims for equitable relief. The Court declined to disqualify Plaintiff's new counsel or to dismiss the equitable claims, but did confirm that the class action claims are dismissed. The case is stayed pending an appeal.

East Texas Technology Partners LP v. Apple Computer, Inc.

Plaintiff filed this patent infringement action on January 23, 2004 in the United States District Court in the Eastern District of Texas alleging infringement by the Company and seven other defendants of U.S. patent 6,574,239 relating to "Virtual Connection of a Remote Unit to a Server." The complaint seeks unspecified damages and other relief. The Plaintiff's law firm withdrew from the case because of a conflict of interest and dismissed the complaint without prejudice. The case was re-filed on February 10, 2004 in the Northern District of Texas by a new law firm. The Company received service of the new complaint on May 17, 2004 and filed a response on August 6, 2004, denying all allegations and asserting numerous affirmative defenses. The Company is investigating this claim, and the case is in discovery.

Gobeli Research Ltd. v. Apple Computer, Inc., et al.

Plaintiff Gobeli Research Ltd. filed this patent infringement action against the Company and Sun Microsystems, Inc. on April 15, 2004 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement of U.S. patent 5,418,968 related to a "System and Method of Controlling Interrupt Processing." Plaintiff alleges that the Company's Mac OS 9 and Mac OS X operating systems infringe Plaintiff's patent. Plaintiff seeks unspecified damages and other relief. The Company has answered the complaint, denying all allegations and asserting numerous defenses. The Company is investigating this claim.

Goldberg, et al. v. Apple Computer, Inc., et al. (f.k.a. "Dan v. Apple Computer, Inc.")

Plaintiffs filed this purported class action on September 22, 2003 in Los Angeles County Superior Court against the Company and other members of the industry on behalf of an alleged nationwide class of purchasers of certain computer hard drives. The case alleges violations of Civil Code Section 17200 (unfair competition), the Consumer Legal Remedies Act ("CLRA") and false advertising related to the size of the drives. Plaintiffs allege that calculation of hard drive size using the decimal method misrepresents the actual size of the drive. The complaint seeks unspecified damages and other relief. Plaintiff filed an amended complaint on March 30, 2004 and the Company filed an answer on September 23, 2004, denying all allegations and asserting numerous affirmative defenses. The Company is investigating this claim. The parties are conducting discovery related to class certification.

Hawaii Structural Iron Workers and Pension Trust Fund v. Apple Computer, Inc. and Steven P. Jobs; Young v. Apple Computer, Inc., et al.; Hsu v. Apple Computer Inc., et al.

Beginning on September 27, 2001, three shareholder class action lawsuits were filed in the United States District Court for the Northern District of California against the Company and its Chief Executive Officer. These lawsuits are substantially identical, and purport to bring suit on behalf of persons who purchased the Company's publicly traded common stock between July 19, 2000, and September 28, 2000. The complaints allege violations of the 1934 Securities Exchange Act and seek unspecified compensatory damages and other relief. The Company filed a motion to dismiss on June 4, 2002, which was heard by the Court on September 13, 2002. On December 11, 2002, the Court granted the Company's motion to dismiss for failure to state a cause of action, with leave to Plaintiffs to amend their complaint within thirty days. Plaintiffs filed their amended complaint on January 31, 2003, and on March 17, 2003, the Company filed a motion to dismiss the amended complaint. The Court heard the Company's motion on July 11, 2003 and dismissed Plaintiffs' claims with prejudice on August 12, 2003. Plaintiffs have appealed the ruling.

Honeywell International, Inc., et al. v. Apple Computer, Inc., et al.

Plaintiffs Honeywell International, Inc. and Honeywell Intellectual Properties, Inc. filed this action on October 6, 2004 in the United States District Court in Delaware alleging infringement by the Company and other defendants of U.S. patent 5,280,371 entitled "Directional Diffuser for a Liquid Crystal Display." Plaintiffs seek unspecified damages and other relief. The Company is investigating this claim in connection with preparing its response to the complaint.

MacTech Systems v. Apple Computer, Inc.; Macadam v. Apple Computer, Inc.; Computer International, Inc. v. Apple Computer, Inc.; Elite Computers and Software, Inc. v. Apple Computer, Inc.; The Neighborhood Computer Store v. Apple Computer, Inc. (all in Santa Clara County Superior Court)

Five resellers have filed similar lawsuits against the Company for various causes of action including breach of contract, fraud, negligent and intentional interference with economic relationship, negligent misrepresentation, trade libel, unfair competition and false advertising. Plaintiffs request unspecified damages and other relief. The Company answered the Computer International complaint on November 12, 2003 denying all allegations and asserting numerous affirmative defenses. The parties are in discovery in that case. The Company expects the other four plaintiffs to file amended complaints. On October 1, 2003, one of the resellers, Macadam, was deauthorized as an Apple reseller. Macadam filed a motion for a temporary order to reinstate it as a reseller, which the Court denied. The Court denied Macadam's motion for a preliminary injunction on December 19, 2003.

Teleshuttle Technologies, LLC and BTG International Inc. v. Microsoft and Apple Computer, Inc.

Plaintiffs filed this case on July 20, 2004 in United States District Court for the Northern District of California alleging infringement of U.S. patent 6,557,054, entitled "Method and System for Distributing Updates by Presenting Directory of Software Available for User Installation That is Not Already Installed on User Station." Plaintiffs seek unspecified damages and other relief. Plaintiffs filed an amended complaint on September 7, 2004, adding a second patent, US patent 6,769,009 entitled "Method and System for Selecting a Personalized Set of Information Channels." The Company filed an answer on October 18, 2004, denying all allegations and asserting numerous affirmative defenses.

VirginMega/French Competition Council

On June 28, 2004, VirginMega filed a complaint with the French Competition Council against Apple Computer France. VirginMega sought "interim measures," requiring the Company to license its FairPlay digital rights management ("DRM") technology to VirginMega and all other interested parties within thirty days. A hearing on VirginMega's request for interim measures took place on October 19, 2004. On November 9, 2004, the French Competition Council issued a decision denying VirginMega's request for interim measures and rejecting VirginMega's complaint.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of the Company's fiscal year ended September 25, 2004.

PART II

Item 5. Market for the Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities

(a) Stock Market Information

The Company's common stock is traded on the over-the-counter market and is quoted on the NASDAQ National Market under the symbol AAPL, on the Tokyo Stock Exchange (TSE) under the symbol APPLE, and on the Frankfurt Stock Exchange under the symbol APCD. On November 17, 2004, the Company filed an application with the TSE to delist the Company's shares from trading on the TSE. As of November 19, 2004, there were 28,518 shareholders of record.

The Company did not pay cash dividends in either fiscal 2004 or 2003. The Company anticipates that, for the foreseeable future, it will retain any earnings for use in the operation of its business. The price range per share of common stock presented below represents the highest and lowest closing prices for the Company's common stock on the NASDAQ National Market during each quarter.

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Fiscal 2004 price range per common share	$38.01-$29.14	$33.70-$25.78	$27.68-$21.15	$24.82-$19.70
Fiscal 2003 price range per common share	$23.10-$19.06	$19.29-$13.12	$15.27-$13.80	$17.22-$13.59

(b) Related Shareholder Matters

None.

(c) Issuer Purchases of Equity Securities

In July 1999, the Company's Board of Directors authorized a plan for the Company to repurchase up to $500 million of its common stock. During the fourth quarter of 2001, the Company entered into a forward purchase agreement to acquire 1.5 million shares of its common stock in September of 2003 at an average price of $16.64 per share for a total cost of $25.5 million. In August 2003, the Company settled this agreement prior to its maturity, at which time the Company's common stock had a fair value of $22.81. Since inception of the stock repurchase plan, the Company has repurchased a total of 6.55 million shares at a cost of $217 million. The Company was authorized to repurchase up to an additional $283 million of its common stock as of September 25, 2004. The Company did not repurchase any shares of its common stock during the fourth quarter of fiscal 2004.

Item 6. Selected Financial Data

The following selected financial information has been derived from the audited consolidated financial statements. The information set forth below is not necessarily indicative of results of future operations, and should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and related notes thereto included in

Item 8 of this Form 10-K in order to fully understand factors that may affect the comparability of the information presented below.

Five fiscal years ended September 25, 2004 (In millions, except share and per share amounts)	2004	2003	2002	2001	2000
Net sales	$ 8,279	$ 6,207	$ 5,742	$ 5,363	$ 7,983
Net income (loss)	$ 276	$ 69	$ 65	$ (25)	$ 786
Earnings (loss) per common share:					
Basic	$ 0.74	$ 0.19	$ 0.18	$ (0.07)	$ 2.42
Diluted	$ 0.71	$ 0.19	$ 0.18	$ (0.07)	$ 2.18
Cash dividends declared per common share	$ —	$ —	$ —	$ —	$ —
Shares used in computing earnings (loss) per share (in thousands):					
Basic	371,590	360,631	355,022	345,613	324,568
Diluted	387,311	363,466	361,785	345,613	360,324
Cash, cash equivalents, and short-term investments	$ 5,464	$ 4,566	$ 4,337	$ 4,336	$ 4,027
Total assets	$ 8,050	$ 6,815	$ 6,298	$ 6,021	$ 6,803
Long-term debt (including current maturities)	$ —	$ 304	$ 316	$ 317	$ 300
Total liabilities	$ 2,974	$ 2,592	$ 2,203	$ 2,101	$ 2,696
Shareholders' equity	$ 5,076	$ 4,223	$ 4,095	$ 3,920	$ 4,107

Net gains before taxes related to the Company's non-current debt and equity investments of $4 million, $10 million, $75 million, and $367 million were recognized in 2004, 2003, 2001, and 2000, respectively. A net loss before taxes related to the Company's non-current debt and equity investments of $42 million was recognized in 2002. In 2002, the Company acquired Emagic resulting in a charge of approximately $1 million for acquired in-process technologies with no alternative future use. The Company recognized a similar charge of $11 million in 2001 related to its acquisition of PowerSchool. Net charges related to Company restructuring actions of $23 million, $26 million, $30 million, and $8 million were recognized in 2004, 2003, 2002, and 2000, respectively. During 2000, the Company recognized the cost of a special executive bonus for the Company's Chief Executive Officer for past services in the form of an aircraft with a total cost to the Company of approximately $90 million. In 2002, of the original $90 million accrual, $2 million remained unspent and was reversed. In 2003, settlement of the Company's forward stock purchase agreement resulted in a gain of $6 million. Favorable cumulative-effect type adjustments, net of taxes, of $1 million and $12 million were recognized in 2003 and 2001, respectively.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This section and other parts of this Form 10-K contain forward-looking statements that involve risks and uncertainties. Forward-looking statements can also be identified by words such as "anticipates," "expects," "believes," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and the Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Factors That May Affect Future Results and Financial Condition" below. The following discussion should be read in conjunction with the consolidated financial statements and notes thereto included in Item 8 of this Form 10-K. All information presented herein is based on the Company's fiscal calendar. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Executive Overview

Apple designs, manufactures and markets personal computers and related software, services, peripherals and networking solutions. The Company also designs, develops and markets a line of portable digital music players along with related accessories and services including the online distribution of third-party music and audio books. The Company's products and services include the Macintosh line of desktop and notebook computers, the iPod digital music player, the Xserve server and Xserve RAID storage products, a portfolio of consumer and professional software applications, the Mac OS X operating system, the online iTunes Music Store, a portfolio of peripherals that support and enhance the Macintosh and iPod product lines, and a variety of other service and support offerings. The Company sells its products worldwide through its online stores, its own retail stores, its direct sales force, and third-party wholesalers, resellers and value added resellers. In addition, the Company sells a variety of third-party Macintosh compatible products, including computer printers and printing supplies, storage devices, computer memory, digital video and still cameras, personal digital assistants, and various other computing products and supplies through its online and retail stores. The Company sells to education, consumer, creative professional, business and government customers. A further description of the Company's products may be found in Part I, Item 1 of this document under the heading "Business."

The Company's business strategy leverages its unique ability, through the design and development of its own operating system, hardware and many software applications and technologies, to bring to its customers around the world compelling new products and solutions with superior ease-of-use, seamless integration and innovative industrial design.

The Company participates in several highly competitive markets, including personal computers with its Macintosh line of computers, consumer electronics with its iPod line of digital music players and distribution of third-party digital music through its online iTunes Music Store. While the Company is widely recognized as an innovator in the personal computer market as well as a leader in the emerging market for distribution of digital music, these are highly competitive markets that are subject to aggressive pricing and increased competition. In order to remain competitive, the Company believes that increased investment in research and development (R&D) is necessary in order to maintain and extend its position in the markets where it competes. The Company's R&D spending is focused on delivering timely updates and enhancements to its existing line of personal computers, displays, operating systems, software applications and portable music players; developing new digital lifestyle consumer and professional software applications; and investing in new product areas such as rack-mount servers, RAID storage systems, and wireless technologies.

The Company utilizes a variety of direct and indirect distribution channels. The Company believes that sales of its innovative and differentiated products are enhanced by knowledgeable salespersons who can convey the value of the hardware, software and peripheral integration, demonstrate the unique digital lifestyle solutions that are available only on Macintosh computers, and demonstrate the seamless compatibility of the Macintosh with the Windows platform and networks. The Company further believes that providing a high-quality sales and after-sales support experience is critical to attracting and retaining customers. To ensure a high-quality buying experience for its products in which service and education are emphasized, the Company has expanded and improved its distribution capabilities by opening its own retail stores in the U.S. and internationally. The Company had 86 stores open as of September 25, 2004.

The Company has also staffed selected third-party stores with the Company's own employees to improve the buying experience through reseller channels. The Company has deployed Apple employees in reseller locations around the world including the U.S., Europe, Japan and Australia. The Company also sells to customers direct through one of its online stores around the world.

To improve the accessibility of its iPod product line, the Company has significantly expanded the number of distribution points where iPods are sold. The iPod product line can now be purchased in department stores, discount stores and specialty music and audio-visual stores.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles and the Company's discussion and analysis of its financial condition and results of operations require the Company's management to make judgments, assumptions, and estimates that affect the amounts reported in its consolidated financial statements and accompanying notes. Note 1 of the Notes to Consolidated Financial Statements of this Form 10-K describes the significant accounting policies and methods used in the preparation of the Company's consolidated financial statements. Management bases its estimates on historical experience and on various other assumptions it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates and such differences may be material.

Management believes the Company's critical accounting policies and estimates are those related to revenue recognition, allowance for doubtful accounts, inventory valuation and exposures related to inventory purchase commitments, valuation of long-lived assets including acquired intangibles, warranty costs, and income taxes. Management believes these policies to be critical because they are both important to the portrayal of the Company's financial condition and results, and they require management to make judgments and estimates about matters that are inherently uncertain. The Company's senior management has reviewed these critical accounting policies and related disclosures with the Audit and Finance Committee of the Company's Board of Directors.

Revenue Recognition

Net sales consist primarily of revenue from the sale of products (i.e., hardware, software, and peripherals), and extended warranty and support contracts. The Company recognizes revenue pursuant to applicable accounting standards, including Statement of Position (SOP) No. 97-2, *Software Revenue Recognition*, as amended, and Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition.*

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection is probable. Product is considered delivered to the customer once it has been shipped, and title and risk of loss have been transferred. For most of the Company's product sales, these criteria are met at the time the product is shipped. For online sales to individuals, for some sales to education customers in the U.S., and for certain other sales, the Company defers revenue until the customer receives the product because the Company legally retains a portion of the risk of loss on these sales during transit. If at the outset of an arrangement the Company determines the arrangement fee is not, or is presumed not to be, fixed or determinable, revenue is deferred and subsequently recognized as amounts become due and payable.

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end-user rebates, and other sales programs and volume-based incentives. The estimated cost of these programs is accrued as a reduction to revenue in the period the Company has sold the product and committed to a plan. The Company also records reductions to revenue for expected future product returns based on the Company's historical experience. Future market conditions and product transitions may require the Company to increase customer incentive programs and incur incremental price protection obligations that could result in additional reductions to revenue at the time such programs are offered. Additionally, certain customer incentive programs require management to estimate the number of customers who will actually redeem the incentive based on historical experience and the specific terms and conditions of particular incentive programs. If a greater than estimated proportion of customers redeem such incentives, the Company would be required to record additional reductions to revenue, which could have a material adverse impact on the Company's results of operations.

Allowance for Doubtful Accounts

The Company distributes its products through third-party resellers and directly to certain education, consumer, and commercial customers. The Company generally does not require collateral from its customers. However, when possible the Company does attempt to limit credit risk on trade receivables with credit insurance for certain customers in Latin America, Europe and Asia and by arranging with third-party financing companies to provide flooring arrangements and other loan and lease programs to the Company's direct customers. These credit-financing arrangements are directly between the third-party financing company and the end customer. As such, the Company generally does not assume any recourse or credit risk sharing related to any of these arrangements. However, considerable trade receivables that are not covered by collateral, third-party flooring arrangements, or credit insurance are outstanding with the Company's distribution and retail channel partners.

The allowance for doubtful accounts is based on management's assessment of the collectibility of specific customer accounts and includes consideration of the credit worthiness and financial condition of those specific customers. The Company records an allowance to reduce the specific receivables to the amount that is reasonably believed to be collectible. The Company also records an allowance for all other trade receivables based on multiple factors including historical experience with bad debts, the general economic environment, the financial condition of the Company's distribution channels, and the aging of such receivables. If there is a deterioration of a major customer's financial condition, if the Company becomes aware of additional information related to the credit worthiness of a major customer, or if future actual default rates on trade receivables in general differ from those currently anticipated, the Company may have to adjust its allowance for doubtful accounts, which would affect earnings in the period the adjustments are made.

Inventory Valuation and Inventory Purchase Commitments

The Company must order components for its products and build inventory in advance of product shipments. The Company records a write-down for inventories of components and products, including third-party products held for resale, which have become obsolete or are in excess of anticipated demand or net realizable value. The Company performs a detailed review of inventory each period that considers multiple factors including demand forecasts, product life cycle status, product development plans, current sales levels, and component cost trends. The personal computer industry is subject to a rapid and unpredictable pace of product and component obsolescence and demand changes. If future demand or market conditions for the Company's products are less favorable than forecasted or if unforeseen technological changes negatively impact the utility of component inventory, the Company may be required to record additional write-downs which would negatively affect gross margins in the period when the write-downs are recorded.

The Company accrues necessary reserves for cancellation fees related to component orders that have been cancelled. Consistent with industry practice, the Company acquires components through a combination of formal purchase orders, supplier contracts, and open orders based on projected demand information. These commitments typically cover the Company's requirements for periods ranging from 30 to 130 days. If there is an abrupt and substantial decline in demand for one or more of the Company's products or an unanticipated change in technological requirements for any of the Company's products, the Company may be required to record additional reserves for cancellation fees that would negatively affect gross margins in the period when the cancellation fees are identified.

Valuation of Long-Lived Assets Including Acquired Intangibles

The Company reviews property, plant, and equipment and certain identifiable intangible assets for impairment when events or changes in circumstances indicate the carrying amount of such an asset may not be recoverable. Recoverability of these assets is measured by comparison of their carrying amount to future undiscounted cash flows the assets are expected to generate. If such assets are considered to be impaired, the impairment to be recognized in earnings equals the amount by which the carrying value of the assets exceeds their fair market value. Although the Company has recognized no material impairment adjustments related to its property, plant, and equipment or identifiable intangibles during the past three fiscal years, except those made in conjunction with restructuring actions, deterioration in the Company's business in a geographic region or business segment in the future, including deterioration in the performance of individual retail stores, could lead to such impairment adjustments in future periods in which such business issues are identified.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*, the Company performs a review of goodwill for impairment annually, or earlier if indicators of potential impairment exist. The review of goodwill for potential impairment is highly subjective and requires that: (1) goodwill be allocated to various reporting units of the Company's business to which it relates; (2) the Company estimate the fair value of those reporting units to which the goodwill relates; and (3) the Company determine the book value of those reporting units. If the estimated fair value of reporting units with allocated goodwill is determined to be less than their book value, the Company is required to estimate the fair value of all identifiable assets and liabilities of those reporting units in a manner similar to a purchase price allocation for an acquired business. This requires independent valuation of certain internally developed and unrecognized assets including in-process research and development and developed technology. Once this process is complete, the amount of goodwill impairment, if any, can be determined.

Based on the Company's estimates as of September 25, 2004 there was no impairment of goodwill. However, changes in various circumstances including changes in the Company's market capitalization, changes in the Company's forecasts, and changes in the Company's internal business structure could cause one or more of the Company's reporting units to be valued differently thereby causing an impairment of goodwill. Additionally, in response to changes in the personal computer industry and changes in global or regional economic conditions, the Company may strategically realign its resources and consider restructuring, disposing, or otherwise exiting businesses, which could result in an impairment of property, plant, and equipment, identifiable intangibles, or goodwill.

Warranty Costs

The Company provides currently for the estimated cost for product warranties at the time the related revenue is recognized based on historical and projected warranty claim rates, historical and projected cost-per-claim, and knowledge of specific product failures that are outside of the Company's typical experience. Each quarter, the Company reevaluates its estimates to assess the adequacy of its recorded warranty liabilities considering the size of the installed base of products subject to warranty protection, and adjusts the amounts as necessary. If actual product failure rates or repair costs differ from estimates, revisions to the estimated warranty liability would be required and could negatively affect the Company's results of operations.

Income Taxes

The Company records a tax provision for the anticipated tax consequences of the reported results of operations. In accordance with SFAS No. 109, *Accounting for Income Taxes*, the provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. The Company records a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized.

Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets. In the event that all or part of the net deferred tax assets are determined not to be realizable in the future, an adjustment to the valuation allowance would be charged to earnings in the period such determination is made. Similarly, if the Company subsequently realizes deferred tax assets that were previously determined to be unrealizable, the respective valuation allowance would be reversed, resulting in a positive adjustment to earnings or a decrease in goodwill in the period such determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with management's expectations could have a material impact on the Company's results of operations and financial position.

Net Sales

Net sales and Macintosh unit sales by operating segment and net sales and unit sales by product follow (net sales in millions and Macintosh unit sales in thousands):

	2004	Change	2003	Change	2002
Net Sales by Operating Segment:					
Americas net sales	$ 4,019	26 %	$ 3,181	2 %	$ 3,131
Europe net sales	1,799	37 %	1,309	5 %	1,251
Japan net sales	677	(3)%	698	(2)%	710
Retail net sales	1,185	91 %	621	119 %	283
Other segments net sales (a)	599	51 %	398	8 %	367
Total net sales	$ 8,279	33 %	$ 6,207	8 %	$ 5,742
Unit Sales by Operating Segment:					
Americas Macintosh unit sales	1,682	4 %	1,620	(6)%	1,728
Europe Macintosh unit sales	773	13 %	684	(5)%	722
Japan Macintosh unit sales	291	(14)%	339	(12)%	386
Retail Macintosh unit sales	314	68 %	187	103 %	92
Other segments Macintosh unit sales (a)	230	26 %	182	5 %	173
Total Macintosh unit sales	3,290	9 %	3,012	(3)%	3,101
Net Sales by Product:					
Power Macintosh net sales (b)	$ 1,419	15 %	$ 1,237	(10)%	$ 1,380
PowerBook net sales	1,589	22 %	1,299	56 %	831
iMac net sales (c)	954	(23)%	1,238	(15)%	1,448
iBook net sales	961	34 %	717	(18)%	875
Total Macintosh net sales	4,923	10 %	4,491	(1)%	4,534
iPod	1,306	279 %	345	141 %	143
Other Music Products (d)	278	672 %	36	800 %	4
Peripherals and Other Hardware (e)	951	38 %	691	31 %	527
Software (f)	502	39 %	362	18 %	307
Service and other sales	319	13 %	282	24 %	227
Total net sales	$ 8,279	33 %	$ 6,207	8 %	$ 5,742

Unit Sales by Product:					
Power Macintosh unit sales (b)	709	6 %	667	(13)%	766

PowerBook unit sales	785	30 %	604	69 %	357
iMac unit sales (c)	916	(16)%	1,094	(16)%	1,301
iBook unit sales	880	36 %	647	(4)%	677
Total Macintosh unit sales	3,290	9 %	3,012	(3)%	3,101
Net sales per Macintosh unit sold (g)	$ 1,496	0 %	$ 1,491	2 %	$ 1,462
iPod unit sales	4,416	370 %	939	146 %	381

Notes:

(a) Other Segments include Asia Pacific and FileMaker.

(b) Includes Xserve product line.

(c) Includes eMac product line.

(d) Other Music Products consists of iTunes Music Store sales, iPod-related services, and Apple-branded and third-party iPod-related accessories.

(e) Net sales of Peripherals and Other Hardware include sales of Apple-branded and third-party displays, wireless connectivity and networking solutions, and other hardware accessories.

(f) Net sales of Software include sales of Apple-branded operating system and application software and sales of third-party software.

(g) Net sales per Macintosh unit sold is derived by dividing total Macintosh net sales by total Macintosh unit sales.

Fiscal Year 2004 versus 2003

During fiscal 2004, net sales increased 33% or $2.1 billion from fiscal 2003. Several factors have contributed favorably to net sales during 2004:

- Net sales of Macintosh systems increased $432 million or 10% during fiscal 2004 compared to 2003 while net sales per Macintosh unit sold remained relatively flat on a year-over-year basis. Unit sales of Macintosh systems increased 278,000 units or 9% during fiscal 2004 compared to 2003. These increases in net sales and unit sales were a result of strong demand for all of the Company's Macintosh systems, except for the iMac. The Company's portable systems, consisting of the PowerBook and iBook, produced the strongest revenue and unit growth during fiscal 2004 compared to 2003 of approximately 26% and 33%, respectively. Unit sales of portable systems accounted for 51% of all Macintosh systems sold during fiscal 2004 compared to only 42% during 2003. The Company believes that these results reflect an overall trend in the industry towards portable systems. Performance of the Company's Power Macintosh systems also yielded positive results in fiscal 2004, including a 15% and 6% increase in net sales and unit sales, respectively. The increase in year-to-date Power Macintosh sales is due primarily to the introduction of the Power Mac G5, which began shipping at the end of fiscal 2003. Although Power Macintosh sales have increased from the prior year, sales of this product were constrained in the second half of 2004 as a result of manufacturing problems at IBM, the Company's sole supplier of the PowerPC G5 processor.

- Net sales of iPods rose $961 million or 279% during fiscal 2004 compared to 2003. Unit sales of iPods totaled 4.4 million in fiscal 2004, which represents an increase of 370% from the 939,000 iPod units sold in fiscal 2003. Strong demand for the iPods during fiscal 2004 continued to be experienced in all of the Company's operating segments and was driven by enhancements to the iPod, the introduction of the iPod mini, increased expansion of the Company's iPod distribution network, and continued success of the iTunes Music Store due largely to making it available to both Macintosh and Windows users in the U.S., U.K., France and Germany. Since inception of the iPod product line in fiscal 2002, the Company has sold approximately 5.7 million iPods.

- The Retail segment's net sales grew 91% to $1.2 billion during fiscal 2004 compared to 2003. This increase is largely attributable to the increase in total stores from 65 at the end of 2003 to 86 at the end of 2004, as well as a 36% year-over-year increase in average revenue per store. While the Company's customers in areas where the Retail segment has opened stores may elect to purchase from the Retail segment stores rather than the Company's preexisting sales channels in the U.S. and Japan, the Company believes that a substantial portion of the Retail segment's net sales is incremental to the Company's total net sales. See additional comments below related to the Retail segment under the heading "Segment Operating Performance."

- Net sales of peripherals and other hardware rose by 38% during fiscal 2004 compared to 2003 primarily due to an increase in net sales of displays and other computer accessories. Net sales of other computer accessories include AirPort cards and base stations, iSight digital video cameras, and third party hardware products. The increase in total net sales of peripherals and other hardware is related to the overall increase in Macintosh unit sales and the introduction of new and updated peripheral products and was experienced predominantly by the Company's Americas, Europe, and Retail segments.

- Other music products consists of sales associated with the iTunes Music Store and iPod related services and accessories. Net sales of other music products increased $242 million or 672% during fiscal 2004 compared to 2003. The Company has experienced strong growth in sales of iPod services and accessories consistent with the increase in overall iPod unit sales for fiscal 2004. The increased sales from the iTunes Music Store, which was originally introduced in April 2003, is primarily due to making the store available for Windows in October 2003 and the introduction of the store in the U.K., France, and Germany in June 2004.

- Net sales of software rose $140 million or 39% during fiscal 2004 compared to 2003 due primarily to higher net sales of the Company's Apple-branded software and in particular, higher net sales of the Company's operating system software, Mac OS X version 10.3 "Panther," which was released in October 2003. Net sales of Panther accounted for approximately $74 million or over 50% of the increase in software net sales for fiscal 2004 compared to 2003.

- The Company's U.S. education channel experienced year-over-year growth in net sales of approximately 19% for fiscal 2004 compared to 2003. Unit sales also increased by 10% during fiscal 2004 compared to 2003. The increase in U.S. education net sales for fiscal 2004 relates primarily to a 40% year-over-year increase in higher education net sales and to a lesser extent the Company's 3% growth in K-12 net sales.

  The Company believes the U.S. K-12 education market remains challenging due to multiple factors including funding pressures due to weak economic conditions, large budget deficits in many states, and increased competition particularly for desktop computers. Although the Company has taken steps, and will continue to take steps, to address weakness in the U.S. education channel, it remains difficult to anticipate when and if this trend will reverse.

- Service and other sales increased $37 million or 13% during fiscal 2004 compared to 2003. These increases are the result of significant year-over-year increases in net sales associated with AppleCare Protection Plan (APP) extended maintenance and support services, as well as increases in net sales associated with the Company's .Mac Internet service. Increased net sales associated with APP are primarily the result of higher Macintosh unit sales and higher attach rates on APP over the last several years.

Offsetting the favorable factors discussed above, the Company's net sales during fiscal 2004 were negatively impacted by the following:

- Net sales and unit sales of iMac systems were down 23% and 16%, respectively, during fiscal 2004 versus 2003. The decrease in iMac net sales and unit sales was largely due to the delay in the introduction of the new iMac, based on the PowerPC G5 processor, primarily as a result of manufacturing problems experienced by IBM. The delays in the new iMac resulted in the depletion of inventory of the old iMac flat panel prior to availability of the new iMac G5. The old flat panel iMac form factor which was available during most of fiscal 2004, was nearly 3 years old by the time the new iMac G5 began shipping in September 2004 and had experienced declines in sales as a result of the age of this product. The Company believes that sales of iMac systems have also declined due to a shift in consumer preference to portable systems and competitor desktop models with price points below $1,000. The Company introduced a new version of the eMac in April 2004 with a suggested retail price starting at $799 aimed at the price sensitive customer.

- Net sales and unit sales in the Company's Japan segment decreased 3% and 14%, respectively, during fiscal 2004 versus 2003. The Company believes these declines relate to a shift in sales from the Japan Segment to the Retail segment as a result of the Tokyo and Osaka store openings in fiscal 2004. Declines in Japan may also relate to delays in computer upgrades by certain professional and creative customers pending release in Japan of certain Mac OS X native applications, such as Quark Xpress 6, which did not become available until September 2004. When sales from the Japan retail stores are included in the results for the Japan segment, the combined revenue in Japan resulted in a 3% year-over-year increase in fiscal 2004 as compared to 2003. See additional comments below related to the Japan segment under the heading "Segment Operating Performance."

Fiscal Year 2003 versus 2002

Net sales increased $465 million or 8% during 2003 compared to 2002 while Macintosh unit sales declined 3% year-over-year to approximately 3 million units in 2003. Several factors contributed favorably to net sales during 2003 including:

- The Retail segment's net sales grew to $621 million during 2003 from $283 million in 2002, an increase of 119%. While the Company's customers may have elected to purchase product from their local Apple Retail store rather than through other preexisting sales channels in the U.S., the Company believes that a substantial portion of the Retail segment's net sales was incremental to total net sales. See additional comments below related to the Retail segment under the heading "Segment Operating Performance."

- Net sales of iPods rose $202 million or 141% during 2003 compared to 2002. This increase was experienced by all of the Company's operating segments. iPod sales during 2003 were favorably affected by the introduction of substantially redesigned new models, which were compatible with both Macintosh and Windows operating systems. The Company's iPod digital music player is sold by a variety of resellers, many of which do not currently market the Company's Macintosh systems. The Company expanded this distribution network during 2003, which contributed to the 2003 increase in iPod unit sales of 146%.

- The Company also experienced an increase in net sales of peripherals and other hardware totaling $164 million or 31% during 2003 compared to 2002, reflecting an overall increase in net sales of other computer accessories including AirPort cards and base stations, which facilitate wireless connectivity; third party digital cameras and printers; and a number of portable computer related accessories.

- Net sales of other music products, including sales associated with the iTunes Music Store and iPod related services and accessories, increased $32 million or 800% during 2003 compared to 2002. This increase was due primarily to the introduction of the iTunes Music Store for the Macintosh operating system in April 2003 and higher sales of iPod services and accessories consistent with the increase in iPod net sales and unit sales during 2003.

- Although total Macintosh unit sales were down 3% in 2003, unit sales of the Company's portable systems were relatively strong primarily due to the 69% or 247,000 unit increase in PowerBook unit sales, slightly offset by a 4% or 30,000 unit decrease in iBook unit sales. The increase in PowerBook net sales of $468 million or 56% was due primarily to the success of the Company's new 12-inch, 15-inch and 17-inch models that were introduced during 2003. The decline in iBook consumer portable sales during 2003 was primarily due to a lower average price per unit. Portable systems represented 42% of all Macintosh systems sold in 2003 versus 33% in 2002, which reflected an overall industry trend towards portable systems.

- The Company's average net sales per Macintosh unit sold increased 2% to $1,491 in 2003 as a result of various changes in overall unit mix towards relatively higher-priced PowerBook systems and increases direct sales primarily from the Company's retail and online stores, offset by somewhat lower year-over-year pricing on comparable Macintosh systems for most of the Company's Macintosh product lines in response to industry pricing pressure, particularly with the Company's iBook consumer portable systems. PowerBook and Power Macintosh systems accounted for 42% of total unit sales in 2003 versus 36% in 2002.

- Net sales of software increased $55 million or 18% during 2003 compared to the prior year and reflected higher net sales of Apple-branded application and server software and third-party software. Net sales of Apple-branded application and server software increased due to the introduction of several new software titles during fiscal 2003 including Final Cut Express, iLife, and Keynote, as well as from higher sales of software related to recent acquisitions including PowerSchool and Emagic. Growth in net sales of third-party software during 2003 was particularly strong in the Americas Segment due to strong sales of software by the Company's online store and its Retail segment.

- Service and other sales rose $55 million or 24% during 2003 which primarily resulted from significant year-over-year increases in net sales associated with APP extended maintenance and support services, as well as the Company's Internet related services. Increased net sales associated with APP were primarily the result of increasing attach rates over the last several years. Increased net sales associated with Internet services were due to increased net sales of the Company's .Mac Internet service.

Offsetting the favorable factors discussed above, the Company's net sales during 2003 were negatively impacted by the following factors:

- Total unit sales of desktop systems fell 15% during 2003 compared to 2002. iMac systems unit sales declined 16% from 2003 to 2002 resulting from a shift in sales away from desktop systems in favor of portables. Also, the flat panel iMac form factor available during fiscal 2003 was in the eighth quarter of its life cycle by the end of 2003.

- Unit sales of Power Macintosh systems fell 13% during 2003 compared to 2002. For the first nine months of 2003 compared to the same period in 2002, unit sales of Power Macintosh systems decreased 24%, which was representative of the decline of Power Macintosh systems sales experienced by the Company during recent years and was also believed to be attributable to delays in purchasing pending the release of the Power Mac G5. As expected, this trend reversed in the fourth quarter of 2003 with unit sales increasing 26% during the quarter as compared to the same period in the prior year due largely to the new Power Mac G5, which the Company introduced in June 2003 and began shipping at the end of fiscal 2003. The decline in Power Macintosh sales over the previous several years also reflects the shift in sales to portable systems, particularly PowerBooks. In addition, the Company believes that weak economic conditions over the past several years had a pronounced negative impact on its professional and creative customers. Additionally, some of the Company's professional and creative customers may have delayed upgrades of their systems in anticipation of certain software vendors transitioning their professionally oriented Macintosh software applications to run natively on Mac OS X.

- The Company experienced ongoing weakness in its U.S. education channel during 2003. Net sales and unit sales in U.S. education during 2003 were down 4% and 6%, respectively, as compared to 2002. This decline was due to a decrease in K-12 sales, partially offset by an increase in higher education sales. Net sales declined primarily as a result of a continued shift in mix away from higher priced Power Macintosh and iMac systems towards lower priced eMac and iBook systems, although the Company did experience a significant increase in sales of its PowerBook systems primarily to higher education customers. Portable systems accounted for approximately 43% of total unit sales in the education channel during 2003, as compared to approximately 34% in 2002.

Segment Operating Performance

The Company manages its business primarily on a geographic basis. The Company's reportable operating segments are comprised of the Americas, Europe, Japan, and Retail. The Americas segment includes both North and South America, except for the activities of the Company's Retail segment. The Europe segment includes European countries as well as the Middle East and Africa. The Japan segment includes only Japan and excludes revenue from the Company's own retail stores in Japan, which is included in the Company's Retail segment. The Retail segment operated Apple-owned retail stores in the U.S. and Japan during fiscal 2004. Each reportable geographic operating segment provides similar hardware and software products and similar services. Further information regarding the Company's operating segments may be found in Item 8 of this Form 10-K in the Notes to Consolidated Financial Statements at Note 11, "Segment Information and Geographic Data."

Americas

During fiscal 2004, net sales in the Americas segment grew 26% or $838 million compared to fiscal 2003. The increase in net sales during 2004 was primarily attributable to the significant year-over-year increase in iPod sales as well as strong sales of peripherals, software, and services. This increase was partially offset by a shift in sales to the Retail segment, which had 84 stores in the U.S. as of the end of fiscal 2004. Macintosh unit sales also increased by 4% in fiscal 2004 compared to 2003, driven primarily by strong sales of portable and Power Macintosh systems, partially offset by continued weakness in iMac sales. During 2004 and 2003, the Americas segment represented approximately 49% and 51%, respectively, of the Company's total net sales and represented approximately 51% and 54%, respectively, of total Macintosh unit sales. As noted above, the Company experienced an increase in U.S. education channel net sales of 19% for fiscal 2004 compared to 2003. Strong U.S. education net sales for the current year relate primarily to strength in higher education net sales that resulted from a successful back-to-school selling season with strong demand for the Company's portables. This strength drove year-over-year growth in net sales of 40% for the higher education channel during fiscal 2004. The Company's K-12 net sales grew year-over-year by 3% during fiscal 2004, despite the challenges in the K-12 market from continued budget constraints and increased competition, due to the Company's continued focus and success with delivering 1:1 education solutions.

Net sales in the Americas segment during 2003 increased $50 million or 2% compared to 2002. During 2003 and 2002, the Americas segment represented approximately 51% and 55%, respectively, of the Company's total net sales and represented approximately 54% and 56%, respectively, of total Macintosh unit sales. The results of the Americas segment are similar to the overall results of the Company as they reflect substantially lower unit sales and net sales of Power Macintosh systems and iMac systems, partially offset by increases in unit sales and net sales of PowerBooks. The net sales of the Americas segment, and the Company in total, also reflect substantially higher sales of iPods, peripherals, software, and services during 2003 compared to 2002. The Americas segment had been negatively affected by weakness in its U.S. education channel during 2003. Total net sales and unit sales in the U.S. education channel during 2003 were down 4% and 6%, respectively, compared to the same period in 2002. The Company believes this decline was caused by increased competition in the education market and by a reduction in spending by U.S. educational institutions due to federal and state funding concerns and tax revenue shortfalls resulting from the weak economy. Additionally, some of the decline during 2003 in net sales and unit sales of Macintosh systems in the Americas segment may be the result of the operation of the Company's Retail segment whose net sales, all of which occurred within the U.S., increased significantly during 2003.

Europe

Net sales in Europe rebounded in fiscal 2004 increasing $490 million or 37% from 2003. Total Macintosh unit sales in Europe also experienced growth during the current year by increasing 13% in fiscal 2004 compared to 2003. Consistent with the Americas segment, Europe experienced strong net sales across all product lines, except for the iMac systems. Demand in Europe during fiscal 2004 was particularly strong for the Company's Power Macintosh systems and portable Macintosh systems, which experienced year-over-year increases of 29% and 42%, respectively. Similar to the results of the Company's other segments, net sales of iPods, peripherals and software were strong in fiscal 2004.

Net sales in Europe increased $58 million or 5% during 2003 as compared to 2002 while Macintosh unit sales declined by 5% during the same period. Europe's operating results were consistent with the trend experienced in the Americas and by the Company as a whole. Europe experienced weakened demand for Power Macintosh, iMac and iBook systems in 2003, partially offset by strong demand for PowerBooks whose net sales increased by 48% or $100 million from 2002. Europe also realized increased sales of iPods, peripherals, software, and services.

Japan

The Japan segment continues to be a challenge for the Company, with four consecutive years of year-over-year declines in both net sales and Macintosh unit sales. Japan's net sales and unit sales were down 3% and 14%, respectively during fiscal 2004 compared to 2003, continuing to lag behind all of the Company's other operating segments. These decreases in net sales and unit sales are believed to be attributable in part to a shift in sales from the Japan segment to the Retail segment as a result of the opening of two stores in Japan in fiscal 2004. In addition, such decreases may have been related to delayed computer system upgrades by some professional and creative customers who were awaiting the release of Quark XPress 6 for Mac OS X, which did not occur until September 2004. The decrease in net sales was partially offset by strong iPod and iBook sales during fiscal 2004 compared to 2003.

Net sales in Japan decreased $12 million or 2% during 2003 as compared to the same period in 2002, the weakest year-to-date performance of any of the Company's operating segments. Japan's Macintosh unit sales were particularly weak in 2003, declining 12%, and were primarily attributable to lower sales of iMac and iBook systems, partially offset by an increase in PowerBook sales as well as higher sales of iPods, and peripherals and other hardware. Japan's Macintosh unit sales remained significantly below the segment's historic levels due to economic conditions that remained particularly negative in Japan.

Retail

The Company opened 21 new retail stores during 2004, including its first two international stores in Tokyo and Osaka, Japan, bringing the total number of open stores to 86 as of September 25, 2004. This compares to 65 open stores as of September 27, 2003 and 40 open stores as of September 28, 2002. During the first quarter of 2005, the Company anticipates opening approximately 14 additional stores to end the calendar year at approximately 100 stores. Approximately half of the stores expected to open during the first quarter of 2005 will be in the new "mini" store design, which is the Company's smallest store format to date; allowing it to be placed in a variety of new locations to introduce the Company's innovative products to even more customers. The Company also opened its third international store in London, England during the first quarter of 2005.

Net sales of the Retail segment grew to $1.185 billion during 2004 from $621 million and $283 million, in 2003 and 2002, respectively. The increases in net sales during both 2004 and 2003 reflect the impact of new store openings for each fiscal year, including the opening of 21 new stores in 2004 and 25 new stores in 2003. An increase in average revenue per store also contributed to the segment's strong sales in fiscal 2004. With an average of 76 stores open during 2004, the Retail segment achieved annualized revenue per store of approximately $15.6 million, as compared to $11.5 million in 2003 with a 54 store average and $10.2 million in 2002 with a 28 store average.

As measured by the Company's operating segment reporting, the Retail segment reported profit of $39 million during fiscal 2004 as compared to losses of $5 million and $22 million during 2003 and 2002, respectively. This improvement is primarily attributable to the segment's year-over-year increase in average quarterly revenue per store, the impact of opening new stores, and the segment's year-over-year increase in net sales, which resulted in higher leverage on occupancy, depreciation and other fixed costs.

Expansion of the Retail segment has required and will continue to require a substantial investment in fixed assets and related infrastructure, operating lease commitments, personnel, and other operating expenses. Capital expenditures associated with the Retail segment were $104 million in fiscal 2004, bringing the total capital expenditures since inception of the Retail segment to approximately $394 million. As of September 25, 2004, the Retail segment had approximately 2,100 employees and had outstanding operating lease commitments associated with retail store space and related facilities of approximately $436 million. The Company would incur substantial costs should it choose to terminate its Retail segment or close individual stores. Such costs could adversely affect the Company's results of operations and financial condition.

Gross Margin

Gross margin for the three fiscal years ended September 25, 2004 are as follows (in millions, except gross margin percentages):

	2004	2003	2002
Net sales	$ 8,279	$ 6,207	$ 5,742
Cost of sales	6,020	4,499	4,139
Gross margin	$ 2,259	$ 1,708	$ 1,603
Gross margin percentage	27.3%	27.5%	27.9%

Gross margin declined in fiscal 2004 to 27.3% of net sales from 27.5% of net sales in 2003. The Company's gross margin during fiscal 2004 declined due to an increase in mix towards lower margin iPod and iBook sales, pricing actions on certain Power Macintosh G5 models that were transitioned during the beginning of 2004, higher warranty costs on certain portable Macintosh products, and higher freight and duty costs during fiscal 2004. These unfavorable factors were partially offset by an increase in direct sales and a 39% year-over-year increase in higher margin software sales.

The Company anticipates that its gross margin and the gross margin of the overall personal computer and consumer electronics industries will remain under pressure throughout fiscal 2005 in light of price competition, especially for the iPod product line. The Company also expects to continue to incur air freight charges, which negatively impact gross margins on the iMac and other products during the first quarter of 2005 and possibly beyond.

The foregoing statements regarding the Company's expected gross margin during 2005, general demand for personal computers, anticipated air freight charges, and future economic conditions are forward- looking. There can be no assurance that current gross margins will be maintained or targeted gross margin levels will be achieved. In general, gross margins and margins on individual products, including iPods, will remain under significant downward pressure due to a variety of factors, including continued industry wide global pricing pressures, increased competition, compressed product life cycles, potential increases in the cost and availability of raw material and outside manufacturing services, and potential changes to the Company's product mix, including higher unit sales of consumer products with lower average selling prices and lower gross margins. In response to these downward pressures, the Company expects it will continue to take pricing actions with respect to its products. Gross margins could also be affected by the Company's ability to effectively manage product quality and warranty costs and to stimulate demand for certain of its products. The Company's operating strategy and pricing take into account anticipated changes in foreign currency exchange rates over time; however, the Company's results of operations can be significantly affected in the short-term by fluctuations in exchange rates.

The Company orders components for its products and builds inventory in advance of product shipments. Because the Company's markets are volatile and subject to rapid technology and price changes, there is a risk the Company will forecast incorrectly and produce or order from third-parties excess or insufficient inventories of particular products or components. The Company's operating results and financial condition in the past have been and may in the future be materially adversely affected by the Company's ability to manage its inventory levels and outstanding purchase commitments and to respond to short-term shifts in customer demand patterns.

Gross margin decreased to 27.5% of net sales in 2003 from 27.9% of net sales in 2002. This decline in gross margin reflects relatively aggressive pricing actions on several Macintosh models instituted by the Company beginning in late fiscal 2002 as a result of continued pricing pressure throughout the personal computer industry, lower sales of relatively higher margin Power Macintosh systems during the first three fiscal quarters of 2003, and increased air freight and manufacturing costs associated with the production ramp-up of the new Power Mac G5 and 15-inch PowerBook, both of which began shipping in volume during September 2003. This decline is also attributable to a rise in certain component costs as the year progressed. The aforementioned negative factors affecting gross margins during 2003 were partially offset by the increase in higher margin software and direct sales.

Operating Expenses

Operating expenses for the three fiscal years ended September 25, 2004 are as follows (in millions, except for percentages):

	2004	2003	2002
Research and development	$ 489	$ 471	$ 446
Percentage of net sales	6%	8%	8%
Selling, general, and administrative expenses	$ 1,421	$ 1,212	$ 1,109
Percentage of net sales	17%	20%	19%
Restructuring costs	$ 23	$ 26	$ 30
Purchased in-process research and development	—	—	$ 1

Research and Development (R&D)

The Company recognizes that focused investments in R&D are critical to its future growth and competitive position in the marketplace and are directly related to timely development of new and enhanced products that are central to the Company's core business strategy. The Company has historically relied upon innovation to remain competitive. R&D expense amounted to approximately 6% of total net sales during fiscal 2004 down from 8% of total net sales in both 2003 and 2002. This decrease is due to the significant increase of 33% in total net sales of the Company for fiscal 2004. Although R&D expense decreased as a percentage of total net sales in fiscal 2004, actual expenditures for R&D in fiscal 2004 increased $18 million or 4% from fiscal 2003, which follows a 6% or $25 million increase in 2003 compared to 2002. The overall increase in R&D expense relates primarily to increased headcount and support for new product development activities and the impact of employee salary merit increases in 2004. R&D spending also included capitalized software development costs of approximately $4.5 million related to the development of Mac OS X Tiger and $2.3 million related to the development of FileMaker Pro 7 in 2004; $14.7 million related to the development of Mac OS X Panther in 2003; and approximately $13.3 million associated with the development of Mac OS X Jaguar and approximately $6 million associated with the PowerSchool enterprise student information system in 2002. Further information related to the Company's capitalization of software development costs may be found in Part II, Item 8 of this Form 10-K at Note 1 of Notes to Consolidated Financial Statements.

Selling, General, and Administrative Expense (SG&A)

Expenditures for SG&A increased $209 million or 17% during 2004 compared to 2003. These increases are due primarily to the Company's continued expansion of its Retail segment in both domestic and international markets, a current year increase in discretionary spending on marketing and advertising, an increase in amortization costs associated with restricted stock compensation, and higher direct and channel selling expenses resulting from the increase in net sales and employee salary merit increases. SG&A as a percentage of total net sales in 2004 was 17%, down from 20% in 2003. This decrease is due to the increase of 33% in total net sales of the Company for fiscal 2004, reflecting leverage on the Company's fixed costs.

SG&A increased $103 million or 9% during 2003 as compared to 2002 due primarily to the Company's continued expansion of the Retail segment and increases in headcount. The overall increase was partially offset by a decrease in 2003 discretionary spending on marketing and advertising and by savings resulting from the 2003 and 2002 restructuring activities described below.

Fiscal 2004 Restructuring Actions

The Company recorded total restructuring charges of approximately $23 million during the year ended September 25, 2004, including approximately $14 million in severance costs, $5.5 million in asset impairments, and a $3.5 million charge for lease cancellations. Of the $23 million charge, $14.3 million had been spent by the end of 2004, with the remaining $8.7 million consisting of $5.2 million for employee severance benefits and $3.5 million for lease cancellations.

During the fourth quarter of 2004, the Company recognized restructuring expense of $5.5 million. In conjunction with the European workforce reduction during the second quarter of 2004, the Company vacated a leased sales facility during the fourth quarter of 2004 resulting in a charge of $3.7 million for contract termination and asset impairment costs. The Company also recognized employee termination costs of $1.8 million related to the elimination of non-essential positions, principally in Europe. In addition, the Company reversed $400,000 of excess restructuring expense from prior periods related primarily to lower than expected disposal costs on Sacramento manufacturing-related fixed assets. The net cost of the restructuring plans for the fourth quarter of 2004 was $5.1 million, of which $300,000 had been paid prior to the end of 2004. These actions will result in the termination of 54 positions, 4 of which had been terminated prior to the end of 2004.

During the third quarter of 2004, the Company finalized restructuring plans related to closing Company-owned manufacturing activities in Sacramento. In addition, the Company's management approved restructuring plans related to certain headcount reductions primarily for various sales and marketing activities principally in the U.S. Total cost of the restructuring plan for the third quarter of 2004 was $7.9 million, of which $7.2 million had been paid prior to the end of 2004. These actions will result in the termination of 83 positions, 77 of which had been terminated prior to the end of 2004.

The closing of manufacturing operations in Sacramento resulted in the elimination of 67 positions for a severance cost of $1.9 million and write-off of $5.3 million in manufacturing-related fixed assets whose use ceased during the third quarter of 2004. Termination of sales and marketing activities, principally in the U.S., resulted in severance of $0.7 million for the elimination of 16 positions.

During the second quarter of 2004, the Company's management approved restructuring plans related to the termination of Company-owned manufacturing activities in Sacramento and headcount reductions related primarily to various sales and marketing activities in the U.S. and Europe. Total cost of the actions was $9.6 million for the termination of 348 positions. As of the end of the fourth quarter of 2004, $6.8 million had been spent and 310 positions had been eliminated related to these actions.

The Company estimates the closing of the Sacramento manufacturing operations will result in reduced ongoing quarterly operating expenses of approximately $2 million. In addition, the Company estimates that the remaining restructuring actions taken in fiscal 2004 will ultimately result in reduced ongoing quarterly operating expenses of approximately $6 million.

Fiscal 2003 Restructuring Actions

The Company recorded total restructuring charges of approximately $26.8 million during the year ended September 27, 2003, including approximately $7.4 million in severance costs, a $5.0 million charge to write-off deferred compensation, $7.1 million in asset impairments and a $7.3 million charge for lease cancellations. Of the $26.8 million charge, all had been spent by the end of 2004, except for approximately $3.0 million related to operating lease costs on abandoned facilities. During the third quarter of 2003, approximately $500,000 of the amount originally accrued for lease cancellations was determined to be in excess due to the sublease of a property sooner than originally estimated and an approximately $500,000 shortfall was identified in the severance accrual due to higher than expected severance costs related to the closure of the Company's Singapore manufacturing operations. These adjustments had no net effect on reported operating expense.

During the second quarter of 2003, the Company's management approved and initiated restructuring actions that resulted in recognition of a total restructuring charge of $2.8 million, including $2.4 million in severance costs and $400,000 for asset write-offs and lease payments on an abandoned facility. Actions taken in the second quarter were for the most part supplemental to actions initiated in the prior two quarters and focused on further headcount reductions in various sales and marketing functions in the Company's Americas and Europe operating segments and further reductions associated with PowerSchool-related activities in the Americas operating segment, including an accrual for asset write-offs and lease payments on an abandoned facility. The second quarter actions resulted in the termination of 93 employees.

During the first quarter of 2003, the Company's management approved and initiated restructuring actions with a total cost of $24 million that resulted in the termination of manufacturing operations at the Company-owned facility in Singapore, further reductions in headcount resulting from the shift in PowerSchool product strategy that took place at the end of fiscal 2002, and termination of various sales and marketing activities in the U.S. and Europe. These restructuring actions resulted in the elimination of 260 positions worldwide.

Closure of the Company's Singapore manufacturing operations resulted in severance costs of $1.8 million and costs of $6.7 million to write-off manufacturing related fixed assets, whose use ceased during the first quarter. PowerSchool related costs included severance of approximately $550,000 and recognition of $5 million of previously deferred stock compensation that arose when PowerSchool was acquired by the Company in 2001 related to certain PowerSchool employee stockholders who were terminated in the first quarter of 2003. Termination of sales and marketing activities and employees, principally in the U.S. and Europe, resulted in severance costs of $2.8 million and accrual of costs associated with operating leases on closed facilities of $6.7 million. The total net restructuring charge of $23 million recognized during the first quarter of 2003 also reflects the reversal of $600,000 of unused restructuring accrual originally made during the first quarter of 2002.

Fiscal 2002 Restructuring Actions

During fiscal 2002, the Company recorded total restructuring charges of approximately $30 million related to actions intended to eliminate certain activities and better align the Company's operating expenses with existing general economic conditions and to partially offset the cost of continuing investments in new product development and investments in the Company's Retail operating segment.

During the fourth quarter of 2002, the Company's management approved and initiated restructuring actions with a total cost of approximately $6 million designed to reduce headcount costs in corporate operations and sales and to adjust its PowerSchool product strategy. These restructuring actions resulted in the elimination of approximately 180 positions worldwide at a cost of $1.8 million, all of which were eliminated by September 27, 2003. Eliminated positions were primarily in corporate operations, sales, and PowerSchool related research and development in the Americas operating segment. The shift in product strategy at PowerSchool included discontinuing development and marketing of PowerSchool's PSE product. This shift resulted in the impairment of previously capitalized development costs associated with the PSE product in the amount of $4.5 million.

During the first quarter of 2002, the Company's management approved and initiated restructuring actions with a total cost of approximately $24 million. These restructuring actions resulted in the elimination of approximately 425 positions worldwide at a cost of $8 million. Positions were eliminated primarily in the Company's operations, information systems, and administrative functions. In addition, these restructuring actions also included significant changes in the Company's information systems strategy resulting in termination of equipment leases and cancellation of existing projects and activities. The Company ceased using the assets associated with first quarter 2002 restructuring actions during that same quarter. Related lease and contract cancellation charges totaled $12 million, and charges for asset impairments totaled $4 million. The first quarter 2002 restructuring actions were primarily related to corporate activity not allocated to operating segments. During the first quarter of 2003, the Company reversed the remaining unused accrual of $600,000.

Purchased In-Process Research and Development (IPR&D)

During 2002, the Company acquired Emagic GmbH, a provider of professional software solutions for computer based music production, for approximately $30 million in cash; $551,000 of which was allocated to IPR&D. The amount of the purchase price allocated to IPR&D was expensed upon acquisition, because the technological feasibility of products under development had not been established and no alternative future uses existed. The fair value of the IPR&D was determined using the income approach, which reflects the projected free cash flows that will be generated by the IPR&D projects and that are attributable to the acquired technology, and discounting the projected net cash flows back to their present value using a discount rate of 25%.

Other Income and Expense

Other income and expense for the three fiscal years ended September 25, 2004 are as follows (in millions):

	2004	2003	2002
Gains (losses) on non-current investments, net	$ 4	$ 10	$ (42)
Interest income	$ 64	$ 69	$ 118
Interest expense	(3)	(8)	(11)
Gains on sales of short term investments, net	1	21	7
Other income (expense), net	(9)	(5)	(2)
Gain on forward purchase agreement	—	6	—
Interest and other income, net	$ 53	$ 83	$ 112
Total other income and expense	$ 57	$ 93	$ 70

Gains and Losses on Non-current Investments

Over the course of the last three years, the Company has held investments that were classified as available-for-sale in EarthLink Inc. (EarthLink), Akamai Technologies, Inc. (Akamai), ARM Holdings plc (ARM) and certain investments in private companies. Further information related to the Company's non-current debt and equity investments may be found in Part II, Item 8 of this Form 10-K at Note 2 of Notes to Consolidated Financial Statements.

During 2004, the Company sold its remaining 986,000 shares of Akamai stock. The transaction generated proceeds of approximately $5 million and a gain before taxes of approximately $4 million. As of September 25, 2004, the Company does not have any non-current public company investments reflected in its consolidated balance sheet.

During 2003, the Company sold 1,875,000 shares of Akamai stock for net proceeds of approximately $9 million, and a gain before taxes of approximately $8 million. Additionally, the Company sold its remaining investment in ARM stock, 278,000 shares, for net proceeds of approximately $295,000, and a gain before taxes of $270,000, and sold its remaining investment in EarthLink stock, 6,540,000 shares, for net proceeds of approximately $37 million, and a gain before taxes of $2 million.

During 2002, the Company determined that declines in the fair value of certain investments were other-than-temporary. As a result, the Company recognized a $44 million charge to earnings to writedown the basis of its investment in EarthLink, a $6 million charge to earnings to writedown the basis of its investment in Akamai, and a $15 million charge to earnings to writedown the basis of its investment in a private company investment. These losses in 2002 were partially offset by the sale of 117,000 shares of EarthLink stock for net proceeds of $2 million and a gain before taxes of $223,000, the sale of 250,000 shares of Akamai stock for net proceeds of $2 million and a gain before taxes of $710,000, and the sale of approximately 4.7 million shares of ARM stock for both net proceeds and a gain before taxes of $21 million.

Interest and Other Income, Net

Total interest and other income, net decreased $30 million or 36% to $53 million during fiscal 2004 compared to $83 million in 2003 and $112 million in 2002. These decreases are attributable primarily to declining investment yields on the Company's cash and short-term investments resulting from lower market interest and a shortening of the average maturity of the Company's investment portfolio, as well as lower gains on sales of short-term investments in fiscal 2004. The weighted average interest rate earned by the Company on its cash, cash equivalents and short-term investments fell to 1.38% in 2004 compared to the 1.89% and 2.85% rates earned during 2003 and 2002, respectively. The Company occasionally sells short-term investments prior to their stated maturities. As a result of such sales, the Company recognized net gains of $1 million, $21 million and $7 million during fiscal 2004, 2003 and 2002, respectively. The decrease in total interest and other income, net during fiscal 2003 was also offset by the $6 million gain related to the forward purchase agreement during the fourth quarter of 2003 which is further discussed below under the heading "Cumulative Effects of Accounting Changes."

Interest expense consisted primarily of interest on the Company's $300 million aggregate principal amount unsecured notes, which were repaid upon their maturity in February 2004, partially offset by amortization of deferred gains realized in 2002 and 2001 that resulted from the closure of swap positions associated with the unsecured notes. The unsecured notes were sold at 99.925% of par for an effective yield to maturity of 6.51%. Total deferred gain resulting from the closure of debt swaps of approximately $23 million was fully amortized as of the notes' maturity in February 2004.

Provision for Income Taxes

The Company's effective tax rate for the year ended September 25, 2004 was approximately 28%. The Company's effective rate differs from the statutory federal income tax rate of 35% due primarily to certain undistributed foreign earnings for which no U.S. taxes are provided because such earnings are intended to be indefinitely reinvested outside the U.S. As of September 25, 2004, the Company had deferred tax assets arising from deductible temporary differences, tax losses, and tax credits of $647 million before being offset against certain deferred tax liabilities and a valuation allowance for presentation on the Company's balance sheet. Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, will be sufficient to fully recover the remaining net deferred tax assets. As of September 25, 2004, a valuation allowance of $30 million was recorded against the deferred tax asset for the benefits of tax losses that may not be realized. The valuation allowance relates principally to the operating loss carryforwards acquired from NeXT and other acquisitions, the utilization of which is subject to certain limitations imposed by the Internal Revenue Code. The Company will continue to evaluate the realizability of the deferred tax assets quarterly by assessing the need for and amount of the valuation allowance.

The Internal Revenue Service (IRS) has completed its field audit of the Company's federal income tax returns for all years prior to 2001 and proposed certain adjustments. Certain of these adjustments are being contested through the IRS Appeals Office. Substantially all IRS audit issues for these years have been resolved. In addition, the Company is also subject to audits by state, local, and foreign tax authorities. Management believes that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. Should any issues addressed in the Company's tax audits be resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs.

Cumulative Effects of Accounting Changes

Financial Instruments with Characteristics of Both Liabilities and Equity

On May 15, 2003, the Financial Accounting Standards Board (FASB) issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*. SFAS No. 150 requires issuers to classify as liabilities certain freestanding financial instruments that embody obligations for the issuer and have characteristics of both liabilities and equity. The Company adopted the provisions of SFAS No. 150 on June 29, 2003, which resulted in a favorable cumulative effect type adjustment of approximately $3 million. This adjustment represented the mark-to-market adjustment to fair value for a forward purchase agreement that allowed the Company to acquire 1.5 million shares of its common stock at a price of $16.64 per share. The Company settled this forward purchase agreement in August 2003. The settlement resulted in an additional gain of approximately $6 million, which is included in interest and other income, net.

Accounting for Asset Retirement Obligations

On September 29, 2002, the Company adopted SFAS No. 143, *Accounting for Asset Retirement Obligations*, which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. Net of the related income tax effect of approximately $1 million, adoption of SFAS No. 143 resulted in an unfavorable cumulative-effect type adjustment to net income during 2003 of approximately $2 million. This adjustment represents cumulative depreciation and accretion that would have been recognized through the date of adoption of SFAS No. 143 had the statement been applied to the Company's existing asset retirement obligations at the time they were initially incurred.

Recent Accounting Pronouncements

In December 2003, the Securities and Exchange Commission released Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition*, which supercedes SAB 101, *Revenue Recognition in Financial Statements*. SAB 104 clarifies existing guidance regarding revenue contracts that contain multiple deliverables to make it consistent with Emerging Issues Task Force (EITF) No. 00-21. The adoption of SAB 104 did not have a material impact on the Company's results of operations or financial position.

In December 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. (FIN) 46R, a revision to FIN 46, *Consolidation of Variable Interest Entities.* FIN 46R clarifies some of the provisions of FIN 46 and exempts certain entities from its requirements. FIN 46R is effective at the end of the first interim period ending after March 15, 2004. The adoption of FIN 46R did not have a material impact on the Company's results of operations or financial position.

In March 2004, the FASB issued EITF Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments.* EITF 03-1 includes new guidance for evaluating and recording impairment losses on debt and equity investments, as well as new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the FASB issued FASB Staff Position EITF 03-1-1, which delays the effective date until additional guidance is issued for the application of the recognition and measurement provisions of EITF 03-1 to investments in securities that are impaired; however, the disclosure requirements are effective for annual periods ending after June 15, 2004. Although the Company will continue to evaluate the application of EITF 03-1, management does not currently believe adoption will have a material impact on its results of operations or financial position.

Accounting for Stock-Based Compensation

The Company currently measures compensation expense for its employee stock-based compensation plans using the intrinsic value method prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* and provides pro forma disclosures of the effect on net income and earnings per share as if the fair value-based method had been applied in measuring compensation expense. The Company has elected to follow APB Opinion No. 25 because, as further discussed in Part II, Item 8 of this Form 10-K at Note 1 of the Notes to Consolidated Financial Statements, the alternative fair value accounting provided for under SFAS No. 123, *Accounting for Stock-Based Compensation*, requires use of option valuation models that were not developed for use in valuing employee stock options and employee stock purchase plan shares. Under APB Opinion No. 25, when the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of the grant, no compensation expense is recognized.

On March 31, 2004, the FASB issued a proposed Statement, *Share-Based Payment,* that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The proposed Statement would eliminate the ability to account for share-based compensation transactions using APB Opinion No. 25 and generally would require instead that such transactions be accounted for using a fair-value-based method. If adopted, it is currently anticipated that the proposed Statement would be effective for the Company beginning in its fourth fiscal quarter of 2005.

At the Company's annual shareholders meeting on April 24, 2003, shareholders approved a proposal requesting that the Company's Board of Directors (the Board) establish a policy of expensing the value of all future employee stock options issued by the Company. The Board and management appreciate and take seriously the views expressed by the Company's shareholders. The Company decided not to expense the value of employee stock options until the FASB finalizes its new accounting standard on the matter, which may play a significant role in determining the fair value of and accounting for employee stock options. The Company monitors progress at the FASB and other developments with respect to the general issue of employee stock compensation. The Company is currently reviewing the potential impact from the guidance of the proposed statement, which may require the Company to recognize substantially more compensation expense in future periods that could have a material adverse impact on the Company's future results of operations. The accounting impact had the Company chosen to apply the fair-value recognition provisions of SFAS No. 123, instead of the recognition provisions under APB Opinion No. 25, is described in Part II, Item 8 of this Form 10-K at Note 1 of the Notes to Consolidated Financial Statements.

Liquidity and Capital Resources

The following table presents selected financial information and statistics for each of the last three fiscal years (dollars in millions):

	2004	2003	2002
Cash, cash equivalents, and short-term investments	$ 5,464	$ 4,566	$ 4,337
Accounts receivable, net	$ 774	$ 766	$ 565
Inventory	$ 101	$ 56	$ 45
Working capital	$ 4,375	$ 3,530	$ 3,730
Days sales in accounts receivable (DSO) (a)	30	41	36
Days of supply in inventory (b)	5	4	4
Days payables outstanding (DPO) (c)	76	82	77
Annual operating cash flow	$ 934	$ 289	$ 89

(a) DSO is based on ending net trade receivables and most recent quarterly net sales for each period.

(b) Days supply of inventory is based on ending inventory and most recent quarterly cost of sales for each period.

(c) DPO is based on ending accounts payable and most recent quarterly cost of sales adjusted for the change in inventory.

As of September 25, 2004, the Company had $5.464 billion in cash, cash equivalents, and short-term investments, an increase of $898 million over the same balances at the end of fiscal 2003. The principal components of this increase were cash generated by operating activities of $934 million and proceeds of $427 million from the issuance of common stock under stock plans, partially offset by cash used to repay the Company's outstanding debt of $300 million and purchases of property, plant, and equipment of $176 million. The Company's short-term investment portfolio is primarily invested in high credit quality, liquid investments. Approximately $3.2 billion of this cash, cash equivalents, and short-term investments are held by the Company's foreign subsidiaries and would be subject to U.S. income taxation on repatriation to the U.S. The Company is currently assessing the impact of the one-time favorable foreign dividend provisions recently enacted as part of the American Jobs Creation Act of 2004, and may decide to repatriate earnings from some of its foreign subsidiaries.

The Company believes its existing balances of cash, cash equivalents, and short-term investments will be sufficient to satisfy its working capital needs, capital expenditures, stock repurchase activity, outstanding commitments, and other liquidity requirements associated with its existing operations over the next 12 months.

Debt

In February 2004, the Company retired $300 million of debt outstanding in the form of 6.5% unsecured notes. The notes were originally issued in 1994 and were sold at 99.9925% of par for an effective yield to maturity of 6.51%. The Company currently has no long-term debt obligations.

Capital Expenditures

The Company's total capital expenditures were $176 million during fiscal 2004, $104 million of which were for retail store facilities and equipment related to the Company's Retail segment and $72 million of which were primarily for corporate infrastructure, including information systems enhancements and operating facilities enhancements and expansions. The Company currently anticipates it will utilize approximately $240 million for capital expenditures during 2005, approximately $125 million of which is expected to be utilized for further expansion of the Company's Retail segment and the remainder utilized to support normal replacement of existing capital assets and enhancements to general information technology infrastructure.

Stock Repurchase Plan

In July 1999, the Company's Board of Directors authorized a plan for the Company to repurchase up to $500 million of its common stock. This repurchase plan does not obligate the Company to acquire any specific number of shares or acquire shares over any specified period of time.

During the fourth quarter of 2001, the Company entered into a forward purchase agreement to acquire 1.5 million shares of its common stock in September of 2003 at an average price of $16.64 per share for a total cost of $25.5 million. In August 2003, the Company settled this agreement prior to its maturity, at which time the Company's common stock had a fair value of $22.81. Other than this forward purchase transaction, the Company has not engaged in any transactions to repurchase its common stock since fiscal 2000. Since inception of the stock repurchase plan, the Company had repurchased a total of 6.55 million shares at a cost of $217 million. The Company was still authorized to repurchase up to an additional $283 million of its common stock as of September 25, 2004.

Off-Balance Sheet Arrangements and Contractual Obligations

The Company has not entered into any transactions with unconsolidated entities whereby the Company has financial guarantees, subordinated retained interests, derivative instruments or other contingent arrangements that expose the Company to material continuing risks, contingent liabilities, or any other obligation under a variable interest in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to the Company.

The following table presents certain payments due by the Company under contractual obligations with minimum firm commitments as of September 25, 2004 and excludes amounts already recorded on the Company's balance sheet as current liabilities (in millions):

	TOTAL	Payments Due in Less Than 1 year	Payments Due in 1-3 years	Payments Due in 4-5 years	Payments Due in More Than 5 years
Operating Leases	$ 617	$ 89	$ 170	$ 126	$ 232
Purchase Obligations	1,112	1,112	—	—	—
Asset Retirement Obligations	12	—	1	2	9
Other Obligations	24	14	10	—	—
Total	$ 1,765	$ 1,215	$ 181	$ 128	$ 241

Lease Commitments

As of September 25, 2004, the Company had total outstanding commitments on noncancelable operating leases of approximately $617 million, $436 million of which related to the lease of retail space and related facilities. Remaining terms on the Company's existing operating leases range from 2 to 16 years.

Purchase Obligations

The Company utilizes several contract manufacturers to manufacture sub-assemblies for the Company's products and to perform final assembly and test of finished products. These contract manufacturers acquire components and build product based on demand information supplied by the Company, which typically covers periods ranging from 30 to 130 days. The Company also obtains individual components for its products from a wide variety of individual suppliers. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. Such purchase commitments typically cover the Company's forecasted component and manufacturing requirements for periods ranging from 30 to 130 days. The nature of the Company's outstanding third-party manufacturing commitments and component purchase commitments has not changed significantly since the end of its fiscal 2003. As of September 25, 2004, the Company had outstanding third-party manufacturing commitments and component purchase commitments of approximately $1.1 billion.

Asset Retirement Obligations

The Company's asset retirement obligations are associated with commitments to return property subject to operating leases to original condition upon lease termination. As of September 25, 2004, the Company estimates that gross expected future cash flows of approximately $12 million would be required to fulfill these obligations.

Other Obligations

The Company's other obligations of approximately $24 million are primarily related to telecommunications services.

Indemnifications

The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against itself or an indemnified third-party and, in the opinion of management, does not have a liability related to unresolved infringement claims subject to indemnification that would have a material adverse affect on its financial condition, liquidity or results of operations.

Factors That May Affect Future Results and Financial Condition

Because of the following factors, as well as other factors affecting the Company's operating results and financial condition, past financial performance should not be considered to be a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

General economic conditions and current economic and political uncertainty could adversely affect the demand for the Company's products and the financial health of its suppliers, distributors, and resellers.

The Company's operating performance depends significantly on general economic conditions in the U.S. and abroad. Over the past several years, demand for the Company's products has been negatively impacted by difficult global economic conditions. Additionally, some of the Company's education customers appeared to be delaying technology purchases due to concerns about the overall impact of the weaker economy and state budget deficits on their available funding. Although recent macroeconomic trends seem to indicate an economic recovery, continued uncertainty about future economic conditions makes it difficult to forecast future demand for the Company's products and related operating results. Should global and/or regional economic conditions deteriorate, demand for the Company's products could be adversely affected, as could the financial health of its suppliers, distributors, and resellers.

War, terrorism, public health issues or other business interruptions could disrupt supply, delivery or demand of products, which could negatively affect the Company's operations and performance.

War, terrorism, public health issues and other business interruptions whether in the U.S. or abroad, have caused and could continue to cause damage or disruption to international commerce by creating economic and political uncertainties that may have a strong negative impact on the global economy, the Company, and the Company's suppliers or customers. The Company's major business operations are subject to interruption by earthquake, fire, power shortages, terrorist attacks and other hostile acts, labor disputes, medical conditions, and other events beyond its control. The majority of the Company's research and development activities, its corporate headquarters, information technology systems, and other critical business operations, including certain component suppliers and manufacturing vendors, are located near major seismic faults. Because the Company does not carry earthquake insurance for direct quake-related losses, the Company's operating results and financial condition could be materially adversely affected in the event of a major earthquake or other natural or manmade disaster.

Although it is impossible to predict the occurrences or consequences of any such events, such events could result in a decrease in demand for the Company's products, make it difficult or impossible to deliver products to its customers or to receive components from its suppliers, and could create delays and inefficiencies in the Company's supply chain. In addition, should major public health issues, including epidemics, arise the Company could be negatively impacted by the need for more stringent employee travel restrictions, additional limitations in the availability of freight services, governmental actions limiting the movement of products between various regions, delays in production ramps of new products, and disruptions in the operations of the Company's manufacturing vendors and component suppliers. The Company's operating results and financial condition have been, and in the future may continue to be, adversely affected by these events.

The market for personal computers and related peripherals and services, as well as digital music devices and related services, is highly competitive. If the Company is unable to effectively compete in these markets, its results of operations could be adversely affected.

The personal computer industry is highly competitive and is characterized by aggressive pricing practices, downward pressure on gross margins, frequent introduction of new products, short product life cycles, evolving industry standards, continual improvement in product price/performance characteristics, rapid adoption of technological and product advancements by competitors, price sensitivity on the part of consumers, and a large number of competitors. Over the past several years, price competition in the market for personal computers and related peripherals has been particularly intense. The Company's competitors who sell Windows and Linux based personal computers have aggressively cut prices and lowered their product margins in order to gain or maintain market share in response to the weakness in demand that began in the second half of calendar 2000 for personal computing products. The Company's results of operations and financial condition have been, and in the future may continue to be, adversely affected by these and other industry-wide pricing pressures and downward pressures on gross margins.

The personal computer industry has also been characterized by rapid technological advances in software functionality, hardware performance, and features based on existing or emerging industry standards. Further, as the personal computer industry and its customers place more reliance on the Internet, an increasing number of Internet devices that are smaller and simpler than traditional personal computers may compete for market share with the Company's existing products. Several competitors of the Company have either targeted or announced their intention to target certain of the Company's key market segments, including consumer, education, professional and consumer digital video editing, and design and publishing. Several of the Company's competitors have introduced or announced plans to introduce digital music products and/or online stores offering digital music distribution that mimic many of the unique design, technical features, and solutions of the Company's products. The Company has a significant number of competitors, many of whom have greater financial, marketing, manufacturing, and technological resources, as well as broader product lines and larger installed customer bases than those of the Company. Additionally, there has been a trend towards consolidation in the personal computer industry that has resulted in larger and potentially stronger competitors in the Company's markets.

The Company is currently the only maker of hardware using the Mac OS. The Mac OS has a minority market share in the personal computer market, which is dominated by makers of computers utilizing other competing operating systems, including Windows and Linux. The Company's future operating results and financial condition are substantially dependent on its ability to continue to develop improvements to the Macintosh platform in order to maintain perceived design and functional advantages over competing platforms.

The Company is currently focused on market opportunities related to digital music distribution and related consumer electronic devices, including iPods. The Company faces increasing competition from other companies promoting their own digital music products and distribution services and free peer-to-peer music services. These competitors include both new entrants with novel market approaches, such as subscription services models, and also larger companies that may have greater technical, marketing, distribution and other resources than those of the Company, as well as established hardware, software and music content supplier relationships. Failure to effectively compete could negatively affect the Company's operating results and financial position. There can be no assurance that the Company will be able to continue to provide products and services that effectively compete in these markets or successfully distribute and sell digital music outside the U.S. The Company may also have to respond to price competition by lowering prices and/or increasing features which could adversely affect the Company's music product gross margins as well as overall Company gross margins.

The Company also faces increased competition in the U.S. education market. Sales in the U.S. to both elementary and secondary schools, as well as for college and university customers, remain a core market for the Company. Uncertainty in this channel remains as several competitors of the Company have either targeted or announced their intention to target the education market for personal computers, which could negatively affect the Company's market share. In an effort to regain market share and remain competitive, the Company has been and will continue to pursue one-to-one (1:1) learning solutions in education. The Company's 1:1 learning solutions are a complete solution consisting of an iBook portable system for every student and teacher along with a wireless network connected to a central server. These 1:1 learning solutions and other strategic sales are generally priced more aggressively and could result in significantly less profitability or even in financial losses, particularly for larger deals. Although the Company believes it has taken certain steps to strengthen its position in the education market, there can be no assurance that the Company will be able to increase or maintain its share of the education market or execute profitably on large strategic arrangements. Failure to do so may have an adverse impact on the Company's operating results and financial condition.

The Company must successfully manage frequent product introductions and transitions in order to remain competitive and effectively stimulate customer demand.

Due to the highly volatile and competitive nature of the personal computer and consumer electronics industries, which are characterized by dynamic customer demand patterns and rapid technological advances, the Company must continually introduce new products and technologies, enhance existing products in order to remain competitive, and effectively stimulate customer demand for new products and upgraded versions of the Company's existing products. The success of new product introductions is dependent on a number of factors, including market acceptance; the Company's ability to manage the risks associated with product transitions, including production ramp issues; the availability of application software for new products; the effective management of inventory levels in line with anticipated product demand; the availability of products in appropriate quantities to meet anticipated demand; and the risk that new products may have quality or other defects in the early stages of introduction. Accordingly, the Company cannot determine in advance the ultimate effect that new products will have on its sales or results of operations.

The Company's products, from time to time, experience quality problems that can result in decreased net sales and operating profits.

The Company sells highly complex hardware and software products that can contain defects in design and manufacture. Sophisticated operating system software and applications, such as those sold by the Company, often contain "bugs" that can unexpectedly interfere with the operation of the software. Defects may also occur in components and products the Company purchases from third-parties. There can be no assurance that the Company will be able to detect and fix all defects in the hardware and software it sells.

Failure to do so could result in lost revenue, loss of reputation, and significant warranty and other expense to remedy.

Because orders for components, and in some cases commitments to purchase components, must be placed in advance of customer orders, the Company faces substantial inventory risk.

The Company records a write-down for inventories of components and products that have become obsolete or are in excess of anticipated demand or net realizable value and accrues necessary reserves for cancellation fees of orders for inventories that have been cancelled. Although the Company believes its inventory and related provisions are adequate, given the rapid and unpredictable pace of product obsolescence in the computer and consumer electronics industries, no assurance can be given that the Company will not incur additional inventory and related charges. In addition, such charges have had, and may have, a material effect on the Company's financial position and results of operations.

The Company must order components for its products and build inventory in advance of product shipments. Because the Company's markets are volatile and subject to rapid technology and price changes, there is a risk the Company will forecast incorrectly and produce or order from third parties excess or insufficient inventories of particular products. Consistent with industry practice, components are normally acquired through a combination of formal purchase orders, supplier contracts, and open orders based on projected demand information. Such purchase commitments typically cover the Company's forecasted component and manufacturing requirements for periods ranging from 30 to 130 days. The Company's operating results and financial condition have been in the past and may in the future be materially adversely affected by the Company's ability to manage its inventory levels and respond to short-term shifts in customer demand patterns.

Future operating results are dependent upon the Company's ability to obtain a sufficient supply of components, including microprocessors, some of which are in short supply or available only from limited sources.

Although most components essential to the Company's business are generally available from multiple sources, certain key components including microprocessors and ASICs are currently obtained by the Company from single or limited sources. Some key components (including without limitation DRAM, and TFT-LCD flat-panel displays), while currently available to the Company from multiple sources, are at times subject to industry-wide availability and pricing pressures. In addition, new products introduced by the Company often initially utilize custom components obtained from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. In situations where a component or product utilizes new technologies, initial capacity constraints may exist until such time as the suppliers' yields have matured. The Company and other producers in the personal computer industry also compete for various components with other industries that have experienced increased demand for their products. The Company uses some components that are not common to the rest of the personal computer industry including certain microprocessors and ASICs. Continued availability of these components may be affected if producers were to decide to concentrate on the production of components other than those customized to meet the Company's requirements. If the supply of a key component were to be delayed or constrained on a new or existing product, the Company's results of operations and financial condition could be adversely affected.

The Company's ability to produce and market competitive products is also dependent on the ability and desire of IBM and Freescale Semiconductor, Inc. (formerly the Semiconductor Products Segment of Motorola, Inc.), the sole suppliers of the PowerPC RISC-based microprocessor for the Company's Macintosh computers, to provide the Company with a sufficient supply of microprocessors with price/performance features that compare favorably to those supplied to the Company's competitors by Intel Corporation and other developers and producers of microprocessors used by personal computers using other operating systems. Further, despite its efforts to educate the marketplace to the contrary, the Company believes that many of its current and potential customers believe that the relatively slower MHz rating or clock speed of the microprocessors it utilizes in its Macintosh systems compares unfavorably to those utilized by other operating systems and translates to slower overall system performance. There have been instances in recent years where the inability of the Company's suppliers to provide advanced PowerPC microprocessors in sufficient quantity has had significant adverse effects on the Company's results of operations. In addition, IBM is currently the Company's sole supplier of the PowerPC G5 processor, which is used in the Company's current Power Mac, Xserve, and iMac products. Freescale Semiconductor, Inc. is the sole supplier of the G4 processor, which is used in the Company's eMac and portable products. IBM has recently experienced manufacturing problems with the PowerPC G5 processor, which resulted in the Company delaying the shipment of various products and constrained certain product shipments during the second half of 2004. The inability of IBM to remedy these problems in a timely manner, avoid manufacturing problems in the future, and to deliver to the Company microprocessors in sufficient quantities with competitive price/performance features could further constrain shipments of products containing the G5 processor and could adversely affect the Company's results of operations and financial condition.

The Company is dependent on manufacturing and logistics services provided by third parties, many of whom are located outside of the U.S.

Most of the Company's products are manufactured in whole or in part by third-party manufacturers. In addition, the Company has outsourced much of its transportation and logistics management. While outsourcing arrangements may lower the cost of operations, they also reduce the Company's direct control over production and distribution. It is uncertain what effect such diminished control will have on the quality or quantity of the products manufactured or services rendered, or the flexibility of the Company to respond to changing market conditions. Moreover, although arrangements with such manufacturers may contain provisions for warranty expense reimbursement, the Company may remain at least initially responsible to the ultimate consumer for warranty service in the event of product defects. Any unanticipated product defect or warranty liability, whether pursuant to arrangements with contract manufacturers or otherwise, could adversely affect the Company's future operating results and financial condition.

Final assembly of products sold by the Company is currently conducted in the Company's manufacturing facility in Cork, Ireland, and by external vendors in Fremont, California, Fullerton, California, Taiwan, Korea, the Netherlands, the People's Republic of China, and the Czech Republic. Currently, manufacture of many of the components used in the Company's products and final assembly of substantially all of the Company's portable products including PowerBooks, iBooks, and the iPod is performed by third-party vendors in Taiwan and China. If for any reason manufacturing or logistics in any of these locations is disrupted by events such as regional economic, business, environmental, medical, political, information technology system failures, or military actions, the Company's results of operations and financial condition could be adversely affected.

The Company's future operating performance is dependent on the performance of distributors and other resellers of the Company's products.

The Company distributes its products through wholesalers, resellers, national and regional retailers and cataloguers, many of whom distribute products from competing manufacturers. In addition, the Company also sells many of its products and resells certain third-party products in most of its major markets directly to end users, certain education customers, and certain resellers through its online stores around the world and its retail stores. Many of the Company's significant resellers operate on narrow product margins and have been negatively affected by recent economic conditions. Considerable trade receivables that are not covered by collateral or credit insurance are outstanding with the Company's distribution and retail channel partners. The Company's business and financial results could be adversely affected if the financial condition of these resellers weaken, if resellers within consumer channels were to cease distribution of the Company's products, or if uncertainty regarding demand for the Company's products caused resellers to reduce their ordering and marketing of the Company's products. The Company has invested and will continue to invest in various programs to enhance reseller sales, including staffing selected resellers' stores with Company employees. These programs could require a substantial investment from the Company, while providing no assurance of return or incremental revenue to offset this investment.

Over the past several years, an increasing proportion of the Company's net sales have been made by the Company directly to end-users through its online stores around the world and through its retail stores in the U.S. and Japan. Some of the Company's resellers have perceived this expansion of the Company's direct sales as conflicting with their own business and economic interests as distributors and resellers of the Company's products. Perception of such a conflict could discourage the Company's resellers from investing additional resources in the distribution and sale of the Company's products or lead them to limit or cease distribution of the Company's products. The Company's business and financial results could be adversely affected if expansion of its direct sales to end-users causes some or all of its resellers to cease or limit distribution of the Company's products.

Further information regarding risks associated with Marketing and Distribution may be found in Part I, Item 1 of this Form 10-K under the heading "Markets and Distribution."

The Company relies on third-party music content, which may not be available to the Company on commercially reasonable terms or at all.

The Company contracts with third parties to offer their music content to customers through the Company's iTunes Music Store. The Company pays substantial fees to obtain the rights to offer to its customers this third-party music. Many of the Company's licensing arrangements with these third-party content providers are short-term in nature and do not guarantee the future renewal of these arrangements at commercially reasonable terms, if at all. Certain parties in the music industry have announced their intent to consolidate their music distribution operations, which could limit the availability and increase the fees required to offer music content to customers through the iTunes Music Store. Further, some third-party content providers currently, or may in the future, offer music products and services that compete with the Company's music products and services, and could take action to make it more difficult or impossible for the Company to license their music content in the future. If the Company is unable to continue to offer a wide variety of music content at reasonable prices with acceptable usage rules, or continue to expand its geographic reach outside the U.S., then sales and gross margins of the Company's iTunes Music Store as well as related hardware and peripherals, including iPods, may be adversely affected.

Third-party content providers and artists require that the Company provide certain digital rights management solutions and other security mechanisms. If the requirements from content providers or artists change, then the Company may be required to further develop or license technology to address such new rights and requirements. There is no assurance that the Company will be able to develop or license such solutions at a reasonable cost and in a timely manner, if at all, which could have a materially adverse effect on the Company's operating results and financial position.

The Company's future performance is dependent upon support from third-party software developers. If third-party software applications cease to be developed or available for the Company's hardware products, then customers may choose not to buy the Company's products.

The Company believes that decisions by customers to purchase the Company's personal computers, as opposed to Windows-based systems, are often based on the availability of third-party software for particular applications such as Microsoft Office. The Company also believes the availability of third-party application software for the Company's hardware products depends in part on third-party developers' perception and analysis of the relative benefits of developing, maintaining, and upgrading such software for the Company's products versus software for the larger Windows market. This analysis is based on factors such as the perceived strength of the Company and its products, the anticipated potential revenue that may be generated, continued acceptance by customers of Mac OS X, and the costs of developing such software products. To the extent the Company's financial losses in prior years and the minority market share held by the Company in the personal computer market, as well as the Company's decision to end its Mac OS licensing program, have caused software developers to question the Company's prospects in the personal computer market, developers could be less inclined to develop new application software or upgrade existing software for the Company's products and more inclined to devote their resources to developing and upgrading software for the larger Windows market. Moreover, there can be no assurance software developers will continue to develop software for Mac OS X, the Company's operating system, on a timely basis or at all.

In addition, past and future development by the Company of its own software applications and solutions may negatively impact the decision of software developers to develop, maintain, and upgrade similar or competitive software for the Company's products. The Company currently markets and sells a variety of software applications for use by professionals, consumers, and education customers that could influence the decisions of third-party software developers to develop or upgrade Macintosh-compatible software products. Software applications currently marketed by the Company include software for professional film and video editing, professional compositing and visual effects for large format film and video productions, professional music production and music post production, professional and consumer DVD encoding and authoring, consumer digital video and digital photo editing and management, digital music management, desktop-based database management, and high-quality presentations. The Company also markets an integrated productivity application that incorporates word processing, page layout, image manipulation, spreadsheets, databases, and presentations in a single application.

In August 1997, the Company and Microsoft Corporation entered into patent cross license and technology agreements. In addition, for a period of five years through August 2002, and subject to certain limitations related to the number of Macintosh computers sold by the Company, Microsoft was required to make versions of its Microsoft Office and Internet Explorer products for the Mac OS. Although Microsoft has released Microsoft Office and Internet Explorer for Mac OS X, Microsoft has not been obligated to produce future versions of its products subsequent to August 2002. While the Company believes its relationship with Microsoft has been and will continue to be beneficial to the Company and to its efforts to increase the installed base for the Mac OS, the Company does compete directly with Microsoft in a number of key areas. Accordingly, Microsoft's interest in producing application software for the Mac OS following expiration of the agreements may be influenced by Microsoft's perception of its interests as the vendor of the Windows operating system and competing digital media applications, including music distribution service and technology. In June of 2003, Microsoft stated that it would no longer develop new versions of Internet Explorer for the Mac OS, subsequent to the Company's introduction during 2003 of its own web browser, Safari. Further discontinuance of products for the Macintosh platform, including Microsoft Office and other Microsoft products could have an adverse effect on the Company's net sales and results of operations.

The Company's business relies on access to patents and intellectual property obtained from third parties, and the Company's future results could be adversely affected if it is alleged or found to have infringed on the intellectual property rights of others.

Many of the Company's products are designed to include intellectual property obtained from third-parties. While it may be necessary in the future to seek or renew licenses relating to various aspects of its products and business methods, the Company believes that based upon past experience and industry practice, such licenses generally could be obtained on commercially reasonable terms. However, there can be no assurance that the necessary licenses would be available or available on acceptable terms.

Because of technological changes in the computer and consumer electronics industries, current extensive patent coverage, and the rapid rate of issuance of new patents, it is possible certain components of the Company's products and business methods may unknowingly infringe existing patents of others. The Company has from time to time been notified that it may be infringing certain patents or other intellectual property rights of others. Responding to such claims, regardless of their merit, can be time consuming, result in significant expenses, and cause the diversion of management and technical personnel. Several pending claims are in various stages of evaluation. The Company may consider the desirability of entering into licensing agreements in certain of these cases. However, no assurance can be given that such licenses can be obtained on acceptable terms or that litigation will not occur. In the event there is a temporary or permanent injunction entered prohibiting the Company from marketing or selling certain of its products or a successful claim of infringement against the Company requiring it to pay royalties to a third-party, the Company's future operating results and financial condition could be adversely affected. Information regarding certain claims and litigation involving the Company related to alleged patent infringement and other matters is set forth in Part I, Item 3 of this Form 10-K. In the opinion of management, the Company does not have a potential liability for damages or royalties from any current legal proceedings or claims related to the infringement of patent or other intellectual property rights of others that would individually or in the aggregate have a material adverse effect on its results of operations, or financial condition. However, the results of such legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of the matters related to infringement of patent or other intellectual property rights of others described in Part I, Item 3 of this Form 10-K or should several of these matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

The Company's retail initiative has required and will continue to require a substantial investment and commitment of resources and is subject to numerous risks and uncertainties.

Through September 2004, the Company has opened 86 retail stores. The Company's retail initiative has required substantial investment in equipment and leasehold improvements, information systems, inventory, and personnel. The Company has also entered into substantial operating lease commitments for retail space with lease terms ranging from 5 to 16 years, the majority of which are for 10 years. The Company could incur substantial costs should it choose to terminate this initiative or close individual stores. Such costs could adversely affect the Company's results of operations and financial condition. Additionally, a relatively high proportion of the Retail segment's costs are fixed because of depreciation on store construction costs and lease expense. As a result, significant losses would result should the Retail segment experience a decline in sales for any reason.

Certain of the Company's stores have been designed and built to serve as high profile venues that function as vehicles for general corporate marketing, corporate events, and brand awareness. Because of their unique design elements, locations and size, these stores require substantially more investment in equipment and leasehold improvements than the Company's more typical retail stores. The Company has opened seven such stores through November 2004. Because of their location and size, these high profile stores also require the Company to enter into substantially larger operating lease commitments compared to those required for its more typical stores. Current leases on such locations have terms ranging from 10 to 16 years with total commitments per location over the lease terms ranging from $25 million to $50 million. Closure or poor performance of one of these high profile stores could have a particularly significant negative impact on the Company's results of operations and financial condition.

Many of the general risks and uncertainties the Company faces could also have an adverse impact on its Retail segment. Also, many factors unique to retail operations present risks and uncertainties, some of which are beyond the Company's control, that could adversely affect the Retail segment's future results, cause its actual results to differ from those currently expected, and/or have an adverse effect on the Company's consolidated results of operations. Potential risks and uncertainties unique to retail operations that could have an adverse impact on the Retail segment include, among other things, macro-economic factors that have a negative impact on general retail activity; inability to manage costs associated with store construction and operation; lack of consumer acceptance of the Company's retail approach; failure to attract new users to the Macintosh platform; inability to sell third-party hardware and software products at adequate margins; failure to manage relationships with existing retail channel partners; lack of experience in managing retail operations outside the U.S.; costs associated with unanticipated fluctuations in the value of Apple-branded and third-party retail inventory; and inability to obtain quality retail locations at reasonable cost.

Investment in new business strategies and initiatives could disrupt the Company's ongoing business and may present risks not originally contemplated.

The Company may decide to invest in new business strategies or engage in acquisitions that complement the Company's strategic direction and product roadmap. Such endeavors may involve significant risks and uncertainties, including distraction of management's attention away from normal business operations; insufficient revenue generation to offset liabilities assumed and expenses associated with the strategy; and unidentified issues not discovered in the Company's due diligence process. Because these new ventures are inherently risky, no assurance can be given that such strategies and initiatives will be successful and will not materially adversely affect the Company's business, operating results or financial condition.

Declines in the sales of the Company's professional products or increases in sales of consumer products, including iPods, may negatively impact the Company's gross margin and operating margin percentages

Unit sales of the Company's professional products, including Power Macintosh and PowerBook systems, generally have higher gross margins than the Company's consumer products, including iMacs, iBooks, iPods, and content from the iTunes Music Store. A shift in sales mix away from higher margin professional products towards lower margin consumer products could adversely affect the Company's future gross margin and operating margin percentages. The Company's traditional professional customers may choose to buy consumer products, specifically the iMac G5 and iBook, instead of professional products. Professional users may choose to buy the iMac G5 due to its relative price performance, use of the same PowerPC G5 processor used in the Company's Power Macs, and unique design featuring a flat panel screen. Potential PowerBook customers may also choose to purchase iBooks instead due to their price performance and screen size. Additionally, significant future growth in iPod sales without corresponding growth in higher margin product sales could also reduce gross margin and operating margin percentages.

The Company believes that weak economic conditions over the past several years are having a pronounced negative impact on its professional and creative customers who are significant users of its professional systems. Also, it is likely that many of the Company's current and potential professional, creative, and small business customers, who are most likely to utilize professional systems, believe that the relatively slower MHz rating or clock speed of the microprocessors the Company utilizes in its Macintosh systems compares unfavorably to those utilized by other computer manufacturers and translates to slower overall system performance. These factors may result in an adverse impact to sales of the Company's professional products as well as to gross margin and operating margin percentages.

The Company expects its quarterly revenue and operating results to fluctuate for a variety of reasons.

The Company's profit margins vary among its products and its distribution channels. The Company's direct sales, primarily through its retail and online stores, generally have higher associated profitability than its indirect sales. Additionally, the Company's direct channels have traditionally had more sales of software and higher priced hardware products, which generally have higher gross margins, than through its indirect channels. As a result, the Company's gross margin and operating margin percentages as well as overall profitability may be adversely impacted as a result of a shift in product, geographic or channel mix. In addition, the Company generally sells more products during the third month of each quarter than it does during either of the first two months, a pattern typical in the personal computer industry. This sales pattern can produce pressure on the Company's internal infrastructure during the third month of a quarter and may adversely impact the Company's ability to predict its financial results accurately. Developments late in a quarter, such as lower-than-anticipated demand for the Company's products, an internal systems failure, or failure of one of the Company's key logistics, components suppliers, or manufacturing partners, can have significant adverse impacts on the Company and its results of operations and financial condition.

The Company has higher research and development and selling, general and administrative costs, as a percentage of revenue, than many of its competitors.

The Company's ability to compete successfully and maintain attractive gross margins and revenue growth is heavily dependent upon its ability to ensure a continuing and timely flow of innovative and competitive products and technologies to the marketplace. As a result, the Company incurs higher research and development costs as a percentage of revenue than its competitors who sell personal computers based on other operating systems. Many of these competitors seek to compete aggressively on price and maintain very low cost structures. Further, as a result of the expansion of the Company's Retail segment and costs associated with marketing the Company's brand including its unique operating system, the Company incurs higher selling costs as a percentage of revenue than many of its competitors. If the Company is unable to continue to develop and sell innovative new products with attractive gross margins, its results of operations may be materially adversely affected by its operating cost structure.

The Company is exposed to credit risk on its accounts receivables. This risk is heightened during periods when economic conditions worsen.

The Company distributes its products through third-party computer resellers and retailers and directly to certain educational institutions and commercial customers. A substantial majority of the Company's outstanding trade receivables are not covered by collateral or credit insurance. The Company also has unsecured non-trade receivables from certain of its manufacturing vendors resulting from the sale by the Company of raw material components to these manufacturing vendors who manufacture sub-assemblies or assemble final products for the Company. While the Company has procedures in place to monitor and limit exposure to credit risk on its trade and non-trade receivables, there can be no assurance that such procedures will be effective in limiting its credit risk and avoiding losses. Additionally, if the global economy and regional economies fail to improve or continue to deteriorate, it becomes more likely that the Company will incur a material loss or losses as a result of the weakening financial condition of one or more of its customers or manufacturing vendors.

The Company's success depends largely on its ability to attract and retain key personnel.

Much of the future success of the Company depends on the continued service and availability of skilled personnel, including its Chief Executive Officer, members of its executive team, and those in technical, marketing and staff positions. Experienced personnel in the information technology industry are in high demand and competition for their talents is intense, especially in the Silicon Valley, where the majority of the Company's key employees are located. The Company has relied on its ability to grant stock options as one mechanism for recruiting and retaining this highly skilled talent. Potential accounting regulations requiring the expensing of stock options may impair the Company's future ability to provide these incentives without incurring significant compensation costs. There can be no assurance that the Company will continue to successfully attract and retain key personnel.

The Company is subject to risks associated with the availability and cost of insurance.

The Company has observed rapidly changing conditions in the insurance markets relating to nearly all areas of traditional commercial insurance. Such conditions have and may continue to result in higher premium costs, higher policy deductibles, lower coverage limits and may also yield possible policy form exclusions. For some risks, because of cost and/or availability, the Company does not have insurance coverage. Because the Company retains some portion of its insurable risks, and in some cases self insures completely, unforeseen or catastrophic losses in excess of insured limits may have a material adverse effect on the Company's results of operations and financial position.

Failure of information technology systems and breaches in the security of data upon which the Company relies could adversely affect the Company's future operating results.

Information technology system failures and breaches of data security could disrupt the Company's ability to function in the normal course of business by potentially causing delays or cancellation of customer orders, impeding the manufacture or shipment of products, or resulting in the unintentional disclosure of customer or Company information. Management has taken steps to address these concerns for its own systems by implementing sophisticated network security and internal control measures. However, there can be no assurance that a system failure or data security breach of the Company or a third-party vendor will not have a material adverse effect on the Company's results of operations.

The Company's business is subject to the risks of international operations.

A large portion of the Company's revenue is derived from its international operations. As a result, the Company's operating results and financial condition could be significantly affected by risks associated with international activities, including economic and labor conditions, political instability, tax laws (including U.S. taxes on foreign subsidiaries), and changes in the value of the U.S. dollar versus the local currency in which the products are sold and goods and services are purchased. The Company's primary exposure to movements in foreign currency exchange rates relate to non-dollar denominated sales in Europe, Japan, Australia, Canada, and certain parts of Asia and non-dollar denominated operating expenses incurred throughout the world. Weaknesses in foreign currencies, particularly the Japanese Yen and the Euro, can adversely impact consumer demand for the Company's products and the U.S. dollar value of the Company's foreign currency denominated sales. Conversely, strengthening in these and other foreign currencies can increase the cost to the Company of product components, negatively affecting the Company's results of operations.

Margins on sales of the Company's products in foreign countries, and on sales of products that include components obtained from foreign suppliers, can be adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including tariffs and antidumping penalties.

Derivative instruments, such as foreign exchange forward and option positions have been utilized by the Company to hedge exposures to fluctuations in foreign currency exchange rates. The use of such hedging activities may not offset more than a portion of the adverse financial impact resulting from unfavorable movements in foreign exchange rates.

Further information related to the Company's global market risks may be found in Part II, Item 7A of this Form 10-K under the subheading "Foreign Currency Risk" and may be found in Part II, Item 8 of this Form 10-K at Notes 1 and 2 of Notes to Consolidated Financial Statements.

The Company is subject to risks associated with environmental regulations.

Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations including, in some instances, the requirement to provide customers the ability to return product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have recently been passed in several jurisdictions in which the Company operates, including various European Union member countries, Japan and certain states within the U.S. In the future, these laws could have a material adverse affect on the Company.

Changes in accounting rules could adversely affect the Company's future operating results.

Financial statements are prepared in accordance with U.S. generally accepted accounting principles. These principles are subject to interpretation by various governing bodies, including the FASB and the Securities and Exchange Commission (SEC), who interpret and create appropriate accounting regulations. A change from current accounting regulations, including accounting for stock-based compensation, could have a significant effect on the Company's results of operations and could impact the manner in which the Company conducts business.

Unanticipated changes in the Company's tax rates could affect its future results.

The Company's future effective tax rates could be favorably or unfavorably affected by unanticipated changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of the Company's deferred tax assets and liabilities, or by changes in tax laws or their interpretation. In addition, the Company is subject to the continuous examination of its income tax returns by the Internal Revenue Service and other tax authorities. The Company regularly assesses the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of its provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse effect on the Company's operating results and financial condition.

The Company's stock price may be volatile.

The Company's stock has at times experienced substantial price volatility as a result of variations between its actual and anticipated financial results and as a result of announcements by the Company and its competitors. The stock market has experienced extreme price and volume fluctuations that have affected the market price of many technology companies in ways that have been unrelated to the operating performance of these companies. These factors, including lack of positive performance in the Company's stock price, as well as general economic and political conditions and investors' concerns regarding the credibility of corporate financial reporting and integrity of financial markets, may materially adversely affect the market price of the Company's stock in the future. In addition, increases in the Company's stock price may result in greater dilution of earnings per share.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate and Foreign Currency Risk Management

The Company regularly reviews its foreign exchange forward and option positions and its interest rate swap and option positions, both on a stand-alone basis and in conjunction with its underlying foreign currency and interest rate related exposures. However, given the effective horizons of the Company's risk management activities and the anticipatory nature of the exposures, there can be no assurance the hedges will offset more than a portion of the financial impact resulting from movements in either foreign exchange or interest rates. In addition, the timing of the accounting for recognition of gains and losses related to mark-to-market instruments for any given period may not coincide with the timing of gains and losses related to the underlying economic exposures and, therefore, may adversely affect the Company's operating results and financial position.

Interest Rate Risk

While the Company is exposed to interest rate fluctuations in many of the world's leading industrialized countries, the Company's interest income and expense is most sensitive to fluctuations in the general level of U.S. interest rates. In this regard, changes in U.S. interest rates affect the interest earned on the Company's cash, cash equivalents, and short-term investments as well as costs associated with foreign currency hedges.

The Company's short-term investment policy and strategy is to ensure the preservation of capital, meet liquidity requirements, and optimize return in light of current credit and interest rate trends. The Company benchmarks its performance by utilizing external money managers to manage a small portion of the aggregate investment portfolio. The external managers adhere to the Company's investment policies and also provide occasional research and market information that supplements internal research used to make credit decisions in the investment process.

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's investment portfolio. The Company places its short-term investments in highly liquid securities issued by high credit quality issuers and, by policy, limits the amount of credit exposure to any one issuer. The Company's general policy is to limit the risk of principal loss and ensure the safety of invested funds by limiting market and credit risk. All highly liquid investments with maturities of three months or less are classified as cash equivalents; highly liquid investments with maturities greater than three months are classified as short-term investments. As of September 25, 2004, approximately $180 million of the Company's short-term investments had underlying maturities ranging from 1 to 5 years. As of September 27, 2003, $629 million of the Company's investment portfolio classified as short-term investments had maturities ranging from 1 to 5 years. The remainder all had underlying maturities between 3 and 12 months. The Company may sell its investments prior to their stated maturities, due to liquidity needs, in anticipation of credit deterioration, or for duration management. As a result of such activity, the Company recognized net gains of $1 million in 2004, $21 million in 2003, and $7 million in 2002.

In order to provide a meaningful assessment of the interest rate risk associated with the Company's investment portfolio, the Company performed a sensitivity analysis to determine the impact that a change in interest rates would have on the value of the investment portfolio assuming a 100 basis point parallel shift in the yield curve. Based on investment positions as of September 25, 2004, a hypothetical 100 basis point increase in interest rates across all maturities would result in a $14.4 million decline in the fair market value of the portfolio. As of September 27, 2003, a similar 100 basis point shift in the yield curve would have resulted in a $12.9 million decline in fair value. Such losses would only be realized if the Company sold the investments prior to maturity. Except in instances noted above, the Company's policy is to hold investments to maturity.

From time to time, the Company has entered into interest rate derivative transactions with financial institutions in order to better match the Company's floating-rate interest income on its cash equivalents and short-term investments with its fixed-rate interest expense on its debt, and/or to diversify a portion of the Company's exposure away from fluctuations in short-term U.S. interest rates. The Company did not enter into any interest rate derivatives during 2004 or 2003 and had no open interest rate derivatives at September 25, 2004.

In prior years, the Company had entered into interest rate debt swaps with financial institutions. The interest rate debt swaps required the Company to pay a floating interest rate based on the three- or six-month U.S. dollar LIBOR and receive a fixed rate of interest without exchanges of the underlying notional amounts. These swaps effectively converted the Company's fixed-rate 10-year debt to floating-rate debt. Due to prevailing market interest rates, during 2001 and 2002 the Company entered into and then subsequently closed out interest rate debt swap positions realizing gains of $23 million. The gains were deferred, recognized in long-term debt and were amortized to other income and expense over the remaining life of the debt.

Foreign Currency Risk

In general, the Company is a net receiver of currencies other than the U.S. dollar. Accordingly, changes in exchange rates, and in particular a strengthening of the U.S. dollar, may negatively affect the Company's net sales and gross margins as expressed in U.S. dollars. There is also a risk that the Company will have to adjust local currency product pricing due to competitive pressures when there has been significant volatility in foreign currency exchange rates.

The Company may enter into foreign currency forward and option contracts with financial institutions to protect against foreign exchange risks associated with existing assets and liabilities, certain firmly committed transactions, forecasted future cash flows, and net investments in foreign subsidiaries. Generally, the Company's practice is to hedge a majority of its existing material foreign exchange transaction exposures. However, the Company may not hedge certain foreign exchange transaction exposures due to immateriality, prohibitive economic cost of hedging particular exposures, and limited availability of appropriate hedging instruments.

In order to provide a meaningful assessment of the foreign currency risk associated with certain of the Company's foreign currency derivative positions, the Company performed a sensitivity analysis using a value-at-risk (VAR) model to assess the potential impact of fluctuations in exchange rates. The VAR model consisted of using a Monte Carlo simulation to generate 3000 random market price paths. The VAR is the maximum expected loss in fair value, for a given confidence interval, to the Company's foreign exchange portfolio due to adverse movements in rates. The VAR model is not intended to represent actual losses but is used as a risk estimation and management tool. The model assumes normal market conditions. Forecasted transactions, firm commitments, and assets and liabilities denominated in foreign currencies were excluded from the model. Based on the results of the model, the Company estimates with 95% confidence a maximum one-day loss in fair value of $3.2 million as of September 25, 2004 compared to a maximum one-day loss of $7.5 million as of September 27, 2003. Because the Company uses foreign currency instruments for hedging purposes, losses incurred on those instruments are generally offset by increases in the fair value of the underlying exposures.

Actual gains and losses in the future associated with the Company's investment portfolio and derivative positions may differ materially from the sensitivity analyses performed as of September 25, 2004 due to the inherent limitations associated with predicting the changes in the timing and amount of interest rates, foreign currency exchanges rates, and the Company's actual exposures and positions.

Item 8. Financial Statements and Supplementary Data

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All financial statement schedules have been omitted, since the required information is not applicable or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Consolidated Financial Statements and Notes thereto.

CONSOLIDATED BALANCE SHEETS

(In millions, except share amounts)

	September 25, 2004	September 27, 2003
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 2,969	$ 3,396
Short-term investments	2,495	1,170
Accounts receivable, less allowances of $47 and $49, respectively	774	766
Inventories	101	56
Deferred tax assets	231	190
Other current assets	485	309
Total current assets	7,055	5,887
Property, plant, and equipment, net	707	669
Goodwill	80	85
Acquired intangible assets	17	24
Other assets	191	150
Total assets	$ 8,050	$ 6,815
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	$ 1,451	$ 1,154
Accrued expenses	1,229	899
Current debt	—	304
Total current liabilities	2,680	2,357
Deferred tax liabilities and other non-current liabilities	294	235
Total liabilities	2,974	2,592
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value; 900,000,000 shares authorized; 391,443,617 and 366,726,584 shares issued and outstanding, respectively	2,514	1,926
Deferred stock compensation	(93)	(62)
Retained earnings	2,670	2,394
Accumulated other comprehensive income (loss)	(15)	(35)
Total shareholders' equity	5,076	4,223
Total liabilities and shareholders' equity	$ 8,050	$ 6,815

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except share and per share amounts)

Three fiscal years ended September 25, 2004	2004	2003	2002
Net sales	$ 8,279	$ 6,207	$ 5,742
Cost of sales	6,020	4,499	4,139
Gross margin	2,259	1,708	1,603
Operating expenses:			
Research and development	489	471	446
Selling, general, and administrative	1,421	1,212	1,109
Restructuring costs	23	26	30
Purchased in-process research and development	—	—	1
Total operating expenses	1,933	1,709	1,586
Operating income (loss)	326	(1)	17
Other income and expense:			
Gains (losses) on non-current investments, net	4	10	(42)
Interest and other income, net	53	83	112
Total other income and expense	57	93	70
Income before provision for income taxes	383	92	87
Provision for income taxes	107	24	22
Income before accounting changes	276	68	65
Cumulative effects of accounting changes, net of income taxes	—	1	—
Net income	$ 276	$ 69	$ 65
Earnings per common share before accounting changes:			
Basic	$ 0.74	$ 0.19	$ 0.18
Diluted	$ 0.71	$ 0.19	$ 0.18
Earnings per common share:			
Basic	$ 0.74	$ 0.19	$ 0.18
Diluted	$ 0.71	$ 0.19	$ 0.18
Shares used in computing earnings per share (in thousands):			
Basic	371,590	360,631	355,022
Diluted	387,311	363,466	361,785

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In millions, except share amounts which are in thousands)

	Common Stock					
	Shares	Amount	Deferred Stock Compensation	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances as of September 29, 2001	350,922	$ 1,693	$ (11)	$ 2,260	$ (22)	$ 3,920
Components of comprehensive income:						
Net income	—	—	—	65	—	65
Change in foreign currency translation	—	—	—	—	5	5
Change in unrealized gain on available-for-sale securities, net of tax	—	—	—	—	(17)	(17)
Change in unrealized gain on derivative investments, net of tax	—	—	—	—	(15)	(15)
Total comprehensive income						38
Amortization of deferred stock compensation	—	—	4	—	—	4
Common stock issued under stock plans	8,037	105	—	—	—	105
Tax benefit related to stock options	—	28	—	—	—	28
Balances as of September 28, 2002	358,959	$ 1,826	$ (7)	$ 2,325	$ (49)	$ 4,095
Components of comprehensive income:						
Net income	—	—	—	69	—	69
Change in foreign currency translation	—	—	—	—	31	31
Change in unrealized gain on available-for-sale securities, net of tax	—	—	—	—	(12)	(12)
Change in unrealized gain on derivative investments, net of tax	—	—	—	—	(5)	(5)
Total comprehensive income						83
Amortization of deferred stock compensation	—	—	15	—	—	15
Write-off of deferred stock compensation	—	—	5	—	—	5
Common stock issued under stock plans	9,299	128	(75)	—	—	53
Settlement of forward purchase agreement	(1,531)	(35)	—	—	—	(35)
Tax benefit related to stock options	—	7	—	—	—	7
Balances as of September 27, 2003	366,727	$ 1,926	$ (62)	$ 2,394	$ (35)	$ 4,223
Components of comprehensive income:						
Net income	—	—	—	276	—	276
Change in foreign currency translation	—	—	—	—	13	13
Change in unrealized gain on available-for-sale securities, net of tax	—	—	—	—	(5)	(5)
Change in unrealized loss on derivative investments, net of tax	—	—	—	—	12	12

Total comprehensive income						296
Issuance of restricted stock units	—	64	(64)	—	—	—
Adjustment to common stock related to a prior year acquisition	(79)	(2)	—	—	—	(2)
Amortization of deferred stock compensation	—	—	33	—	—	33
Common stock issued under stock plans	24,796	427	—	—	—	427
Tax benefit related to stock options	—	99	—	—	—	99
Balances as of September 25, 2004	391,444	$ 2,514	$ (93)	$ 2,670	$ (15)	$ 5,076

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

Three fiscal years ended September 25, 2004	2004	2003	2002
Cash and cash equivalents, beginning of the year	$ 3,396	$ 2,252	$ 2,310
Operating Activities:			
Net income	276	69	65
Cumulative effects of accounting changes, net of taxes	—	(1)	—
Adjustments to reconcile net income to cash generated by operating activities:			
Depreciation, amortization and accretion	150	113	114
Stock-based compensation expense	33	16	5
Non-cash restructuring	5	12	8
Provision for (benefit from) deferred income taxes	20	(11)	(34)
Loss on disposition of property, plant, and equipment	7	2	7
Gains on sales of short-term investments, net	(1)	(21)	(7)
(Gains) losses on non-current investments, net	(4)	(10)	42
Gain on forward purchase agreement	—	(6)	—
Purchased in-process research and development	—	—	1
Changes in operating assets and liabilities:			
Accounts receivable	(8)	(201)	(99)
Inventories	(45)	(11)	(34)
Other current assets	(176)	(34)	(114)
Other assets	(39)	(30)	(11)
Accounts payable	297	243	110
Other liabilities	419	159	36
Cash generated by operating activities	934	289	89
Investing Activities:			
Purchases of short-term investments	(3,270)	(2,648)	(4,144)
Proceeds from maturities of short-term investments	1,141	2,446	2,846
Proceeds from sales of short-term investments	801	1,116	1,254
Proceeds from sales of non-current investments	5	45	25
Purchases of property, plant, and equipment	(176)	(164)	(174)
Cash used for business acquisitions	—	—	(52)
Other	11	33	(7)
Cash generated by (used for) investing activities	(1,488)	828	(252)
Financing Activities:			
Payment of long-term debt	(300)	—	—
Proceeds from issuance of common stock	427	53	105
Cash used for repurchase of common stock	—	(26)	—
Cash generated by financing activities	127	27	105
Increase (decrease) in cash and cash equivalents	(427)	1,144	(58)
Cash and cash equivalents, end of the year	$ 2,969	$ 3,396	$ 2,252
Supplemental cash flow disclosures:			
Cash paid during the year for interest	$ 10	$ 20	$ 20
Cash paid (received) for income taxes, net	$ (7)	$ 45	$ 11

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1—Summary of Significant Accounting Policies

Apple Computer, Inc. and subsidiaries (the Company) designs, manufactures and markets personal computers and related software, services, peripherals and networking solutions. The Company also designs, develops and markets a line of portable digital music players along with related accessories and services including the online distribution of third-party music and audio books. The Company sells its products worldwide through its online stores, its own retail stores, its direct sales force and third-party wholesalers, resellers and value added resellers. In addition to its own hardware, software and peripheral products, the Company sells a variety of third-party hardware and software products through its online and retail stores. The Company sells to education, consumer, creative professional, business and government customers.

Basis of Presentation and Preparation

The accompanying consolidated financial statements include the accounts of the Company. Intercompany accounts and transactions have been eliminated. The preparation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in these consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates. Certain prior year amounts in the consolidated financial statements and notes thereto have been reclassified to conform to the current year presentation.

Typically, the Company's fiscal year ends on the last Saturday of September. Fiscal years 2004, 2003 and 2002 were each 52-week years. However, approximately every six years, the Company reports a 53-week fiscal year to align its fiscal quarters with calendar quarters by adding a week to its first fiscal quarter. The Company expects to add this additional week in its first fiscal quarter of 2006. All information presented herein is based on the Company's fiscal calendar.

Financial Instruments

Cash Equivalents and Short-term Investments

All highly liquid investments with maturities of three months or less at the date of purchase are classified as cash equivalents. Highly liquid investments with maturities greater than three months are classified as short-term investments. Management determines the appropriate classification of its investments in debt and marketable equity securities at the time of purchase and reevaluates such designation as of each balance sheet date. The Company's debt and marketable equity securities have been classified and accounted for as available-for-sale. These securities are carried at fair value, with the unrealized gains and losses, net of taxes, reported as a component of shareholders' equity. The cost of securities sold is based upon the specific identification method.

Financial Instruments with Characteristics of Both Liabilities and Equity

On May 15, 2003, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*. SFAS No. 150 requires issuers to classify as liabilities (or assets in some circumstances) certain freestanding financial instruments that embody obligations for the issuer and have characteristics of both liabilities and equity. The Company adopted the provisions of SFAS No. 150 on June 29, 2003, which resulted in a favorable cumulative-effect type adjustment of approximately $3 million. This adjustment related to a forward purchase agreement that allowed the Company to acquire 1.5 million shares of its common stock at an average price of $16.64 per share for a total cost of $25.5 million. The Company settled this forward purchase agreement in August 2003, which resulted in an additional gain of approximately $6 million representing the increase in fair value of the agreement from June 29, 2003 through the settlement date.

Derivative Financial Instruments

The Company accounts for its derivative instruments as either assets or liabilities and carries them at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in fair value will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings.

For derivative instruments that hedge the exposure to variability in expected future cash flows that are designated as cash flow hedges, the net gain or loss on the derivative instrument is reported as a component of other comprehensive income in shareholders' equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. To receive hedge accounting treatment, cash flow hedges must be highly effective in achieving offsetting changes to expected future cash flows on hedged transactions. For derivative instruments that hedge the exposure to changes in the fair value of an asset or a liability and that are designated as fair value hedges, the net gain or loss on the derivative instrument as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in earnings in the current period. The net gain or loss on the effective portion of a derivative instrument that is designated as an economic hedge of the foreign currency translation exposure of the net investment in a foreign operation is reported in the same manner as a foreign currency translation adjustment. For forward contracts designated as net investment hedges, the Company excludes changes in fair value relating to changes in the forward carry component from its definition of effectiveness. Accordingly, any gains or losses related to this component are recognized in current earnings. For derivative instruments not designated as hedging instruments, changes in fair value are recognized in earnings in the current period.

In accordance with SFAS No. 133, hedges related to probable but not firmly committed transactions of an anticipatory nature are designated and documented at hedge inception as cash flow hedges and evaluated for hedge effectiveness quarterly. For foreign currency forward contracts designated as cash flow hedges, hedge effectiveness is measured based on changes in the fair value of the contract attributable to changes in the forward exchange rate. Changes in the expected future cash flows on the forecasted hedged transaction and changes in the fair value of the forward hedge are both measured from the contract rate to the forward exchange rate associated with the forward contract's maturity date. For currency option contracts, hedge effectiveness is assessed by comparing the present value of the cumulative change in expected future cash flows on the hedged transaction to changes in expected cash flow of the option hedge at maturity. The net gains or losses on derivative instruments qualifying as cash flow hedges are reported as components of other comprehensive income in shareholders' equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Any hedge ineffectiveness is recognized in current earnings in other income and expense. For interest rate swap agreements qualifying as fair value hedges, the Company assumes no ineffectiveness because these swaps meet the criteria for accounting under the short-cut method.

The Company may enter into foreign currency forward contracts to hedge the translation and economic exposure of a net investment position in a foreign subsidiary. For such contracts, hedge effectiveness is measured based on changes in the fair value of the contract attributable to changes in the spot exchange rate. The effective portion of the net gain or loss on a derivative instrument designated as a hedge of the net investment position in a foreign subsidiary is reported in the same manner as a foreign currency translation adjustment. Any residual changes in fair value of the forward contract, including changes in fair value based on the differential between the spot and forward exchange rates, are recognized in current earnings in other income and expense.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market. If the cost of the inventories exceeds their market value, provisions are made currently for the difference between the cost and the market value.

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. Depreciation is computed by use of the straight-line method over the estimated useful lives of the assets, which are 30 years for buildings, from 2 to 5 years for equipment, and the shorter of lease terms or 10 years for leasehold improvements. The Company capitalizes eligible costs to acquire or develop internal-use software that are incurred subsequent to the preliminary project stage. Capitalized costs related to internal-use software are amortized using the straight-line method over the estimated useful lives of the assets, which range from 3 to 5 years.

Asset Retirement Obligations

On September 29, 2002, the Company adopted SFAS No. 143, *Accounting for Asset Retirement Obligations*, which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The standard applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the assets. SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset and this additional carrying amount is depreciated over the life of the asset. All of the Company's existing asset retirement obligations are associated with commitments to return property subject to operating leases to original condition upon lease termination. The Company estimated that as of September 29, 2002, gross expected future cash flows of $9.5 million would be required to fulfill these obligations.

As of the date of adoption, the Company recorded a $6 million long-term asset retirement liability and a corresponding increase in leasehold improvements. This amount represents the present value of expected future cash flows associated with returning certain of the Company's leased properties to original condition. The difference between the gross expected future cash flow of $9.5 million and its present value of $6 million at September 29, 2002, is being accreted over the life of the related leases as an operating expense. Net of the related income tax effect of approximately $1 million, adoption of SFAS No. 143 resulted in an unfavorable cumulative-effect type adjustment to net income during the first quarter of 2003 of approximately $2 million. This adjustment represents cumulative depreciation and accretion that would have been recognized through the date of adoption of SFAS No. 143 had the statement been applied to the Company's existing asset retirement obligations at the time they were initially incurred.

The following table reconciles changes in the Company's asset retirement liabilities for fiscal 2003 and 2004 (in millions):

Asset retirement liability as of September 29, 2002	$ 5.5
Additional asset retirement obligations recognized	0.5
Accretion recognized	1.2
Asset retirement liability as of September 27, 2003	$ 7.2
Additional asset retirement obligations recognized	0.5
Accretion recognized	0.5
Asset retirement liability as of September 25, 2004	$ 8.2

Long-Lived Assets Including Goodwill and Other Acquired Intangible Assets

The Company reviews property, plant, and equipment and certain identifiable intangibles, excluding goodwill, for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of these assets is measured by comparison of its carrying amount to future undiscounted cash flows the assets are expected to generate. If property, plant, and equipment and certain identifiable intangibles are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the assets exceeds its fair market value. For the three years ended September 25, 2004, September 27, 2003, and September 28, 2002 the Company had no material impairment of its long-lived assets, except for the impairment of certain assets in connection with the restructuring actions described in Note 5.

The Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets*, in the first quarter of fiscal 2002. SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually or sooner whenever events or changes in circumstances indicate that they may be impaired. Prior to fiscal 2002, goodwill was amortized using the straight-line method over its estimated useful life. The Company completed its transitional goodwill impairment test as of October 1, 2001, and its annual goodwill impairment tests on August 30 of each year thereafter and found no impairment. The Company established reporting units based on its current reporting structure. For purposes of testing goodwill for impairment, goodwill has been allocated to these reporting units to the extent it relates to each reporting unit.

SFAS No. 142 also requires that intangible assets with definite lives be amortized over their estimated useful lives and reviewed for impairment in accordance with SFAS No. 144, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of.* The Company is currently amortizing its acquired intangible assets with definite lives over periods ranging from 3 to 10 years.

Foreign Currency Translation

The Company translates the assets and liabilities of its international non-U.S. functional currency subsidiaries into U.S. dollars using exchange rates in effect at the end of each period. Revenue and expenses for these subsidiaries are translated using rates that approximate those in effect during the period. Gains and losses from these translations are credited or charged to foreign currency translation included in "accumulated other comprehensive income (loss)" in shareholders' equity. The Company's foreign manufacturing subsidiaries and certain other international subsidiaries that use the U.S. dollar as their functional currency remeasure monetary assets and liabilities at exchange rates in effect at the end of each period, and inventories, property, and nonmonetary assets and liabilities at historical rates. Gains and losses from these translations were insignificant and have been included in the Company's results of operations.

Revenue Recognition

Net sales consist primarily of revenue from the sale of products (hardware, software, and peripherals), and extended warranty and support contracts. The Company recognizes revenue pursuant to applicable accounting standards, including Statement of Position (SOP) No. 97-2, *Software Revenue Recognition*, as amended, and Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition*.

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection is probable. Product is considered delivered to the customer once it has been shipped and title and risk of loss have been transferred. For most of the Company's product sales, these criteria are met at the time the product is shipped. For online sales to individuals, for some sales to education customers in the U.S., and for certain other sales, the Company defers revenue until the customer receives the product because the Company legally retains a portion of the risk of loss on these sales during transit. If at the outset of an arrangement the Company determines the arrangement fee is not, or is presumed to not be, fixed or determinable, revenue is deferred and subsequently recognized as amounts become due and payable.

Revenue from extended warranty and support contracts is deferred and recognized ratably over the warranty and support periods. These contracts typically include extended phone support, certain repairs, web-based support resources, diagnostic tools, and extend the Company's one-year basic limited parts and labor warranty.

The Company sells software and peripheral products obtained from other companies. The Company establishes its own pricing and retains related inventory risk, is the primary obligor in sales transactions with its customers, and assumes the credit risk for amounts billed to its customers. Accordingly, the Company recognizes revenue for the sale of products obtained from other companies at the gross amount billed.

Revenue on arrangements that include multiple elements such as hardware, software, and services is allocated to each element based on the relative fair value of each element, which is generally determined by vendor specific objective evidence (VSOE). Allocated revenue for each element is recognized when revenue recognition criteria have been met for each element. VSOE is determined based on the price charged when each element is sold separately.

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end user rebates, and other sales programs and volume-based incentives. The estimated cost of these programs is accrued as a reduction to revenue in the period the Company has sold the product and committed to a plan. The Company also records reductions to revenue for expected future product returns based on the Company's historical experience.

Generally, the Company does not offer specified or unspecified upgrade rights to its customers in connection with software sales or the sale of extended warranty and support contracts. However, a limited number of the Company's software products are available with maintenance agreements that grant customers rights to unspecified future upgrades over the maintenance term on a when and if available basis. Revenue associated with such maintenance is recognized ratably over the maintenance term.

Shipping Costs

The Company's shipping and handling costs are included in cost of sales for all periods presented.

Warranty Expense

The Company provides currently for the estimated cost for product warranties at the time the related revenue is recognized.

Research and Development

Research and development costs are expensed as incurred. Development costs of computer software to be sold, leased or otherwise marketed are subject to capitalization beginning when a product's technological feasibility has been established and ending when a product is available for general release to customers pursuant to SFAS No. 86, *Computer Software to be Sold, Leased, or Otherwise Marketed.* In most instances, the Company's products are released soon after technological feasibility has been established. Therefore, costs incurred subsequent to achievement of technological feasibility are usually not significant, and generally all software development costs have been expensed.

During the fourth quarter of 2004, the Company incurred substantial development costs associated with the development of Mac OS X version 10.4 (code-named "Tiger"), which enhances the features and functionality of the previous version of Mac OS X, subsequent to achievement of technological feasibility as evidenced by public demonstration in August 2004 and subsequent release of a developer beta version of the product, both of which were prior to the planned release of the final version of the product in the first half of calendar year 2005. Therefore, during the fourth quarter of 2004, the Company capitalized approximately $4.5 million of costs associated with development of Tiger. Amortization of this asset will begin when Tiger begins shipping and will be recognized straight-line over a 3 year estimated useful life.

During the second quarter of 2004, the Company incurred substantial development costs associated with FileMaker Pro 7 subsequent to achievement of technological feasibility as evidenced by public demonstration and release of a developer beta version, and prior to the release of the final version of the product in March 2004. Therefore, during the second quarter of 2004, the Company capitalized approximately $2.3 million of costs associated with the development of FileMaker Pro 7. In accordance with SFAS No. 86, amortization of this asset began in March 2004 when FileMaker Pro 7 was shipped and is being recognized on a straight-line basis over a 3 year estimated useful life.

During the third and fourth quarters of 2003, the Company incurred substantial development costs associated with the development of Mac OS X version 10.3 (code-named "Panther"), subsequent to achievement of technological feasibility as evidenced by public demonstration and release of a developer beta in June 2003, and prior to release of the final version of the product in the first quarter of 2004. Therefore, during 2003 the Company capitalized approximately $14.7 million of development costs associated with the development of Panther. Amortization of this asset began in the first quarter of 2004 when Panther was shipped and is being recognized on a straight-line basis in accordance with SFAS No. 86 over a 3 year estimated useful life.

During the third and fourth quarters of 2002, the Company incurred substantial development costs associated with the development of Mac OS X version 10.2 (code-named "Jaguar") subsequent to achievement of technological feasibility as evidenced by public demonstration and release of a developer beta in May 2002, and prior to release of the final version of the product in the fourth quarter of 2002. As such, the Company capitalized approximately $13.3 million of development costs associated with development of Jaguar. Amortization of this asset began in the fourth quarter of 2002 when Jaguar was shipped and is being recognized on a straight-line basis in accordance with SFAS No. 86 over a 3 year estimated useful life. In addition, during 2002, the Company also began capitalizing certain costs related to development of its new PowerSchool enterprise student information system. Capitalization of approximately $6 million began upon achievement of technological feasibility in the first quarter of 2002. The final version of the enterprise student information system was released in July 2002.

Total amortization related to capitalized software development costs was $10.7 million, $5.8 million, and $1.2 million in 2004, 2003 and 2002, respectively.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expense was $206 million, $193 million, and $209 million for 2004, 2003, and 2002, respectively.

Restructuring Charges

In June 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 supersedes Emerging Issues Task Force (EITF) Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs To Exit an Activity (Including Certain Costs Associated with a Restructuring)* and requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, as opposed to when management commits to an exit plan. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. This Statement was effective for exit or disposal activities initiated after December 31, 2002. The provisions of SFAS No. 146 were required to be applied prospectively after the adoption date to newly initiated exit activities.

Stock-Based Compensation

The Company measures compensation expense for its employee stock-based compensation plans using the intrinsic value method prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees.* The Company applies the disclosure provisions of SFAS No. 123, *Accounting for Stock-based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-based Compensation—Transition and Disclosure* as if the fair value-based method had been applied in measuring compensation expense. The Company has elected to follow APB Opinion No. 25 because, as discussed below, the alternative fair value accounting provided for under SFAS No. 123 requires use of option valuation models that were not developed for use in valuing employee stock options and employee stock purchase plan shares. Under APB Opinion No. 25, when the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of the grant, no compensation expense is recognized.

As required under SFAS No. 123, the pro forma effects of stock-based compensation on net income and earnings per common share for employee stock options granted and employee stock purchase plan share purchases have been estimated at the date of grant and beginning of the period, respectively, using a Black-Scholes option pricing model. For purposes of pro forma disclosures, the estimated fair value of the options and shares is amortized to pro forma net income (loss) over the options' vesting period and the shares' plan period.

The Black-Scholes option valuation model was developed for use in estimating the fair value of freely traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected life of options and the Company's expected stock price volatility. Because the Company's employee stock options and employee stock purchase plan shares have characteristics significantly different from those of freely traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not provide a reliable measure of the fair value of the Company's employee stock options and employee stock purchase plan shares.

For purposes of pro forma disclosures, the estimated fair value of the options and shares is amortized to pro forma net income (loss) over the options' vesting period and the shares' plan period. The Company's pro forma information for each of the last three fiscal years follows (in millions, except per share amounts):

	2004	2003	2002
Net income—as reported	$ 276	$ 69	$ 65
Add: Stock-based employee compensation expense included in reported net income, net of tax	33	15	5
Deduct: Stock-based employee compensation expense determined under the fair value based method for all awards, net of tax	(141)	(181)	(234)
Net income (loss)—pro forma	$ 168	$ (97)	$ (164)
Net income per common share—as reported			
Basic	$ 0.74	$ 0.19	$ 0.18
Diluted	$ 0.71	$ 0.19	$ 0.18
Net income (loss) per common share—pro forma			
Basic	$ 0.45	$ (0.27)	$ (0.46)
Diluted	$ 0.44	$ (0.27)	$ (0.46)

Earnings Per Common Share

Basic earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the dilutive potential shares of common stock had been issued. The dilutive effect of outstanding options, restricted stock and restricted stock units is reflected in diluted earnings per share by application of the treasury stock method. Under the treasury stock method, an increase in the fair market value of the Company's common stock can result in a greater dilutive effect from outstanding options, restricted stock and restricted stock units. Additionally, the exercise of employee stock options and the vesting of restricted stock and restricted stock units can result in a greater dilutive effect on earnings per share.

The following table sets forth the computation of basic and diluted earnings per share:

For the Years Ended	September 25, 2004	September 27, 2003	September 28, 2002
Numerator (in millions):			
Income before accounting changes	$ 276	$ 68	$ 65
Cumulative effects of accounting changes, net of tax	—	1	—
Net income	$ 276	$ 69	$ 65
Denominator (in thousands):			
Weighted-average shares outstanding, excluding unvested restricted stock	371,590	360,631	355,022
Effect of dilutive options, restricted stock units and restricted stock	15,721	2,835	6,763
Denominator for diluted earnings per share	387,311	363,466	361,785
Basic earnings per share before accounting changes	$ 0.74	$ 0.19	$ 0.18
Cumulative effects of accounting changes, net of tax	—	—	—
Basic earnings per share after accounting changes	$ 0.74	$ 0.19	$ 0.18
Diluted earnings per share before accounting changes	$ 0.71	$ 0.19	$ 0.18
Cumulative effects of accounting changes, net of tax	—	—	—
Diluted earnings per share after accounting changes	$ 0.71	$ 0.19	$ 0.18

Potentially dilutive securities, including stock options; restricted stock units; and restricted stock, to purchase approximately 4.4 million, 50.8 million, and 58.0 million shares of common stock for the years ended September 25, 2004, September 27, 2003, and September 28, 2002, respectively, were excluded from the computation of diluted earnings per share for these periods because their effect would have been antidilutive.

Comprehensive Income

Comprehensive income consists of two components, net income and other comprehensive income. Other comprehensive income refers to revenue, expenses, gains and losses that under generally accepted accounting principles are recorded as an element of shareholders' equity but are excluded from net income. The Company's other comprehensive income is comprised of foreign currency translation adjustments from those subsidiaries not using the U.S. dollar as their functional currency, unrealized gains and losses on marketable securities categorized as available-for-sale, and net deferred gains and losses on certain derivative instruments accounted for as cash flow hedges.

Segment Information

The Company reports segment information based on the "management" approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of the Company's reportable segments. Information about the Company's products, major customers, and geographic areas on a company-wide basis is also disclosed.

Note 2—Financial Instruments

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximate their fair value due to the short maturities of those instruments.

Cash, Cash Equivalents and Short-Term Investments

The following table summarizes the fair value of the Company's cash and available-for-sale securities held in its short-term investment portfolio, recorded as cash and cash equivalents or short-term investments as of September 25, 2004, and September 27, 2003 (in millions):

	September 25, 2004	September 27, 2003
Cash	$ 200	$ 158
U.S. Treasury and Agency securities	87	87
U.S. corporate securities	1,795	2,368
Foreign securities	887	783
Total cash equivalents	2,769	3,238
U.S. Treasury and Agency securities	1,080	454
U.S. corporate securities	1,352	623
Foreign securities	63	93
Total short-term investments	2,495	1,170
Total cash, cash equivalents, and short-term investments	$ 5,464	$ 4,566

The Company's short-term investment portfolio consists of investments in U.S. Treasury and Agency securities, U.S. corporate securities, and foreign securities. The Company's U.S. corporate securities consist primarily of commercial paper, certificates of deposit, time deposits and corporate debt securities. Foreign securities consist primarily of foreign commercial paper, certificates of deposit and time deposits with foreign institutions, most of which are denominated in U.S. dollars. The Company had net unrealized losses totaling $4 million on its investment portfolio, primarily related to investments with stated maturities less than 1 year as of September 25, 2004 and net unrealized gains of $1 million on its investment portfolio, primarily related to investments with stated maturities greater than 1 year, as of September 27, 2003. The Company occasionally sells short-term investments prior to their stated maturities. As a result of such sales, the Company recognized net gains before taxes of $1 million in 2004, $21 million in 2003 and $7 million in 2002. These net gains were included in interest and other income, net.

As of September 25, 2004, approximately $180 million of the Company's short-term investments had underlying maturities ranging from 1 to 5 years. The remaining short-term investments as of September 25, 2004 had maturities of 3 to 12 months. As of September 27, 2003, approximately $629 million of the Company's short-term investments had underlying maturities ranging from 1 to 5 years. The remaining short-term investments as of September 27, 2003 had maturities of 3 to 12 months.

In accordance with EITF 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, the following table shows the gross unrealized losses and fair value of the Company's investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of September 25, 2004 (in millions):

Security Description	Less than 12 Months Fair Value	Less than 12 Months Unrealized Loss	12 Months or Greater Fair Value	12 Months or Greater Unrealized Loss	Total Fair Value	Total Unrealized Loss
U.S. Treasury and Agencies	$ 1,126	$ (4)	$ —	$ —	$ 1,126	$ (4)
Corporate bonds	134	—	144	(1)	278	(1)
Certificate of deposits	420	(1)	—	—	420	(1)
Asset backed securities	426	—	—	—	426	—
Commercial paper	2,407	(1)	—	—	2,407	(1)
Total	$ 4,513	$ (6)	$ 144	$ (1)	$ 4,657	$ (7)

Market values were determined for each individual security in the investment portfolio. The declines in value of these investments is primarily related to changes in interest rates and are considered to be temporary in nature. Investments are reviewed periodically to identify possible impairment. When evaluating the investments, the Company reviews factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the investee, and the Company's ability and intent to hold the investment for a period of time which may be sufficient for anticipated recovery in market value.

Accounts Receivable

Trade Receivables

The Company distributes its products through third-party resellers and directly to certain education, consumer, and commercial customers. The Company generally does not require collateral from its customers. However, when possible the Company does attempt to limit credit risk on trade receivables with credit insurance for certain customers in Latin America, Europe and Asia and by arranging with third-party financing companies to provide flooring arrangements and other loan and lease programs to the Company's direct customers. These credit financing arrangements are directly between the third-party financing company and the end customer. As such, the Company generally does not assume any recourse or credit risk sharing related to any of these arrangements. However, considerable trade receivables that are not covered by collateral, third-party flooring arrangements, or credit insurance are outstanding with the Company's distribution and retail channel partners. No customer accounted for more than 10% of trade receivables as of September 25, 2004. Trade receivables from a single customer, Ingram Micro, Inc., accounted for approximately 10.3% of net accounts receivable as of September 27, 2003.

The following table summarizes the activity in the allowance for doubtful accounts (in millions):

	2004	2003	2002
Beginning allowance balance	$ 49	$ 51	$ 51
Charged to costs and expenses	3	4	10
Deductions (a)	(5)	(6)	(10)
Ending allowance balance	$ 47	$ 49	$ 51

(a) Represents amounts written off against the allowance, net of recoveries.

Vendor Non-Trade Receivables

The Company has non-trade receivables from certain of its manufacturing vendors resulting from the sale of raw material components to these manufacturing vendors who manufacture sub-assemblies or assemble final products for the Company. The Company purchases these raw material components directly from suppliers. These non-trade receivables, which are included in the consolidated balance sheets in other current assets, totaled $276 million and $184 million as of September 25, 2004 and September 27, 2003, respectively. The Company does not recognize any profits on these sales or reflect the sale of these components in its net sales.

Inventory Prepayment

In April 2002, the Company made a $100 million prepayment to an Asian supplier for the purchase of components over the following nine months. In return for this deposit, the supplier agreed to supply the Company with a specified level of components during the three consecutive fiscal quarters ended December 28, 2002. During the first six months of 2003, the remaining $53 million of the deposit balance was fully utilized for the purchase of components. The deposit was unsecured and had no stated interest component. The Company imputed an amount to cost of sales and interest income during each period the deposit was outstanding at a 3.25% interest rate to reflect the economics of this transaction.

Derivative Financial Instruments

The Company uses derivatives to partially offset its business exposure to foreign exchange and interest rate risk. Foreign currency forward and option contracts are used to offset the foreign exchange risk on certain existing assets and liabilities and to hedge the foreign exchange risk on expected future cash flows on certain forecasted revenue and cost of sales. From time to time, the Company enters into interest rate derivative agreements to modify the interest rate profile of certain investments and debt. The Company's accounting policies for these instruments are based on whether the instruments are designated as hedge or non-hedge instruments. The Company records all derivatives on the balance sheet at fair value.

The following table shows the notional principal, net fair value, and credit risk amounts of the Company's foreign currency instruments as of September 25, 2004 and September 27, 2003 (in millions):

	September 25, 2004			September 27, 2003		
	Notional Principal	Fair Value	Credit Risk Amounts	Notional Principal	Fair Value	Credit Risk Amounts
Foreign exchange instruments qualifying as accounting hedges:						
Spot/Forward contracts	$ 598	$ (3)	$ 3	$ 464	$ (21)	$ —
Purchased options	$ 482	$ 4	$ 4	$ 512	$ 3	$ 3
Sold options	$ 521	$ (3)	$ —	$ 645	$ (8)	$ —
Foreign exchange instruments other than accounting hedges:						
Spot/Forward contracts	$ 609	$ 3	$ 4	$ 445	$ 3	$ 3
Purchased options	$ —	$ —	$ —	$ 8	$ —	$ —
Sold options	$ —	$ —	$ —	$ 5	$ —	$ —

The notional principal amounts for derivative instruments provide one measure of the transaction volume outstanding as of year-end, and do not represent the amount of the Company's exposure to credit or market loss. The credit risk amount shown in the table above represents the Company's gross exposure to potential accounting loss on these transactions if all counterparties failed to perform according to the terms of the contract, based on then-current currency exchange rates at each respective date. The Company's exposure to credit loss and market risk will vary over time as a function of currency exchange rates.

The estimates of fair value are based on applicable and commonly used pricing models using prevailing financial market information as of September 25, 2004 and September 27, 2003. In certain instances where judgment is required in estimating fair value, price quotes were obtained from several of the Company's counterparty financial institutions. Although the table above reflects the notional principal, fair value, and credit risk amounts of the Company's foreign exchange instruments, it does not reflect the gains or losses associated with the exposures and transactions that the foreign exchange instruments are intended to hedge. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

Foreign Exchange Risk Management

The Company may enter into foreign currency forward and option contracts with financial institutions to protect against foreign exchange risk associated with existing assets and liabilities, certain firmly committed transactions and forecasted future cash flows. Generally, the Company's practice is to hedge a majority of its existing material foreign exchange transaction exposures. However, the Company may not hedge certain foreign exchange transaction exposures due to immateriality, prohibitive economic cost of hedging particular exposures, or limited availability of appropriate hedging instruments.

To protect gross margins from fluctuations in foreign currency exchange rates, the Company's U.S. dollar functional subsidiaries hedge a portion of forecasted foreign currency revenues, and the Company's non-U.S. dollar functional subsidiaries selling in local currencies hedge a portion of forecasted inventory purchases not denominated in the subsidiaries' functional currency. Other comprehensive income associated with hedges of foreign currency revenues is recognized as a component of net sales in the same period as the related sales are recognized, and other comprehensive income related to inventory purchases is recognized as a component of cost of sales in the same period as the related costs are recognized. Typically, the Company hedges portions of its forecasted foreign currency exposure associated with revenues and inventory purchases over a time horizon of 3 to 9 months.

Derivative instruments designated as cash flow hedges must be dedesignated as hedges when it is probable that the forecasted hedged transaction will not occur in the initially identified time period or within a subsequent 2 month time period. Deferred gains and losses in other comprehensive income associated with such derivative instruments are immediately reclassified into earnings in other income and expense. Any subsequent changes in fair value of such derivative instruments are also reflected in current earnings unless they are redesignated as hedges of other transactions. During 2004, the Company recorded net losses of $2.8 million in other income and expense related to the loss of hedge designation on discontinued cash flow hedges due to changes in the Company's forecast of future net sales and cost of sales and due to prevailing market conditions. No net gains, or losses, of a similar nature were recorded in 2003. During 2002, the Company recorded net gains of $2.5 million in other income and expense related to the loss of hedge designation on discontinued cash flow hedges due to changes in the Company's forecast of future net sales and cost of sales and due to prevailing market conditions. As of September 25, 2004, the Company had a net deferred loss associated with cash flow hedges of approximately $4.4 million, net of taxes, substantially all of which is expected to be reclassified to earnings by the end of the second quarter of fiscal 2005.

The Company may enter into foreign currency forward contracts to hedge the translation and economic exposure of a net investment position in a foreign subsidiary. The Company may also enter into foreign currency forward and option contracts to offset the foreign exchange gains and losses generated by the remeasurement of certain recorded assets and liabilities in non-functional currencies. Changes in the fair value of these derivatives are recognized in current earnings in other income and expense as offsets to the changes in the fair value of the related assets or liabilities. Due to market movements, changes in option time value can lead to increased volatility in other income and expense.

Interest Rate Risk Management

From time to time, the Company historically entered into interest rate derivative transactions with financial institutions in order to better match the Company's floating-rate interest income on its cash equivalents and short-term investments with its fixed-rate interest expense on any outstanding long-term debt, and/or to diversify a portion of the Company's exposure away from fluctuations in short-term U.S. interest rates.

In prior years, the Company had entered into interest rate debt swaps with financial institutions in order to better match the Company's floating-rate interest income on cash equivalents and short term investments with its fixed rate interest expense on its long term debt, and/or to diversify a portion of the Company's exposure away from fluctuations in short term U.S. interest rates. The interest rate swaps required the Company to pay a floating interest rate based on the three- or six-month U.S. dollar LIBOR and receive a fixed rate of interest without exchanges of the underlying notional amounts. These swaps effectively converted the Company's fixed-rate 10-year debt to floating-rate debt. Due to prevailing market interest rates, during 2001 and 2002 the Company entered into and then subsequently closed out interest rate debt swap positions realizing gains of $23 million which were deferred over the remaining life of the debt.

As of September 25, 2004 and September 27, 2003, the Company had no interest rate derivatives outstanding.

Debt

In February 2004, the Company retired $300 million of debt outstanding in the form of 6.5% unsecured notes. The notes were originally issued in 1994 and were sold at 99.9925% of par for an effective yield to maturity of 6.51%. As of September 27, 2003, the carrying amount of these notes, including unamortized deferred gains associated with closed debt interest rate swaps, was $304 million, respectively, while the fair value was $302 million. The fair value of the notes was based on their listed market values as of September 27, 2003.

Non-Current Debt and Equity Investments and Related Gains and Losses

The Company has held significant investments in ARM Holdings plc (ARM), Akamai Technologies, Inc. (Akamai) and EarthLink Network, Inc. (EarthLink). These investments have been reflected in the consolidated balance sheets as long term assets within other assets and have been categorized as available-for-sale requiring that they be carried at fair value with unrealized gains and losses, net of taxes, reported in equity as a component of accumulated other comprehensive income. All realized gains on the sale of these investments have been included in other income and expense. In fiscal 2004, the Company sold all of its remaining non-current investments in public companies.

EarthLink

In January 2000, the Company invested $200 million in EarthLink, an Internet service provider (ISP). The investment was in EarthLink's Series C Convertible Preferred Stock, which was convertible by the Company after January 4, 2001, into approximately 7.1 million shares of EarthLink common stock. Concurrent with this investment, EarthLink and the Company entered into a multi-year agreement to deliver ISP service to Macintosh users in the U.S. Under the terms of the agreement, the Company profits from each new Macintosh customer that subscribes to EarthLink's ISP service for a specified period of time, and EarthLink is the default ISP in the Company's Internet Setup Software included with all Macintosh computers sold in the U.S.

During the first quarter of 2003, the Company sold 2,580,000 shares of EarthLink stock for net proceeds of approximately $13.7 million, an amount that approximated the Company's carrying value of the shares. During the third quarter of 2003, the Company sold all of its remaining holdings in EarthLink, consisting of 3,960,000 shares of stock for net proceeds of approximately $23 million, and a gain before taxes of $2 million.

During the first quarter of 2002, the Company sold 117,000 shares of EarthLink stock for net proceeds of $2 million and a gain before taxes of $223,000. No sales of EarthLink were made in any of the subsequent quarters of fiscal 2002. However, during the fourth quarter of 2002, the Company determined that the then current decline in the fair value of its investment in EarthLink was other-than-temporary. As a result, the Company recognized a $44 million charge to earnings to write-down the basis of its investment in EarthLink to $35 million. This charge was included in gains (losses) on non-current investments, net. As of September 28, 2002, the Company held 6.5 million shares of EarthLink stock valued at $35 million.

Akamai

In June 1999, the Company invested $12.5 million in Akamai, a global Internet content delivery service. The investment was in the form of convertible preferred stock that converted into 4.1 million shares of Akamai common stock (adjusted for subsequent stock splits) at the time of Akamai's initial public offering in October 1999. Beginning in the first quarter of 2000, the Company categorized its shares in Akamai as available-for-sale.

During 2004, the Company sold its remaining 986,000 shares of Akamai stock. The transaction generated proceeds of approximately $5 million and a gain before taxes of approximately $4 million.

During the fourth quarter of 2003, the Company sold 1,875,000 shares of Akamai stock for net proceeds of $9 million and a gain before taxes of $8 million. As of September 27, 2003, the Company's remaining investment in Akamai consisted of 986,000 shares of Akamai stock valued at $5 million.

During the first quarter of 2002, the Company sold 250,000 shares of Akamai stock for net proceeds of $2 million and a gain before taxes of $710,000. No sales of Akamai were made in any of the subsequent quarters of fiscal 2002. However, during the fourth quarter of 2002, the Company determined the decline in the fair value of its investment in Akamai was other-than-temporary. As a result, the Company recognized a $6 million charge to earnings to write-down the basis of its investment in Akamai to $3 million. This charge was included in gains (losses) on non-current investments, net.

ARM

ARM is a publicly held company in the U.K. involved in the design and licensing of high performance microprocessors and related technology.

During the third quarter of 2003, the Company sold all of its remaining holdings in ARM stock, consisting of 278,000 shares for net proceeds of approximately $295,000, and a gain before taxes of $270,000.

During the first quarter of 2002, the Company sold 4.7 million shares of ARM stock for both net proceeds and a gain before taxes of $21 million. No sales of ARM were made in any of the subsequent quarters of fiscal 2002.

Other Strategic Investments

The Company has made additional minority debt and equity investments in several privately held technology companies, which were reflected in the consolidated balance sheets in other assets. These investments were inherently risky because the products and/or markets of these companies were typically not fully developed. During 2002, the Company determined the decline in fair value of certain of these investments was other-than-temporary and, accordingly, recognized a charge to earnings of $15 million. These charges were included in gains (losses) on non-current investments, net. As of September 25, 2004, the Company had $1.4 million of equity investments reflected in its consolidated balance sheet. As of September 27, 2003, the Company had no private debt or equity investments reflected in its consolidated balance sheet.

Note 3—Consolidated Financial Statement Details (in millions)

Inventories

	2004	2003
Purchased parts	$ 1	$ 2
Work in process	—	4
Finished goods	100	50
Total inventories	$ 101	$ 56

Other Current Assets

	2004	2003
Vendor non-trade receivables	$ 276	$ 184
Other current assets	209	125
Total other current assets	$ 485	$ 309

Property, Plant, and Equipment

	2004	2003
Land and buildings	$ 351	$ 350
Machinery, equipment, and internal-use software	422	393
Office furniture and equipment	79	74
Leasehold improvements	446	357
	1,298	1,174
Accumulated depreciation and amortization	(591)	(505)
Net property, plant, and equipment	$ 707	$ 669

Other Assets

	2004	2003
Non-current deferred tax assets	$ 86	$ 60
Capitalized software development costs, net	25	28
Other assets	80	62
Total other assets	$ 191	$ 150

Accrued Expenses

	2004	2003
Deferred revenue	$ 544	$ 368
Accrued marketing and distribution	147	124
Accrued compensation and employee benefits	134	101
Accrued warranty and related costs	105	67
Other current liabilities	299	239
Total accrued expenses	$ 1,229	$ 899

Interest and Other Income, Net

	2004	2003	2002
Interest income	$ 64	$ 69	$ 118
Interest expense	(3)	(8)	(11)
Gains on sales of short term investments	1	21	7
Other income (expense), net	(9)	(5)	(2)
Gain on forward purchase agreement	—	6	—
Total interest and other income, net	$ 53	$ 83	$ 112

Note 4—Acquisitions

Goodwill and Other Intangible Assets

The Company is currently amortizing its acquired intangible assets with definite lives over periods ranging from 3 to 10 years. The Company ceased amortization of goodwill at the beginning of fiscal 2002 when it adopted SFAS No. 142.

The following table summarizes the components of gross and net intangible asset balances (in millions):

	September 25, 2004			September 27, 2003		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Goodwill (a)	$ 80	—	$ 80	$ 85	—	$ 85
Other acquired intangible assets	5	(5)	—	5	(5)	—
Acquired technology	42	(25)	17	42	(18)	24
Total acquired intangible assets	$ 127	$ (30)	$ 97	$ 132	$ (23)	$ 109

(a) Accumulated amortization related to goodwill of $55 million arising prior to the adoption of SFAS No. 142 has been reflected in the gross carrying amount of goodwill as of September 25, 2004 and September 27, 2003.

During the third quarter of 2004, the Company recorded an adjustment of approximately $5 million to goodwill related to the acquisition of PowerSchool, Inc (PowerSchool) in fiscal 2001. This reduction of goodwill included the cancellation of 79,167 shares of Apple common stock, valued at approximately $2 million, that were previously held in escrow and were refunded upon resolution of certain matters arising out of the acquisition of PowerSchool. This adjustment also included approximately $3 million to adjust the original estimates of the pre-acquisition PowerSchool restructuring liability to actual costs incurred.

Expected annual amortization expense related to acquired technology is as follows (in millions):

Fiscal Years:	
2005	$ 6
2006	3
2007	2
2008	1
2009	1
Thereafter	4
Total expected annual amortization expense	$ 17

Amortization expense related to acquired intangible assets is as follows (in millions):

	2004	2003	2002
Other acquired intangible assets amortization	$ —	$ —	$ 1
Acquired technology amortization	7	10	5
Total amortization	$ 7	$ 10	$ 6

Acquisition of Emagic GmbH

During the fourth quarter of 2002, the Company acquired Emagic GmbH (Emagic), a provider of professional software solutions for computer based music production, for approximately $30 million in cash; $26 million of which was paid immediately upon closing of the deal and $4 million of which was held-back for future payment contingent on continued employment by certain employees that would be allocated to future compensation expense in the appropriate periods over the following 3 years. During fiscal 2003, contingent consideration totaling $1.3 million was paid. The acquisition has been accounted for as a purchase. The portion of the purchase price allocated to purchased in-process research and development (IPR&D) was expensed immediately, and the portion of the purchase price allocated to acquired technology and to tradename will be amortized over their estimated useful lives of 3 years. Goodwill associated with the acquisition of Emagic is not subject to amortization pursuant to the provisions of SFAS No. 142. Total consideration was allocated as follows (in millions):

Net tangible assets acquired	$ 2.3
Acquired technology	3.8
Tradename	0.8
In-process research and development	0.5
Goodwill	18.6
Total consideration	$ 26.0

The amount of the purchase price allocated to IPR&D was expensed upon acquisition, because the technological feasibility of products under development had not been established and no alternative future uses existed. The IPR&D relates primarily to Emagic's Logic series technology and extensions. At the date of the acquisition, the products under development were between 43%-83% complete, and it was expected that the remaining work would be completed during the Company's fiscal 2003 at a cost of approximately $415,000. The remaining efforts, which were completed in 2003, included finalizing user interface design and development, and testing. The fair value of the IPR&D was determined using an income approach, which reflects the projected free cash flows that will be generated by the IPR&D projects and that are attributable to the acquired technology, and discounting the projected net cash flows back to their present value using a discount rate of 25%.

Acquisition of certain assets of Zayante, Inc., Prismo Graphics, and Silicon Grail

During fiscal 2002 the Company acquired certain technology and patent rights of Zayante, Inc., Prismo Graphics, and Silicon Grail Corporation for a total of $20 million in cash. These transactions have been accounted for as asset acquisitions. The purchase price for these asset acquisitions, except for $1 million identified as contingent consideration which would be allocated to compensation expense over the following 3 years, has been allocated to acquired technology and would be amortized on a straight-line basis over 3 years, except for certain assets acquired from Zayante associated with patent royalty streams that would be amortized over 10 years.

Acquisition of Nothing Real, LLC

During the second quarter of 2002, the Company acquired certain assets of Nothing Real, LLC (Nothing Real), a privately-held company that develops and markets high performance tools designed for the digital image creation market. Of the $15 million purchase price, the Company has allocated $7 million to acquired technology, which will be amortized over its estimated life of 5 years. The remaining $8 million, which has been identified as contingent consideration, rather than recorded as an additional component of the cost of the acquired assets, would be allocated to future compensation expense in the appropriate periods over the following 3 years.

Note 5—Restructuring Charges

Fiscal 2004 Restructuring Actions

The Company recorded total restructuring charges of approximately $23 million during the year ended September 25, 2004, including approximately $14 million in severance costs, $5.5 million in asset impairments, and a $3.5 million charge for lease cancellations. Of the $23 million charge, $14.3 million had been spent by the end of 2004, with the remaining $8.7 million consisting of $5.2 million for employee severance benefits and $3.5 million for lease cancellations.

During the fourth quarter of 2004, the Company recognized restructuring expense of $5.5 million. In conjunction with the European workforce reduction during the second quarter of 2004, the Company vacated a leased sales facility during the fourth quarter of 2004 resulting in a charge of $3.7 million for contract termination and asset impairment costs. The Company also recognized employee termination costs of $1.8 million related to the elimination of non-essential positions, principally in Europe. In addition, the Company reversed $400,000 of excess restructuring expense from prior periods related primarily to lower than expected disposal costs on Sacramento manufacturing-related fixed assets. The net cost of the restructuring plans for the fourth quarter of 2004 was $5.1 million, of which $300,000 had been paid prior to the end of 2004. These actions will result in the termination of 54 positions, 4 of which had been terminated prior to the end of 2004.

During the third quarter of 2004, the Company finalized restructuring plans related to closing Company-owned manufacturing activities in Sacramento. In addition, the Company's management approved restructuring plans related to certain headcount reductions primarily for various sales and marketing activities principally in the U.S. Total cost of the restructuring plan for the third quarter of 2004 was $7.9 million, of which $7.2 million had been paid prior to the end of 2004. These actions will result in the termination of 83 positions, 77 of which had been terminated prior to the end of 2004.

The closing of manufacturing operations in Sacramento resulted in the elimination of 67 positions for a severance cost of $1.9 million and write-off of $5.3 million in manufacturing-related fixed assets whose use ceased during the third quarter of 2004. Termination of sales and marketing activities, principally in the U.S., resulted in severance of $0.7 million for the elimination of 16 positions.

During the second quarter of 2004, the Company's management approved restructuring plans related to the termination of Company-owned manufacturing activities in Sacramento and headcount reductions related primarily to various sales and marketing activities in the U.S. and Europe. Total cost of the actions was $9.6 million for the termination of 348 positions. As of the end of the fourth quarter of 2004, $6.8 million had been spent and 310 positions had been eliminated related to these actions.

The following table summarizes activity associated with restructuring actions initiated during fiscal 2004 (in millions):

	Employee Severance Benefits	Asset Impairments	Lease Cancellations	Totals
Total charge	$ 14.0	$ 5.5	$ 3.5	$ 23.0
Total spending through September 25, 2004	(8.7)	—	—	(8.7)
Total non-cash items	—	(5.2)	—	(5.2)
Adjustments	(0.1)	(0.3)	—	(0.4)
Accrual at September 25, 2004	$ 5.2	$ —	$ 3.5	$ 8.7

Fiscal 2003 Restructuring Actions

The Company recorded total restructuring charges of approximately $26.8 million during the year ended September 27, 2003, including approximately $7.4 million in severance costs, a $5.0 million charge to write-off deferred compensation, $7.1 million in asset impairments and a $7.3 million charge for lease cancellations. Of the $26.8 million charge, all had been spent by the end of 2004, except for approximately $3.0 million related to operating lease costs on abandoned facilities. During the third quarter of 2003, approximately $500,000 of the amount originally accrued for lease cancellations was determined to be in excess due to the sublease of a property sooner than originally estimated and a shortfall of approximately $500,000 was identified in the severance accrual due to higher than expected severance costs related to the closure of the Company's Singapore manufacturing operations. These adjustments had no net effect on reported operating expense.

During the second quarter of 2003, the Company's management approved and initiated restructuring actions that resulted in recognition of a total restructuring charge of $2.8 million, including $2.4 million in severance costs and $400,000 for asset write-offs and lease payments on an abandoned facility. Actions taken in the second quarter were for the most part supplemental to actions initiated in the prior two quarters and focused on further headcount reductions in various sales and marketing functions in the Company's Americas and Europe operating segments and further reductions associated with PowerSchool-related activities in the Americas operating segment, including an accrual for asset write-offs and lease payments on an abandoned facility. The second quarter actions resulted in the termination of 93 employees.

During the first quarter of 2003, the Company's management approved and initiated restructuring actions with a total cost of $24 million that resulted in the termination of manufacturing operations at the Company-owned facility in Singapore, further reductions in headcount resulting from the shift in PowerSchool product strategy that took place at the end of fiscal 2002, and termination of various sales and marketing activities in the U.S. and Europe. These restructuring actions resulted in the elimination of 260 positions worldwide.

Closure of the Company's Singapore manufacturing operations resulted in severance costs of $1.8 million and costs of $6.7 million to write-off manufacturing related fixed assets, whose use ceased during the first quarter. PowerSchool related costs included severance of approximately $550,000 and recognition of $5 million of previously deferred stock compensation that arose when PowerSchool was acquired by the Company in 2001 related to certain PowerSchool employee stockholders who were terminated in the first quarter of 2003. Termination of sales and marketing activities and employees, principally in the U.S. and Europe, resulted in severance costs of $2.8 million and accrual of costs associated with operating leases on closed facilities of $6.7 million. The total net restructuring charge of $23 million recognized during the first quarter of 2003 also reflects the reversal of $600,000 of unused restructuring accrual originally made during the first quarter of 2002.

The following table summarizes activity associated with restructuring actions initiated during fiscal 2003 (in millions):

	Employee Severance Benefits	Deferred Compensation Write-off	Asset Impairments	Lease Cancellations	Totals
Total charge	$ 7.4	$ 5.0	$ 7.1	$ 7.3	$ 26.8
Total spending through September 25, 2004	(7.9)	—	—	(3.8)	(11.7)
Total non-cash items	—	(5.0)	(7.1)	—	(12.1)
Adjustments	0.5	—	—	(0.5)	—
Accrual at September 25, 2004	$ —	$ —	$ —	$ 3.0	$ 3.0

Fiscal 2002 Restructuring Actions

During fiscal 2002, the Company recorded total restructuring charges of approximately $30 million related to actions intended to eliminate certain activities and better align the Company's operating expenses with existing general economic conditions and to partially offset the cost of continuing investments in new product development and investments in the Company's Retail operating segment.

During the fourth quarter of 2002, the Company's management approved and initiated restructuring actions with a total cost of approximately $6 million designed to reduce headcount costs in corporate operations and sales and to adjust its PowerSchool product strategy. These restructuring actions resulted in the elimination of approximately 180 positions worldwide at a cost of $1.8 million, all of which were eliminated by September 27, 2003. Eliminated positions were primarily in corporate operations, sales, and PowerSchool related research and development in the Americas operating segment. The shift in product strategy at PowerSchool included discontinuing development and marketing of PowerSchool's PSE product. This shift resulted in the impairment of previously capitalized development costs associated with the PSE product in the amount of $4.5 million.

During the first quarter of 2002, the Company's management approved and initiated restructuring actions with a total cost of approximately $24 million. These restructuring actions resulted in the elimination of approximately 425 positions worldwide at a cost of $8 million. Positions were eliminated primarily in the Company's operations, information systems, and administrative functions. In addition, these restructuring actions also included significant changes in the Company's information systems strategy resulting in termination of equipment leases and cancellation of existing projects and activities. The Company ceased using the assets associated with first quarter 2002 restructuring actions during that same quarter. Related lease and contract cancellation charges totaled $12 million, and charges for asset impairments totaled $4 million. The first quarter 2002 restructuring actions were primarily related to corporate activity not allocated to operating segments. During the first quarter of 2003, the Company reversed the remaining unused accrual of $600,000. All amounts associated with the fiscal 2002 restructuring actions had been spent by the end of fiscal 2003.

Note 6—Income Taxes

The provision for income taxes consisted of the following (in millions):

	2004	2003	2002
Federal:			
Current	$ 34	$ 18	$ 12
Deferred	56	(7)	(32)
	90	11	(20)
State:			
Current	5	4	3
Deferred	(18)	(11)	6
	(13)	(7)	9
Foreign:			
Current	46	21	29
Deferred	(16)	(1)	4
	30	20	33
Provision for income taxes	$ 107	$ 24	$ 22

The foreign provision for income taxes is based on foreign pretax earnings of approximately $384 million, $250 million and $284 million in 2004, 2003, and 2002, respectively. As of September 25, 2004, approximately $3.2 billion of the Company's cash, cash equivalents, and short-term investments are held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S. The Company's consolidated financial statements fully provide for any related tax liability on amounts that may be repatriated, aside from undistributed earnings of certain of the Company's foreign subsidiaries that are intended to be indefinitely reinvested in operations outside the U.S. U.S. income taxes have not been provided on a cumulative total of $972 million of such earnings. It is not practicable to determine the income tax liability that might be incurred if these earnings were to be distributed.

Deferred tax assets and liabilities reflect the effects of tax losses, credits, and the future income tax effects of temporary differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases and are measured using enacted tax rates that apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

As of September 25, 2004 and September 27, 2003, the significant components of the Company's deferred tax assets and liabilities were (in millions):

	2004	2003
Deferred tax assets:		
Accounts receivable and inventory reserves	$ 32	$ 35
Accrued liabilities and other reserves	195	155
Basis of capital assets and investments	65	47
Tax losses and credits	329	204
Other	26	11
Total deferred tax assets	647	452
Less valuation allowance	30	30
Net deferred tax assets	617	422
Deferred tax liabilities:		
Unremitted earnings of subsidiaries	413	398
Total deferred tax liabilities	413	398
Net deferred tax asset	$ 204	$ 24

As of September 25, 2004, the Company had operating loss carryforwards for federal tax purposes of approximately $446 million, which expire from 2011 through 2024. A portion of these carryforwards was acquired from NeXT and other acquisitions, the utilization of which is subject to certain limitations imposed by the Internal Revenue Code. The Company also has Federal credit carryforwards and various state and foreign tax loss and credit carryforwards, the tax effect of which is approximately $132 million and which expire between 2005 and 2024. The remaining benefits from tax losses and credits do not expire. As of September 25, 2004, a valuation allowance of $30 million was recorded against the deferred tax asset for the benefits of tax losses that may not be realized. The valuation allowance relates primarily to the operating loss carryforwards acquired from NeXT and other acquisitions. Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets.

A reconciliation of the provision for income taxes, with the amount computed by applying the statutory federal income tax rate (35% in 2004, 2003, and 2002) to income before provision for income taxes, is as follows (in millions):

	2004	2003	2002
Computed expected tax	$ 134	$ 32	$ 30
State taxes, net of federal effect	(5)	(4)	7
Indefinitely invested earnings of foreign subsidiaries	(31)	(13)	—
Nondeductible executive compensation	10	5	(1)
Stock repurchase	—	(2)	—
Purchase accounting and asset acquisitions	—	4	3
Change in valuation allowance	—	—	(16)
Research and development credit, net	(5)	(7)	(8)
Nondeductible expenses	2	6	4
Other items	2	3	3
Provision for income taxes	$ 107	$ 24	$ 22
Effective tax rate	28%	26%	25%

The Internal Revenue Service (IRS) has completed its field audit of the Company's federal income tax returns for all years prior to 2001 and proposed certain adjustments. Certain of these adjustments are being contested through the IRS Appeals Office. Substantially all IRS audit issues for these years have been resolved. In addition, the Company is also subject to audits by state, local, and foreign tax authorities. Management believes that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. Should any issues addressed in the Company's tax audits be resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs.

Note 7—Shareholders' Equity

Restricted Stock Units

During fiscal 2004, the Company's Board of Directors approved the grant of 2.515 million restricted stock units to selected members of the Company's senior management, excluding its Chief Executive Officer (CEO). These restricted stock units generally vest in two equal installments on the second and fourth anniversaries of the date of grant. The Company has recorded the $64.4 million value of these restricted stock units as a component of shareholders' equity and will amortize that amount on a straight-line basis over the 4 year requisite service period. The value of the restricted stock units was based on the closing market price of the Company's common stock on the date of grant. Quarterly amortization will be approximately $4.0 million, of which approximately $0.5 million will be included in cost of sales; $1.3 million will be included in research and development expense; and the remaining $2.2 million will be included in selling, general and administrative expense. The restricted stock units have been included in the calculation of diluted earnings per share utilizing the treasury stock method.

CEO Restricted Stock Award

On March 19, 2003, the Company entered into an Option Cancellation and Restricted Stock Award Agreement (the Agreement) with Mr. Steven P. Jobs, its CEO. The Agreement cancelled stock option awards for the purchase of 27.5 million shares of the Company's common stock previously granted to Mr. Jobs in 2000 and 2001. Mr. Jobs retained options to purchase 60,000 shares of the Company's common stock granted in August of 1997 in his capacity as a member of the Company's Board of Directors, prior to becoming the Company's CEO. The Agreement replaced the cancelled options with a restricted stock award of 5 million shares of the Company's common stock. The restricted stock award generally vests three years from date of grant. Vesting of some or all of the restricted shares will be accelerated in the event Mr. Jobs is terminated without cause, dies, or has his management role reduced following a change in control of the Company.

The Company has recorded the value of the restricted stock award of $74.75 million as a component of shareholders' equity and is amortizing that amount on a straight-line basis over the 3 year service period. The value of the restricted stock award was based on the closing market price of the Company's common stock of $14.95 on the date of the award. Amortization expense for this award, which amounts to approximately $6.2 million per quarter, has been included in selling, general, and administrative expense beginning in March 2003 and will continue to be included through March 2006. The 5 million restricted shares have been included in the calculation of diluted earnings per share utilizing the treasury stock method.

Stock Repurchase Plan

In July 1999, the Company's Board of Directors authorized a plan for the Company to repurchase up to $500 million of its common stock. This repurchase plan does not obligate the Company to acquire any specific number of shares or acquire shares over any specified period of time.

During the fourth quarter of 2001, the Company entered into a forward purchase agreement to acquire 1.5 million shares of its common stock in September of 2003 at an average price of $16.64 per share for a total cost of $25.5 million. In August 2003, the Company settled this agreement prior to its maturity, at which time the Company's common stock had a fair value of $22.81. Other than this forward purchase transaction, the Company has not engaged in any transactions to repurchase its common stock since fiscal 2000. Since inception of the stock repurchase plan, the Company had repurchased a total of 6.55 million shares at a cost of $217 million. The Company was authorized to repurchase up to an additional $283 million of its common stock as of September 25, 2004.

Preferred Stock

The Company has 5 million shares of authorized preferred stock, none of which is outstanding. Under the terms of the Company's Restated Articles of Incorporation, the Board of Directors is authorized to determine or alter the rights, preferences, privileges and restrictions of the Company's authorized but unissued shares of preferred stock.

Comprehensive Income

Comprehensive income consists of two components, net income and other comprehensive income. Other comprehensive income refers to revenue, expenses, gains and losses that under generally accepted accounting principles are recorded as an element of shareholders' equity but are excluded from net income. The Company's other comprehensive income consists of foreign currency translation adjustments from those subsidiaries not using the U.S. dollar as their functional currency, unrealized gains and losses on marketable securities categorized as available-for-sale, and net deferred gains and losses on certain derivative instruments accounted for as cash flow hedges.

The following table summarizes the components of accumulated other comprehensive income (loss), net of taxes (in millions):

	2004	2003	2002
Unrealized gains (losses) on available-for-sale securities	$ (4)	$ 1	$ 13
Unrealized losses on derivative investments	(4)	(16)	(11)
Cumulative foreign currency translation	(7)	(20)	(51)
Accumulated other comprehensive income (loss)	$ (15)	$ (35)	$ (49)

The following table summarizes activity in other comprehensive income related to available-for-sale securities, net of taxes (in millions):

	2004	2003	2002
Change in fair value of available-for-sale securities	$ (1)	$ 11	$ (49)
Adjustment for net (gains) losses realized and included in net income	(4)	(23)	32
Change in unrealized gain/loss on available-for-sale securities	$ (5)	$ (12)	$ (17)

The tax effect related to the change in unrealized gain on available-for-sale securities was $4 million, $6 million, and $10 million for fiscal 2004, 2003, and 2002, respectively. The tax effect on the reclassification adjustment for net gains (losses) included in net income was $1 million, $(8) million and $10 million for fiscal 2004, 2003, and 2002, respectively.

The following table summarizes activity in other comprehensive income related to derivatives, net of taxes, held by the Company (in millions):

	2004	2003	2002
Changes in fair value of derivatives	$ (21)	$ (24)	$ 4
Adjustment for net gains(losses) realized and included in net income	33	19	(19)
Change in unrealized gain/loss on derivative instruments	$ 12	$ (5)	$ (15)

The tax effect related to the changes in fair value of derivatives was $10 million, $11million and $(2) million for fiscal 2004, 2003, and 2002, respectively. The tax effect related to derivative gains (losses) reclassified from other comprehensive income was $(13) million, $(7) million and $8 million for fiscal 2004, 2003, and 2002, respectively.

Note 8—Employee Benefit Plans

2003 Employee Stock Option Plan

At the Annual Meeting of Shareholders held on April 24, 2003, the shareholders approved an amendment to the 1998 Executive Officer Stock Plan to change the name of the plan to the 2003 Employee Stock Option Plan (the 2003 Plan), to provide for broad-based grants to all employees in addition to executive officers and other key employees and to prohibit future "repricings" of employee stock options, including 6-months-plus-1-day option exchange programs, without shareholder approval. Based on the terms of individual option grants, options granted under the 2003 Plan generally expire 7 to 10 years after the grant date and generally become exercisable over a period of 4 years, based on continued employment, with either annual or quarterly vesting. The 2003 Plan permits the granting of incentive stock options, nonstatutory stock options, restricted stock units, stock appreciation rights, and stock purchase rights.

1997 Employee Stock Option Plan

In August 1997, the Company's Board of Directors approved the 1997 Employee Stock Option Plan (the 1997 Plan), a non-shareholder approved plan for grants of stock options to employees who are not officers of the Company. Based on the terms of individual option grants, options granted under the 1997 Plan generally expire 7 to 10 years after the grant date and generally become exercisable over a period of 4 years, based on continued employment, with either annual or quarterly vesting. As a result of shareholder approval of amendments to the 1998 Executive Officer Stock Plan in April 2003, the Company terminated the 1997 Employee Stock Option Plan and cancelled all remaining unissued shares totaling 14,295,351 following the completion of an employee stock option exchange program in October 2003.

Employee Stock Option Exchange Program

On March 20, 2003, the Company announced a voluntary employee stock option exchange program (the Exchange Program) whereby eligible employees, other than executive officers and members of the Board of Directors, had an opportunity to exchange outstanding options with exercise prices at or above $25.00 per share for a predetermined smaller number of new stock options issued with exercise prices equal to the fair market value of one share of the Company's common stock on the day the new awards are issued, which was to be at least six months plus one day after the exchange options are cancelled. On April 17, 2003, in accordance with the Exchange Program, the Company cancelled options to purchase 16,569,193 shares of its common stock. On October 22, 2003, new stock options totaling 6,697,368 shares were issued to employees at an exercise price of $22.76 per share, which is equivalent to the closing price of the Company's stock on that date. No financial or accounting impact to the Company's financial position, results of operations or cash flow was associated with this transaction.

1997 Director Stock Option Plan

In August 1997, the Company's Board of Directors adopted a shareholder approved Director Stock Option Plan (DSOP) for non-employee directors of the Company. Initial grants of 30,000 options under the DSOP vest in three equal installments on each of the first through third anniversaries of the date of grant, and subsequent annual grants of 10,000 options are fully vested at grant.

Rule 10b5-1 Trading Plans

Certain of the Company's executive officers, including Mr. Timothy D. Cook, Mr. Jonathan Rubinstein, Mr. Bertrand Serlet, and Mr. Avadis Tevanian, Jr., have entered into trading plans pursuant to Rule 10b5-1(c)(1) of the Securities Exchange Act of 1934, as amended. A trading plan is a written document that pre-establishes the amounts, prices and dates (or formula for determining the amounts, prices and dates) of future purchases or sales of the Company's stock including the exercise and sale of employee stock options and shares acquired pursuant to the Company's employee stock purchase plan and upon vesting of restricted stock units.

Employee Stock Purchase Plan

The Company has a shareholder approved employee stock purchase plan (the Purchase Plan), under which substantially all employees may purchase common stock through payroll deductions at a price equal to 85% of the lower of the fair market values as of the beginning and end of six month offering periods. Stock purchases under the Purchase Plan are limited to 10% of an employee's compensation, up to a maximum of $25,000 in any calendar year. Beginning with the six-month offering period that started on June 30, 2003, the number of shares authorized for issuance is limited to a total of 1 million shares per offering period. During 2004, 2003, and 2002, 2.0 million, 2.1 million, and 1.8 million, respectively were issued under the Purchase Plan. As of September 25, 2004, approximately 2 million shares were reserved for future issuance under the Purchase Plan.

Employee Savings Plan

The Company has an employee savings plan (the Savings Plan) qualifying as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code. Under the Savings Plan, participating U.S. employees may defer a portion of their pre-tax earnings, up to the Internal Revenue Service annual contribution limit ($13,000 for calendar year 2004). The Company matches 50% to 100% of each employee's contributions, depending on length of service, up to a maximum 6% of the employee's earnings. The Company's matching contributions to the Savings Plan were approximately $24 million, $21 million, and $19 million in 2004, 2003, and 2002, respectively.

Stock Option Activity

A summary of the Company's stock option activity and related information for the years ended September 25, 2004, September 27, 2003 and September 28, 2002 follows (option amounts are presented in thousands):

		Outstanding Options	
	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price
Balance at September 29, 2001	10,075	97,179	$ 29.24
Additional Options Authorized	15,000	—	—
Options Granted	(23,239)	23,239	$ 19.89
Options Cancelled	4,737	(4,737)	$ 30.98
Options Exercised	—	(6,251)	$ 11.99
Plan Shares Expired	(2)	—	—
Balance at September 28, 2002	6,571	109,430	$ 28.17
Restricted Stock Granted	(5,000)	—	—
Options Granted	(4,179)	4,179	$ 16.38
Options Cancelled	48,443	(48,443)	$ 39.61
Options Exercised	—	(2,154)	$ 14.04
Plan Shares Expired	(5)	—	—
Balance at September 27, 2003	45,830	63,012	$ 19.08
Restricted Stock Units Granted	(2,515)	—	—
Options Granted	(18,197)	18,197	$ 22.97
Options Cancelled	3,005	(3,005)	$ 20.70
Options Exercised	—	(22,843)	$ 17.20
Plan Shares Expired	(16,098)	—	—
Balance at September 25, 2004	12,025	55,361	$ 21.05

The options outstanding as of September 25, 2004 have been segregated into five ranges for additional disclosure as follows (option amounts are presented in thousands):

	Options Outstanding			Options Exercisable	
	Options Outstanding as of September 25, 2004	Weighted-Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Options Exercisable as of September 25, 2004	Weighted Average Exercise Price
$0.83-$15.59	6,426	4.65	$ 12.26	4,958	$ 11.59
$15.60-$18.50	15,729	5.87	$ 17.94	12,969	$ 18.04
$18.51-$20.54	9,998	6.91	$ 20.26	5,769	$ 20.25
$20.55-$22.76	15,109	6.23	$ 22.20	1,401	$ 21.77
$22.77-$69.78	8,099	6.24	$ 32.90	4,926	$ 36.46
$0.83-$69.78	55,361	6.07	$ 21.05	30,023	$ 20.59

As of September 27, 2003, the Company had exercisable options to purchase 38.8 million shares outstanding with a weighted average exercise price of $18.75 per share. As of September 28, 2002, the Company had exercisable options to purchase 57.9 million shares outstanding with a weighted average exercise price of $30.85 per share.

The Company had 2.515 million restricted stock units outstanding as of September 25, 2004, which were excluded from the options outstanding balances in the preceding tables. None of these restricted stock units were vested as of September 25, 2004. The grant of these restricted stock units has been deducted from the shares available for grant under the Company's stock option plans.

Note 9—Stock-Based Compensation

The Company has provided pro forma disclosures in Note 1 of these Notes to Consolidated Financial Statements of the effect on net income and earnings per share as if the fair value method of accounting for stock compensation had been used for its employee stock option grants and employee stock purchase plan purchases. These pro forma effects have been estimated at the date of grant and beginning of the period, respectively, using the Black-Scholes option pricing model.

For purposes of the pro forma disclosures provided pursuant to SFAS No. 123, the option awards issued in October 2003 and the awards cancelled as part of the Employee Stock Option Exchange Program have been accounted for using modification accounting. In accordance with SFAS No. 123, the grant date of the awards issued is the date of acceptance of the exchange offer by participating employees. The cancellation of certain of the Company's CEO's options and replacement with restricted shares in March 2003 is also being accounted for using modification accounting for purposes of the pro forma disclosures provided pursuant to SFAS No. 123.

The assumptions used for each of the last three fiscal years and the resulting estimate of weighted-average fair value per share of options granted during those years are as follows:

	2004	2003	2002
Expected life of stock options	3.5 years	3.5-4 years	4 years
Expected life of stock purchases	6 months	6 months	6 months
Interest rate—stock options	2.33%-3.15%	2.14%-2.45%	2.90%
Interest rate—stock purchases	0.96%-1.67%	1.10%-1.77%	2.71%
Volatility—stock options	40%	40%-63%	64%
Volatility—stock purchases	32%-44%	35%-44%	51%
Dividend yields	—	—	—
Weighted-average fair value of options granted during the year	$ 7.37	$ 6.63	$ 10.11
Weighted-average fair value of stock purchases during the year	$ 5.56	$ 4.24	$ 6.73

For purposes of the pro forma disclosures provided pursuant to SFAS No. 123, the expected volatility assumptions used by the Company prior to the third quarter of 2003 had been based solely on the historical volatility of the Company's common stock over the most recent period commensurate with the estimated expected life of the Company's stock options. Beginning in the third quarter of 2003, the Company has modified this approach to consider other relevant factors including implied volatility in market traded options on the Company's common stock and the impact of unusual fluctuations not reasonably expected to recur on the historical volatility of the Company's common stock. The Company will continue to monitor these and other relevant factors in developing the expected volatility assumption used to value future awards.

Beginning in the third quarter of 2003, the Company shortened its estimate of the expected life of new options granted to its employees from 4 years to 3.5 years. The Company bases its expected life assumption on its historical experience and on the terms and conditions of the stock options it grants to employees. The change in the expected life assumption made during the third quarter of 2003 was the result of the expected impact of shortening the contractual life of new options granted to employees from 10 years to 7 years and changing the vesting provisions of new options granted to employees from 4 year straight-line annual vesting to 4 year straight-line quarterly vesting.

Note 10—Commitments and Contingencies

Lease Commitments

The Company leases various equipment and facilities, including retail space, under noncancelable operating lease arrangements. The Company does not currently utilize any other off-balance-sheet financing arrangements. The major facility leases are for terms of 5 to 10 years and generally provide renewal options for terms of 3 to 5 additional years. Leases for retail space are for terms of 5 to 16 years and often contain multi-year renewal options. As of September 25, 2004, the Company's total future minimum lease payments under noncancelable operating leases were $617 million, of which $436 million related to leases for retail space.

Rent expense under all operating leases, including both cancelable and noncancelable leases, was $103 million, $97 million, and $92 million in 2004, 2003, and 2002, respectively. Future minimum lease payments under noncancelable operating leases having remaining terms in excess of one year as of September 25, 2004, are as follows (in millions):

Fiscal Years	
2005	$ 89
2006	91
2007	79
2008	65
2009	61
Later years	232
Total minimum lease payments	$ 617

Accrued Warranty and Indemnifications

The Company offers a basic limited parts and labor warranty on its hardware products. The basic warranty period for hardware products is typically one year from the date of purchase by the end-user. The Company also offers a 90-day basic warranty for Apple service parts used to repair Apple hardware products. The Company provides currently for the estimated cost that may be incurred under its basic limited product warranties at the time related revenue is recognized. Factors considered in determining appropriate accruals for product warranty obligations include the size of the installed base of products subject to warranty protection, historical and projected warranty claim rates, historical and projected cost-per-claim, and knowledge of specific product failures that are outside of the Company's typical experience. The Company assesses the adequacy of its preexisting warranty liabilities and adjusts the amounts as necessary based on actual experience and changes in future expectations.

The following table reconciles changes in the Company's accrued warranties and related costs (in millions):

	2004	2003	2002
Beginning accrued warranty and related costs	$ 67	$ 69	$ 87
Cost of warranty claims	(105)	(71)	(79)
Accruals for product warranties	143	69	61
Ending accrued warranty and related costs	$ 105	$ 67	$ 69

The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against itself or an indemnified third-party and, in the opinion of management, does not have a potential liability related to unresolved infringement claims subject to indemnification that would have a material adverse effect on its financial condition, liquidity or results of operations. Therefore, the Company did not record a liability for infringement costs as of either September 25, 2004 or September 27, 2003.

Concentrations in the Available Sources of Supply of Materials and Product

Although most components essential to the Company's business are generally available from multiple sources, other key components (including microprocessors and application-specific integrated circuits, or ("ASICs")) are currently obtained by the Company from single or limited sources. Some other key components, while currently available to the Company from multiple sources, are at times subject to industry-wide availability and pricing pressures. In addition, the Company uses some components that are not common to the rest of the personal computer industry, and new products introduced by the Company often initially utilize custom components obtained from only one source until the Company has evaluated whether there is a need for and subsequently qualifies additional suppliers. If the supply of a key single-sourced component to the Company were to be delayed or curtailed or in the event a key manufacturing vendor delays shipments of completed products to the Company, the Company's ability to ship related products in desired quantities and in a timely manner could be adversely affected. The Company's business and financial performance could also be adversely affected depending on the time required to obtain sufficient quantities from the original source, or to identify and obtain sufficient quantities from an alternative source. Continued availability of these components may be affected if producers were to decide to concentrate on the production of common components instead of components customized to meet the Company's requirements. Finally, significant portions of the Company's CPUs, logic boards, and assembled products are now manufactured by outsourcing partners, the majority of which occurs in various parts of Asia. Although the Company works closely with its outsourcing partners on manufacturing schedules, the Company's operating results could be adversely affected if its outsourcing partners were unable to meet their production obligations.

Contingencies

Beginning on September 27, 2001, three shareholder class action lawsuits were filed in the U.S. District Court for the Northern District of California against the Company and its Chief Executive Officer. These lawsuits are substantially identical, and purport to bring suit on behalf of persons who purchased the Company's publicly traded common stock between July 19, 2000, and September 28, 2000. The complaints allege violations of the 1934 Securities Exchange Act and seek unspecified compensatory damages and other relief. The Company believes these claims are without merit and intends to defend them vigorously. The Company filed a motion to dismiss on June 4, 2002, which was heard by the Court on September 13, 2002. On December 11, 2002, the Court granted the Company's motion to dismiss for failure to state a cause of action, with leave to Plaintiffs to amend their complaint within thirty days. Plaintiffs filed their amended complaint on January 31, 2003, and on March 17, 2003, the Company filed a motion to dismiss the amended complaint. The Court heard the Company's motion on July 11, 2003 and dismissed Plaintiffs' claims with prejudice on August 12, 2003. Plaintiffs have appealed the ruling.

The Company is subject to certain other legal proceedings and claims that have arisen in the ordinary course of business and have not been fully adjudicated. In the opinion of management, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate have a material adverse effect on its financial condition, liquidity or results of operations. However, the results of legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations including, in some instances, the requirement to provide customers the ability to return product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have recently been passed in several jurisdictions in which the Company operates including various European Union member countries, Japan and certain states within the U.S. Although the Company does not anticipate any material adverse effects in the future based on the nature of its operations and the thrust of such laws, there is no assurance that such existing laws or future laws will not have a material adverse effect on the Company's results of operations and financial position.

Note 11—Segment Information and Geographic Data

In accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, the Company reports segment information based on the "management" approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of the Company's reportable segments.

The Company manages its business primarily on a geographic basis. The Company's reportable operating segments are comprised of the Americas, Europe, Japan, and Retail. The Americas segment includes both North and South America, except for the activities of the Company's Retail segment. The Europe segment includes European countries as well as the Middle East and Africa. The Japan segment includes only Japan and excludes revenue from the Company's own retail stores in Japan, which is included in the Company's Retail segment. The Retail segment operated Apple-owned retail stores in the U.S. and Japan during fiscal 2004. Other operating segments include Asia-Pacific, which includes Australia and Asia except for Japan, and the Company's subsidiary, FileMaker, Inc. Each reportable geographic operating segment provides similar hardware and software products and similar services, and the accounting policies of the various segments are the same as those described in Note 1, "Summary of Significant Accounting Policies," except as described below for the Retail segment.

The Company evaluates the performance of its operating segments based on net sales. The Retail segment's performance is also evaluated based on operating income. Net sales for geographic segments are generally based on the location of the customers. Operating income for each segment includes net sales to third parties, related cost of sales, and operating expenses directly attributable to the segment. Operating income for each segment excludes other income and expense and certain expenses that are managed outside the operating segments. Costs excluded from segment operating income include various corporate expenses, manufacturing costs not included in standard costs, income taxes, and various nonrecurring charges. Corporate expenses include research and development, corporate marketing expenses, and other separately managed general and administrative expenses including certain corporate expenses associated with support of the Retail segment. The Company does not include intercompany transfers between segments for management reporting purposes. Segment assets exclude corporate assets. Corporate assets include cash, short-term and long-term investments, manufacturing facilities, miscellaneous corporate infrastructure, goodwill and other acquired intangible assets, and retail store construction-in-progress that is not subject to depreciation. Except for the Retail segment, capital expenditures for long-lived assets are not reported to management by segment. Capital expenditures by the Retail segment were $104 million, $92 million and $106 million for 2004, 2003 and 2002, respectively.

Operating income for all segments, except Retail, includes cost of sales at manufacturing standard cost, other cost of sales, related sales and marketing costs, and certain general and administrative costs. This measure of operating income, which includes manufacturing profit, provides a comparable basis for comparison between the Company's various geographic segments. Certain manufacturing expenses and related adjustments not included in segment cost of sales, including variances between standard and actual manufacturing costs and the mark-up above standard cost for product supplied to the Retail segment, are included in corporate expenses.

Management assesses the operating performance of the Retail segment differently than it assesses the operating performance of the Company's geographic segments. The Retail segment revenue and operating income is intended to depict a comparable measure to that of the Company's major channel partners in the U.S. operating retail stores so the Company can evaluate the Retail segment performance as if it were a channel partner. Therefore, the Company makes three significant adjustments to the Retail segment for management reporting purposes that are not included in the results of the Company's other segments.

First, the Retail segment's operating income includes cost of sales for Apple products at an amount normally charged to major channel partners in the U.S. operating retail stores, less the cost of sales programs and incentives provided to those channel partners and the Company's cost to support those partners. For the years ended September 25, 2004, September 27, 2003, and September 28, 2002, this resulted in the recognition of additional cost of sales above standard cost by the Retail segment and an offsetting benefit to corporate expenses of approximately $213 million, $106 million, and $52 million, respectively.

Second, the Company's extended warranty, support and service contracts are transferred to the Retail segment at the same cost as that charged to the Company's major retail channel partners in the U.S., resulting in a comparable measure of revenue and gross margin between the Company's Retail stores and those retail channel partners. The Retail segment recognizes the full amount of revenue and cost of sales at the time of sale of the Company's extended warranty, support and service contracts. Because the Company has not yet earned the revenue or incurred the costs associated with the sale of these contracts, an offset to these amounts is recognized in other operating segments' net sales and cost of sales. For the year ended September 25, 2004, this resulted in the recognition of net sales and cost of sales by the Retail segment, with corresponding offsets in other operating segments, of $54 million and $37 million, respectively. For the year ended September 27, 2003, the net sales and cost of sales recognized by the Retail segment for sales of extended warranty, support and service contracts were $30 million and $20 million, respectively. For the year ended September 28, 2002, this resulted in the recognition of net sales and cost of sales by the Retail segment of $8 million and $6 million, respectively.

Third, the Company has opened six high profile stores in New York, Los Angeles, Chicago, San Francisco, Tokyo, Japan and Osaka, Japan as of September 25, 2004 and has an additional store under development in London, England, which is expected to open by the end of calendar year 2004. These high profile stores are larger than the Company's typical retail stores and were designed to further promote brand awareness and provide a venue for certain corporate sales and marketing activities, including corporate briefings. As such, the Company allocates certain operating expenses associated with these stores to corporate marketing expense to reflect the estimated benefit realized Company-wide. The allocation of these operating costs is based on the excess amount incurred for a high profile store to that of a more typical Company retail location. Expenses allocated to corporate marketing resulting from the operations of these stores were $16 million, $6 million and $1 million for the years ended September 25, 2004, September 27, 2003, and September 28, 2002 respectively.

Summary information by operating segment follows (in millions):

	2004	2003	2002
Americas:			
Net sales	$ 4,019	$ 3,181	$ 3,131
Operating income	$ 465	$ 323	$ 278
Depreciation, amortization and accretion	$ 6	$ 5	$ 4
Segment assets (a)	$ 563	$ 494	$ 395
Europe:			
Net sales	$ 1,799	$ 1,309	$ 1,251
Operating income	$ 280	$ 130	$ 122
Depreciation, amortization and accretion	$ 4	$ 4	$ 4
Segment assets	$ 259	$ 252	$ 165
Japan:			
Net sales	$ 677	$ 698	$ 710
Operating income	$ 115	$ 121	$ 140
Depreciation, amortization and accretion	$ 2	$ 3	$ 2
Segment assets	$ 114	$ 130	$ 50
Retail:			
Net sales	$ 1,185	$ 621	$ 283
Operating income (loss)	$ 39	$ (5)	$ (22)
Depreciation, amortization and accretion (b)	$ 35	$ 25	$ 16
Segment assets (b)	$ 351	$ 243	$ 141
Other Segments (c):			
Net sales	$ 599	$ 398	$ 367
Operating income	$ 90	$ 51	$ 44
Depreciation, amortization and accretion	$ 2	$ 2	$ 2
Segment assets	$ 124	$ 78	$ 67

(a) The Americas asset figures do not include fixed assets held in the U.S. Such fixed assets are not allocated specifically to the Americas segment and are included in the corporate assets figures below.

(b) Retail segment depreciation and asset figures reflect the cost and related depreciation of its retail stores and related infrastructure. Retail store construction-in-progress, which is not subject to depreciation, is reflected in corporate assets.

(c) Other Segments include Asia-Pacific and FileMaker.

A reconciliation of the Company's segment operating income and assets to the consolidated financial statements follows (in millions):

	2004	2003	2002
Segment operating income	$ 989	$ 620	$ 562
Corporate expenses, net	(640)	(595)	(514)
Purchased in-process research and development	—	—	(1)
Restructuring costs	(23)	(26)	(30)
Consolidated operating income (loss)	$ 326	$ (1)	$ 17
Segment assets	$ 1,411	$ 1,197	$ 818
Corporate assets	6,639	$ 5,618	$ 5,480
Consolidated assets	$ 8,050	$ 6,815	$ 6,298
Segment depreciation, amortization and accretion	$ 49	$ 39	$ 28
Corporate depreciation, amortization and accretion	101	74	86
Consolidated depreciation, amortization and accretion	$ 150	$ 113	$ 114

A large portion of the Company's net sales is derived from its international operations. Also, a majority of the raw materials used in the Company's products is obtained from sources outside of the U.S., and a majority of the products sold by the Company is assembled internationally in the Company's facility in Cork, Ireland or by third-party vendors in Taiwan, Korea, the Netherlands, the People's Republic of China, and the Czech Republic. As a result, the Company is subject to risks associated with foreign operations, such as obtaining governmental permits and approvals, currency exchange fluctuations, currency restrictions, political instability, labor problems, trade restrictions, and changes in tariff and freight charges. No single customer accounted for more than 10% of net sales in 2004, 2003 or 2002.

Net sales and long-lived assets related to operations in the U.S., Japan, and other foreign countries are as follows (in millions):

	2004	2003	2002
Net Sales:			
U.S.	$ 4,893	$ 3,627	$ 3,272
Japan	738	698	710
Other Countries	2,648	1,882	1,760
Total Net Sales	$ 8,279	$ 6,207	$ 5,742
Long-Lived Assets:			
U.S.	$ 637	$ 635	$ 561
Japan	52	19	2
Other Countries	72	60	69
Total Long-Lived Assets	$ 761	$ 714	$ 632

Information regarding net sales by product is as follows (in millions):

	2004	2003	2002
Net Sales:			
Power Macintosh (a)	$ 1,419	$ 1,237	$ 1,380
PowerBook	1,589	1,299	831
iMac (b)	954	1,238	1,448
iBook	961	717	875
Total Macintosh Net Sales	$ 4,923	$ 4,491	$ 4,534
iPod	1,306	345	143
Other Music Products (c)	278	36	4
Peripherals and other hardware (d)	951	691	527
Software (e)	502	362	307
Service and other Net Sales	319	282	227
Total Net Sales	$ 8,279	$ 6,207	$ 5,742

(a) Includes Xserve product line.

(b) Includes eMac product line.

(c) Other Music Products includes iTunes Music Store sales and iPod related services, and Apple-branded and third-party iPod-related accessories.

(d) Net sales of peripherals and other hardware include sales of Apple-branded and third-party displays, wireless connectivity and networking solutions, and other hardware accessories.

(e) Net sales of software include sales of Apple-branded operating system and application software and sales of third-party software.

Note 12—Related Party Transactions and Certain Other Transactions

In March 2002, the Company entered into a Reimbursement Agreement with its CEO, Mr. Steven P. Jobs, for the reimbursement of expenses incurred by Mr. Jobs in the operation of his private plane when used for Apple business. The Reimbursement Agreement became effective for expenses incurred by Mr. Jobs for Apple business purposes since he took delivery of the plane in May 2001. The Company recognized a total of $483,000, $404,000, and $1,168,000 in expenses pursuant to the Reimbursement Agreement during 2004, 2003 and 2002, respectively. All expenses recognized pursuant to the Reimbursement Agreement have been included in selling, general, and administrative expenses in the consolidated statements of operations.

In connection with a relocation assistance package, the Company in May 2000 loaned Mr. Ronald B. Johnson, Senior Vice President, Retail, $1.5 million for the purchase of his principal residence. The loan was secured by a deed of trust and was due and payable in May 2004. Under the terms of the loan, Mr. Johnson agreed that should he exercise any of his stock options prior to the due date of the loan, he would pay the Company an amount equal to the lesser of (1) an amount equal to 50% of the total net gain realized from the exercise of the options; or (2) $375,000 multiplied by the number of years between the exercise date and the date of the loan. Mr. Johnson repaid $750,000 of this loan in fiscal 2003 and repaid the remaining balance of $750,000 in fiscal 2004.

Mr. Jerome York, a member of the Board of Directors of the Company, is a member of an investment group that purchased MicroWarehouse, Inc. (MicroWarehouse) in January 2000. Until September 7, 2003, he also served as Microwarehouse's Chairman, President and Chief Executive Officer. MicroWarehouse was a reseller of computer hardware, software and peripheral products, including products made by the

Company. On September 8, 2003, CDW Corporation (CDW), acquired selected North American assets of MicroWarehouse. MicroWarehouse subsequently filed for Chapter 11 bankruptcy protection in the U.S. MicroWarehouse accounted for approximately 0.3%, 2.4% and 3.3% of the Company's net sales for the years ended September 25, 2004, September 27, 2003, and September 28, 2002, respectively. Trade receivables from MicroWarehouse were $4.3 million and $9.9 million as of September 25, 2004 and September 27, 2003, respectively. The Company has provided what it believes to be an adequate allowance on the outstanding receivable based on the Company's secured interest position in selected MicroWarehouse assets and the expected payments to unsecured creditors. Sales to MicroWarehouse and related trade receivables were generally subject to the same terms and conditions as those with the Company's other resellers. In addition, the Company has purchased miscellaneous equipment and supplies from MicroWarehouse. Total purchases amounted to approximately $2.3 million and $2.9 million for the years ended September 27, 2003 and September 28, 2002, respectively. No purchases were made by the Company from MicroWarehouse in fiscal 2004.

Note 13—Selected Quarterly Financial Information (Unaudited)

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
	(Tabular amounts in millions, except per share amounts)			
2004				
Net sales	$ 2,350	$ 2,014	$ 1,909	$ 2,006
Gross margin	$ 634	$ 559	$ 530	$ 536
Net income	$ 106	$ 61	$ 46	$ 63
Earnings per common share:				
Basic	$ 0.28	$ 0.16	$ 0.13	$ 0.17
Diluted	$ 0.26	$ 0.16	$ 0.12	$ 0.17
2003				
Net sales	$ 1,715	$ 1,545	$ 1,475	$ 1,472
Gross margin	$ 456	$ 428	$ 418	$ 406
Net income (loss)	$ 44	$ 19	$ 14	$ (8)
Earnings (loss) per common share:				
Basic	$ 0.12	$ 0.05	$ 0.04	$ (0.02)
Diluted	$ 0.12	$ 0.05	$ 0.04	$ (0.02)

Basic and diluted earnings (loss) per share are computed independently for each of the quarters presented. Therefore, the sum of quarterly basic and diluted per share information may not equal annual basic and diluted earnings per share.

Net income during the fourth, third, and second quarters of 2004 included restructuring charges, net of tax, of $4 million, $6 million, and $7 million, respectively.

Net income during the fourth and third quarters of 2003 included after-tax net gains related to non-current investments of $5 million and $1 million, respectively. Net income for the fourth quarter also included settlement of the Company's forward purchase agreement resulting in a gain of $6 million and a favorable cumulative-effect type adjustment related to the adoption of SFAS No. 150 of $3 million. Net income (loss) during the second and first quarters of 2003 included restructuring charges, net of tax, of $2 million and $18 million, respectively. Net loss for the first quarter of 2003 included an after-tax unfavorable cumulative-effect type adjustment for the adoption of SFAS No.143 of $2 million.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Apple Computer, Inc.:

We have audited the accompanying consolidated balance sheets of Apple Computer, Inc. and subsidiaries (the Company) as of September 25, 2004 and September 27, 2003, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended September 25, 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Apple Computer, Inc. and subsidiaries as of September 25, 2004 and September 27, 2003, and the results of their operations and their cash flows for each of the years in the three-year period ended September 25, 2004, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for asset retirement obligations and for financial instruments with characteristics of both liabilities and equity in 2003 and changed its method of accounting for goodwill in 2002.

/s/ KPMG LLP

Mountain View, California
October 12, 2004

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A. Controls and Procedures

Based on an evaluation under the supervision and with the participation of the Company's management, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures (as defined under the Securities Exchange Act of 1934, as amended (*Exchange Act*)) were effective as of September 25, 2004 to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

There were no significant changes in the Company's internal control over financial reporting identified in management's evaluation during the fourth quarter of fiscal 2004 that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

PART III

Item 10. Directors and Executive Officers of the Registrant

Directors

Listed below are the Company's seven directors whose terms expire at the next annual meeting of shareholders.

Name	Position With the Company	Age	Director Since
Fred D. Anderson	Director	60	2004
William V. Campbell	Director	64	1997
Millard S. Drexler	Director	60	1999
Albert Gore, Jr.	Director	57	2003
Steven P. Jobs	Director and Chief Executive Officer	49	1997
Arthur D. Levinson	Director	54	2000
Jerome B. York	Director	66	1997

Fred D. Anderson has been a founding partner of Elevation Partners, a private equity firm focused on the media and entertainment industry, since July 2004. Previously, Mr. Anderson served as the Company's Executive Vice President and Chief Financial Officer from April 1996 to June 2004. Mr. Anderson also serves on the Board of Directors of eBay Inc. and E.piphany, Inc.

William V. Campbell has been Chairman of the Board of Directors of Intuit, Inc. *("Intuit")* since August 1998. From September 1999 to January 2000, Mr. Campbell acted as Chief Executive Officer of Intuit. From April 1994 to August 1998, Mr. Campbell was President and Chief Executive Officer and a director of Intuit. From January 1991 to December 1993, Mr. Campbell was President and Chief Executive Officer of GO Corporation. Mr. Campbell also serves on the Board of Directors of Opsware, Inc.

Millard S. Drexler has been Chairman and Chief Executive Officer of J. Crew Group, Inc. since January 2003. Previously, Mr. Drexler was Chief Executive Officer of Gap Inc. from 1995 and President from 1987 until September 2002. Mr. Drexler was also a member of the Board of Directors of Gap Inc. from November 1983 until October 2002.

Albert Gore, Jr. has served as a Senior Advisor to Google, Inc. since 2001. He has also served as Executive Chairman of INdTV since 2002 and as Chairman of Generation Investment Management since 2004. He is a visiting professor at Fisk University and Middle Tennessee State University. Mr. Gore was inaugurated as the 45th Vice President of the U.S. in 1993. He was re-elected in 1996 and served for a total of eight years as President of the Senate, a member of the Cabinet and the National Security Council. Prior to 1993, he served eight years in the U.S. Senate and eight years in the U.S. House of Representatives.

Steven P. Jobs is one of the Company's co-founders and currently serves as its Chief Executive Officer. Mr. Jobs is also the Chairman and Chief Executive Officer of Pixar Animation Studios. In addition, Mr. Jobs co-founded NeXT Software, Inc. ("*NeXT*") and served as the Chairman and Chief Executive Officer of NeXT from 1985 until 1997 when NeXT was acquired by the Company.

Arthur D. Levinson, Ph.D. has been Chief Executive Officer and a director of Genentech Inc. ("*Genentech*") since July 1995. Dr. Levinson has been Chairman of the Board of Directors of Genentech since September 1999. He joined Genentech in 1980 and served in a number of executive positions, including Senior Vice President of R&D from 1993 to 1995. Mr. Levinson also serves on the Board of Directors of Google, Inc.

Jerome B. York has been Chief Executive Officer of Harwinton Capital Corporation, a private investment company which he controls, since September 2003. From January 2000 until September 2003, Mr. York was Chairman and Chief Executive Officer of MicroWarehouse, Inc., a reseller of computer hardware, software and peripheral products. From September 1995 to October 1999, he was Vice Chairman of Tracinda

Corporation. From May 1993 to September 1995 he was Senior Vice President and Chief Financial Officer of IBM Corporation, and served as a member of IBM's Board of Directors from January 1995 to August 1995. Mr. York is also a director of Tyco International Ltd. and Metro-Goldwyn-Mayer, Inc.

Role of the Board; Corporate Governance Matters

It is the paramount duty of the Board of Directors to oversee the Chief Executive Officer and other senior management in the competent and ethical operation of the Company on a day-to-day basis and to assure that the long-term interests of the shareholders are being served. To satisfy this duty, the directors take a proactive, focused approach to their position, and set standards to ensure that the Company is committed to business success through maintenance of the highest standards of responsibility and ethics.

Members of the Board bring to the Company a wide range of experience, knowledge and judgment. These varied skills mean that good governance depends on far more than a "check the box" approach to standards or procedures. The governance structure in the Company is designed to be a working structure for principled actions, effective decision-making and appropriate monitoring of both compliance and performance. The key practices and procedures of the Board are outlined in the Corporate Governance Guidelines available on the Company's website at www.apple.com/investor.

Board Committees

The Board has a standing Compensation Committee, a Nominating and Corporate Governance Committee ("*Nominating Committee*") and an Audit and Finance Committee ("*Audit Committee*").

The Compensation Committee is primarily responsible for reviewing the compensation arrangements for the Company's executive officers, including the Chief Executive Officer, and for administering the Company's stock option plans. Members of the Compensation Committee are Messrs. Campbell, Drexler and Gore.

The Nominating Committee assists the Board in identifying qualified individuals to become directors, determines the composition of the Board and its committees, monitors the process to assess Board effectiveness and helps develop and implement the Company's corporate governance guidelines. Members of the Nominating Committee are Messrs. Drexler and Gore and Dr. Levinson.

The Audit Committee is primarily responsible for overseeing the services performed by the Company's independent auditors and internal audit department, evaluating the Company's accounting policies and its system of internal controls and reviewing significant financial transactions. Members of the Audit Committee are Messrs. Campbell and York and Dr. Levinson.

The Audit, Compensation and Nominating Committees operate under written charters adopted by the Board. These charters are available on the Company's website at www.apple.com/investor.

Audit Committee Financial Expert

While more than one member of the Company's Audit Committee qualifies as an "audit committee financial expert" under Item 401(h) of Regulation S-K, Mr. Jerome B. York, the Committee chairperson, is the designated audit committee financial expert. Mr. York is considered "independent" as the term is used in Item 7(d)(3)(iv) of Schedule 14A under the Exchange Act.

Code of Ethics

The Company has a code of ethics that applies to all of the Company's employees, including its principal executive officer, principal financial officer, principal accounting officer and its Board of Directors. A copy of this code, "Ethics: The Way We Do Business Worldwide" is available on the Company's website at www.apple.com/investor. The Company intends to disclose any changes in or waivers from its code of ethics by posting such information on its website or by filing a Form 8-K.

Executive Officers

The following sets forth certain information regarding executive officers of the Company. Information pertaining to Mr. Jobs, who is both a director and an executive officer of the Company, may be found in the section entitled "**Directors**."

Timothy D. Cook, Executive Vice President, Worldwide Sales and Operations (age 44), joined the Company in February 1998. Prior to joining the Company, Mr. Cook held the position of Vice President, Corporate Materials for Compaq Computer Corporation ("*Compaq*"). Previous to his work at Compaq, Mr. Cook was the Chief Operating Officer of the Reseller Division at Intelligent Electronics. Mr. Cook also spent 12 years with IBM, most recently as Director of North American Fulfillment.

Nancy R. Heinen, Senior Vice President, General Counsel and Secretary (age 48), joined the Company in September 1997. Prior to joining the Company, Ms. Heinen held the position of Vice President, General Counsel and Secretary of the Board of Directors at NeXT from February 1994 until the acquisition of NeXT by the Company in February 1997.

Ronald B. Johnson, Senior Vice President, Retail (age 46), joined the Company in January 2000. Prior to joining the Company, Mr. Johnson spent 16 years with Target Stores, most recently as Senior Merchandising Executive.

Peter Oppenheimer, Senior Vice President and Chief Financial Officer (age 41), joined the Company in July 1996. Mr. Oppenheimer also served with the Company in the position of Vice President and Corporate Controller and as Senior Director of Finance for the Americas. Prior to joining the Company, Mr. Oppenheimer was CFO of one of the four business units for Automatic Data Processing, Inc. ("*ADP*"). Prior to joining ADP, Mr. Oppenheimer spent six years in the Information Technology Consulting Practice with Coopers and Lybrand.

Jonathan Rubinstein, Senior Vice President, iPod Division (age 48), joined the Company in February 1997. Mr. Rubinstein also served with the Company in the position of Senior Vice President, Hardware Engineering. Before joining the Company, Mr. Rubinstein was Executive Vice President and Chief Operating Officer of FirePower Systems Incorporated, from May 1993 to August 1996. Mr. Rubinstein also serves as a member of the Board of Directors of Immersion Corporation.

Philip W. Schiller, Senior Vice President, Worldwide Product Marketing (age 44), rejoined the Company in 1997. Prior to rejoining the Company, Mr. Schiller was Vice President of Product Marketing at Macromedia, Inc. from December 1995 to March 1997 and was Director of Product Marketing at FirePower Systems, Inc. from 1993 to December 1995. Prior to that, Mr. Schiller spent six years at the Company in various marketing positions.

Bertrand Serlet, Ph.D., Senior Vice President, Software Engineering (age 43), joined the Company in February 1997 upon the Company's acquisition of NeXT. At NeXT, Dr. Serlet held several engineering and managerial positions, including Director of Web Engineering. Prior to NeXT, from 1985 to 1989, Dr. Serlet worked as a research engineer at Xerox PARC.

Sina Tamaddon, Senior Vice President, Applications (age 47), joined the Company in September 1997. Mr. Tamaddon has also served with the Company in the position of Senior Vice President Worldwide Service and Support, and Vice President and General Manager, Newton Group. Before joining the Company, Mr. Tamaddon held the position of Vice President, Europe with NeXT from September 1996 through March 1997. From August 1994 to August 1996, Mr. Tamaddon held the position of Vice President, Professional Services with NeXT.

Avadis Tevanian, Jr., Ph.D., Senior Vice President, Chief Software Technology Officer (age 43), joined the Company in February 1997 upon the Company's acquisition of NeXT. Dr. Tevanian served with the Company in the position of Senior Vice President, Software Engineering from 1997 to July 2003. With NeXT, Dr. Tevanian held several positions, including Vice President, Engineering, from April 1995 to

February 1997. Prior to April 1995, Dr. Tevanian worked as an engineer with NeXT and held several management positions.

Item 11. Executive Compensation

Information Regarding Executive Compensation

The following table summarizes compensation information for the last three fiscal years for (i) Mr. Jobs, Chief Executive Officer and (ii) the four most highly compensated executive officers other than the Chief Executive Officer who were serving as executive officers of the Company at the end of the fiscal year (collectively, the "*Named Executive Officers*").

SUMMARY COMPENSATION TABLE

		Annual Compensation		Long-Term Compensation		
Name and Principal Position	Fiscal Year	Salary ($)	Bonus ($)	Restricted Stock Award ($)	Securities Underlying Options* (#)	All Other Compensation ($)
Steven P. Jobs	2004	1	—	—	—	—
Chief Executive Officer	2003	1	—	74,750,000(1)	—	—
	2002	1	2,268,698(2)	—	7,500,000(1)	1,302,795(2)
Timothy D. Cook	2004	602,632	—	7,650,000(3)	—	12,588(4)
Executive Vice President,	2003	617,673	—	—	—	9,929(4)
Worldwide Sales and Operations	2002	563,829	—	—	—	8,025(4)
Ronald B. Johnson	2004	484,836	1,500,000	6,375,000(3)	—	—
Senior Vice President, Retail	2003	452,404	1,500,000	—	—	—
	2002	452,404	—	—	300,000	—
Jonathan Rubinstein	2004	485,216	—	6,375,000(3)	—	12,300(4)
Senior Vice President, iPod	2003	452,939	—	—	—	11,986(4)
Division	2002	452,558	—	—	—	9,996(4)
Avadis Tevanian, Jr. Ph.D	2004	469,681	1,000	5,100,000(3)	—	12,338(4)
Senior Vice President, Chief	2003	456,731	—	—	—	11,962(4)
Software Technology Officer	2002	492,212	—	—	—	10,700(4)

(1) In March 2003, Mr. Jobs voluntarily cancelled all of his outstanding options, excluding those granted to him in his capacity as a director. In March 2003, the Board awarded Mr. Jobs five million restricted shares of the Company's Common Stock, that generally vest in full on the third anniversary of the grant date.

(2) In December 1999, Mr. Jobs was given a special executive bonus for past services as the Company's interim Chief Executive Officer, in the form of an aircraft with a total cost to the Company of approximately $90,000,000. In fiscal 2002, approximately $2.27 million paid by the Company towards the purchase of the plane and approximately $1.3 million in related tax assistance was reported as income to Mr. Jobs.

(3) Market value of restricted stock units granted on March 24, 2004 (based on $25.50 per share, the closing price of the Company's common stock on the NASDAQ National Market on the day of grant). Restricted stock units generally vest over four years with 50% of the total number of shares vesting on each of the second and fourth anniversary of the grant date.

(4) Consists of matching contributions made by the Company in accordance with the terms of the 401(k) plan.

Option Grants in Last Fiscal Year

There were no options granted to the Named Executive Officers during fiscal year 2004, although restricted stock units which are shown above in the Summary Compensation Table, were granted.

Options Exercised and Year-End Option Holdings

The following table provides information about stock option exercises by the Named Executive Officers during fiscal year 2004 and stock options held by each of them at fiscal year-end.

AGGREGATED OPTION EXERCISES IN THE LAST FISCAL YEAR AND FISCAL YEAR-END OPTION VALUES

			Number of Securities Underlying Unexercised Options at Fiscal Year-End (#)		Value of Unexercised In-the-Money Options at Fiscal Year-End ($) (1)	
Name	Shares Acquired on Exercise (#)	Value Realized ($)	Exercisable	Unexercisable	Exercisable	Unexercisable
Steven P. Jobs	—	—	60,000(2)	—	$ 1,547,400(2)	$ —
Timothy D. Cook	1,350,000	14,719,950	—	250,000	$ —	$ 5,119,375
Ronald B. Johnson	—	—	1,631,250	168,750	$ 7,359,188	$ 2,426,813
Jonathan J. Rubinstein	1,500,000	26,370,700	650,000	250,000	$ 12,985,375	$ 5,119,375
Avadis Tevanian, Jr.	350,000	8,828,328	1,800,000	250,000	$ 36,652,959	$ 5,119,375

(1) Market value of securities underlying in-the-money options at the end of fiscal year 2004 (based on $37.29 per share, the closing price of Common Stock on the NASDAQ National Market on September 24, 2004), minus the exercise price.

(2) Consists of 60,000 options granted to Mr. Jobs in his capacity as a director pursuant to the 1997 Director Stock Option Plan. In March 2003, Mr. Jobs voluntarily cancelled all of his outstanding options, excluding those granted to him in his capacity as a director.

Director Compensation

The form and amount of director compensation is determined by the Board after a review of recommendations made by the Nominating Committee. The current practice of the Board is to base a substantial portion of a director's annual retainer on equity. In 1998, shareholders approved the 1997 Director Stock Option Plan (the "*Director Plan*") and 800,000 shares were reserved for issuance thereunder. Pursuant to the Director Plan, the Company's non-employee directors are granted an option to acquire 30,000 shares of Common Stock upon their initial election to the Board ("*Initial Options*"). The Initial Options vest and become exercisable in three equal annual installments on each of the first through third anniversaries of the grant date. On the fourth anniversary of a non-employee director's initial election to the Board and on each subsequent anniversary thereafter, the director will be entitled to receive an option to acquire 10,000 shares of Common Stock ("*Annual Options*"). Annual Options are fully vested and immediately exercisable on their date of grant. As of the end of the fiscal year, there were options for 440,000 shares outstanding under the Director Plan. Since accepting the position of CEO, Mr. Jobs is no longer eligible for grants under the Director Plan. Non-employee directors also receive a $50,000 annual retainer paid in quarterly increments. In addition, directors receive up to two free computer systems per year and are eligible to purchase additional equipment at a discount. Directors do not receive any additional consideration for serving on committees or as committee chairperson.

Compensation Committee Interlocks and Insider Participation

The current members of the Compensation Committee are Messrs. William V. Campbell, Millard S. Drexler, and Albert Gore, Jr., none of whom are employees of the Company and all of whom are considered "independent" directors under the applicable NASDAQ rules. No person who was an employee of the Company in fiscal year 2004 served on the Compensation Committee. No executive officer of the Company (i) served as a member of the compensation committee (or other board committee performing similar functions or, in the absence of any such committee, the board of directors) of another entity, one of whose executive officers served on the Company's Compensation Committee, (ii) served as a director of another entity, one of whose executive officers served on the Company's Compensation Committee, or (iii) served as a member of the compensation committee (or other board committee performing similar functions or, in the absence of any such committee, the board of directors) of another entity, one of whose executive officers served as a director of the Company.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth certain information as of November 10, 2004 (the "*Table Date*") with respect to the beneficial ownership of the Company's Common Stock by (i) each person the Company believes beneficially holds more than 5% of the outstanding shares of Common Stock; (ii) each director; (iii) each Named Executive Officer listed in the Summary Compensation Table under the heading **"Executive Compensation;"** and (iv) all directors and executive officers as a group. On the Table Date, 401,476,094 shares of Common Stock were issued and outstanding. Unless otherwise indicated, all persons named as beneficial owners of Common Stock have sole voting power and sole investment power with respect to the shares indicated as beneficially owned. In addition, unless otherwise indicated, all persons named below can be reached at Apple Computer, Inc., 1 Infinite Loop, Cupertino, CA 95014.

Security Ownership of 5% Holders, Directors, Nominees and Executive Officers

Name of Beneficial Owner	Shares of Common Stock Beneficially Owned(1)	Percent of Common Stock Outstanding
Private Capital Management, Inc.	20,457,156(2)	5.10%
Steven P. Jobs	5,060,002(3)	1.26%
Fred D. Anderson	2,672	*
William V. Campbell	100,502(4)	*
Timothy D. Cook	5,903	*
Millard S. Drexler	100,000(5)	*
Albert Gore, Jr.	10,000(6)	*
Ronald B. Johnson	1,355,903(7)	*
Arthur D. Levinson	201,600(8)	*
Jonathan J. Rubinstein	161,087(9)	*
Avadis Tevanian, Jr.	1,501,252(10)	*
Jerome B. York	30,000(11)	*
All executive officers and directors as a group (16 persons)	10,203,443(12)	2.51%

(1) Represents shares of Common Stock held and/or options held by such individuals that were exercisable at the Table Date or within 60 days thereafter.

(2) Based on a Form 13-F showing holdings as of September 30, 2004 by Private Capital Management, Inc. Private Capital Management, Inc. lists its address as 8889 Pelican Bay Blvd., Naples, FL, 34108, in such filing.

(3) Includes 60,000 shares of Common Stock that Mr. Jobs has the right to acquire by exercise of stock options.

(4) Includes 100,000 shares of Common Stock that Mr. Campbell has the right to acquire by exercise of stock options.

(5) Includes 80,000 shares of Common Stock that Mr. Drexler has the right to acquire by exercise of stock options.

(6) Includes 10,000 shares of Common Stock that Mr. Gore has the right to acquire by exercise of stock options.

(7) Includes 1,350,000 shares of Common Stock that Mr. Johnson has the right to acquire by exercise of stock options.

(8) Includes 1,400 shares of Common Stock that Dr. Levinson holds indirectly and 40,000 shares of Common Stock that Dr. Levinson has the right to acquire by exercise of stock options.

(9) Includes 150,000 shares of Common Stock that Mr. Rubinstein has the right to acquire by exercise of stock options.

(10) Includes 1,500,000 shares of Common Stock that Dr. Tevanian has the right to acquire by exercise of stock options.

(11) Includes 10,000 shares of Common Stock that Mr. York has the right to acquire by exercise of stock options.

(12) Includes 4,956,148 shares of Common Stock that executive officers or directors have the right to acquire by exercise of stock options.

* Represents less than 1% of the issued and outstanding shares of Common Stock on the Table Date.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires the Company's officers and directors, and persons who own more than ten percent of a registered class of the Company's equity securities, to file reports of securities ownership and changes in such ownership with the Securities and Exchange Commission ("*SEC*"). Officers, directors and greater than ten percent shareholders also are required by rules promulgated by the SEC to furnish the Company with copies of all Section 16(a) forms they file.

Based solely upon a review of the copies of such forms furnished to the Company or written representations that no Forms 5 were required, the Company believes that all Section 16(a) filing requirements were met during fiscal year 2004.

Equity Compensation Plan Information

The following table sets forth certain information, as of September 25, 2004, concerning shares of common stock authorized for issuance under all of the Company's equity compensation plans.

	(a) Number of Securities to be Issued Upon Exercise of Options	(b) Weighted Average Exercise Price of Outstanding Options	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by shareholders	21,992,912	$ 22.32	14,072,423(1)
Equity compensation plans not approved by shareholders	33,286,253	$ 20.25	—
Total equity compensation plans(2)	55,279,165	$ 21.07	14,072,423

(1) This number includes 2,047,911 shares of common stock reserved for issuance under the Employee Stock Purchase Plan, 240,000 shares available for issuance under the 1997 Director Stock Option Plan and 14,299,512 shares available for issuance under the 2003 Employee Stock Plan. The grant of 2,515,000 shares of restricted stock units have been deducted from the number of shares available for future issuance. It does not include shares under the 1990 Stock Option Plan which was terminated in 1997. No new options can be granted under the 1990 Stock Option Plan.

(2) This table does not include 81,642 outstanding options assumed in connection with mergers and acquisitions of the companies which originally established those plans. These assumed options have a weighted average exercise price of $4.39 per share. No additional options may be granted under those assumed plans.

Arrangements with Named Executive Officers

Change In Control Arrangements—Stock Options, Restricted Stock, and Restricted Stock Units

In the event of a "change in control" of the Company, all outstanding options under the Company's stock option plans, except the Director Plan, will, unless otherwise determined by the plan administrator, become exercisable in full, and will be cashed out at an amount equal to the difference between the applicable "change in control price" and the exercise price. The Director Plan provides that upon a "change in control" of the Company, all unvested options held by non-employee directors will automatically become fully vested and exercisable and will be cashed out at an amount equal to the difference between the applicable "change in control price" and the exercise price of the options. A "change in control" under these plans is generally defined as (i) the acquisition by any person of 50% or more of the combined voting power of the Company's outstanding securities or (ii) the occurrence of a transaction requiring shareholder approval and involving the sale of all or substantially all of the assets of the Company or the merger of the Company with or into another corporation.

In addition, options, restricted stock grants, and restricted stock units granted to the Named Executive Officers generally provide that in the event there is a "change in control," as defined in the Company's stock option plans, and if in connection with or following such "change in control," their employment is terminated without "Cause" or if they should resign for "Good Reason," those options, restricted stock, and restricted stock units outstanding that are not yet vested as of the date of such "change in control" shall become fully vested. Further, restricted stock and restricted stock units granted to the Named Executive Officers also provide that, in the event the Company terminates the Officer without cause at any time, the restricted stock units and restricted stock will vest in full. Generally, "Cause" is defined to include a felony conviction, willful disclosure of confidential information or willful and continued failure to perform his or her employment duties. "Good Reason" includes resignation of employment as a result of a substantial diminution in position or duties, or an adverse change in title or reduction in annual base salary.

Item 13. Certain Relationships and Related Transactions

In connection with a relocation assistance package, the Company loaned Mr. Johnson (Senior Vice President, Retail) $1,500,000 for the purchase of his principal residence. The loan was secured by a deed of trust and was due and payable in May 2004. The largest amount of the indebtedness outstanding on this loan during fiscal year 2004 was $750,000. Mr. Johnson repaid the Company $750,000 during the fiscal year and the loan has been repaid in full.

In March 2002, the Company entered into a Reimbursement Agreement with its Chief Executive Officer, Mr. Steven P. Jobs, for the reimbursement of expenses incurred by Mr. Jobs in the operation of his private plane when used for Apple business. The Reimbursement Agreement is effective for expenses incurred by Mr. Jobs for Apple business purposes since he took delivery of the plane in May 2001. During 2004, the Company recognized a total of $483,000 in expenses pursuant to this reimbursement agreement related to expenses incurred by Mr. Jobs during 2004.

Item 14. Principal Accountant Fees and Services

The following table sets forth the fees paid to the Company's independent registered public accounting firm, KPMG LLP, during fiscal years 2004 and 2003.

Audit and Non-Audit Fees

		2004		2003
Audit Fees	$	3,402,300(1)	$	3,028,000
Audit-Related Fees		57,000(2)		144,600
Tax Fees		784,500(3)		1,017,100
All Other Fees		—		—
Total	$	4,243,800	$	4,189,700

(1) Audit fees relate to professional services rendered in connection with the audit of the Company's annual financial statements, quarterly review of financial statements included in the Company's Forms 10-Q, and audit services provided in connection with other statutory and regulatory filings.

(2) Audit-related fees include professional services related to the audit of the Company's financial statements, consultation on accounting standards or transactions, and audits of employee benefit plans.

(3) Tax fees include $667,600 for professional services rendered in connection with tax compliance and preparation relating to the Company's expatriate program, tax audits and international tax compliance; and $116,900 for tax consulting and planning services relating to interest computations and international tax changes. The Company does not engage KPMG to perform personal tax services for its executive officers.

Policy on Audit Committee Pre-Approval of Audit and Non-Audit Services Performed by the Independent Registered Public Accounting Firm

Prior to the enactment of the Sarbanes-Oxley Act of 2002 (the "*Act*"), the Company adopted an auditor independence policy that banned its auditors from performing non-financial consulting services, such as information technology consulting and internal audit services. This auditor policy also mandates that the audit and non-audit services and the related budget be approved by the Audit Committee in advance, and that the Audit Committee be provided with quarterly reporting on actual spending. This policy also mandates that no auditor engagements for non-audit services may be entered into without the express approval of the Audit Committee.

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) Index to Exhibits

Exhibit Number	Exhibit Description	Incorporated by Reference Form	Filing Date/ Period End Date	Filed herewith
3.1	Restated Articles of Incorporation, filed with the Secretary of State of the State of California on January 27, 1988.	S-3	7/27/88	
3.2	Amendment to Restated Articles of Incorporation, filed with the Secretary of State of the State of California on May 4, 2000.	10-Q	5/11/00	
3.3	By-Laws of the Company, as amended through June 7, 2004.	10-Q	6/26/04	
4.2	Indenture dated as of February 1, 1994, between the Company and Morgan Guaranty Trust Company of New York.	10-Q	4/01/94	
4.3	Supplemental Indenture dated as of February 1, 1994, among the Company, Morgan Guaranty Trust Company of New York, as resigning trustee, and Citibank, N.A., as successor trustee.	10-Q	4/01/94	
4.5	Form of the Company's $6^1/2$% Notes due 2004.	10-Q	4/01/94	
4.8	Registration Rights Agreement, dated June 7, 1996 among the Company and Goldman, Sachs & Co. and Morgan Stanley & Co. Incorporated.	S-3	8/28/96	
4.9	Certificate of Determination of Preferences of Series A Non-Voting Convertible Preferred Stock of Apple Computer, Inc.	10-K	9/26/97	
10.A.3	Apple Computer, Inc. Savings and Investment Plan, as amended and restated effective as of October 1, 1990.	10-K	9/27/91	
10.A.3-1	Amendment of Apple Computer, Inc. Savings and Investment Plan dated March 1, 1992.	10-K	9/25/92	
10.A.3-2	Amendment No. 2 to the Apple Computer, Inc. Savings and Investment Plan.	10-Q	3/28/97	
10.A.5	1990 Stock Option Plan, as amended through November 5, 1997.	10-Q	12/26/97	
10.A.6	Apple Computer, Inc. Employee Stock Purchase Plan, as amended through April 24, 2003.	S-8	6/24/03	
10.A.8	Form of Indemnification Agreement between the Registrant and each officer of the Registrant.	10-K	9/26/97	
10.A.43	NeXT Computer, Inc. 1990 Stock Option Plan, as amended.	S-8	3/21/97	

10.A.49	1997 Employee Stock Option Plan, as amended through October 19, 2001.	10-K	9/28/02	
10.A.50	1997 Director Stock Option Plan.	10-Q	3/27/98	
10.A.51	2003 Employee Stock Option Plan, as amended through April 24, 2003.	10-Q	6/28/03	
10.A.52	Reimbursement Agreement dated as of May 25, 2001 by and between the Registrant and Steven P. Jobs.	10-Q	6/29/02	
10.A.53	Option Cancellation and Restricted Stock Award Agreement dated as of March 19, 2003 by and between The Registrant and Steven P. Jobs.	10-Q	6/28/03	
10.A.54	Form of Restricted Stock Unit Award Agreement	10-Q	3/27/04	
10.B.18	Custom Sales Agreement effective October 21, 2002 between the Registrant and International Business Machines Corporation.	10-K	9/27/03	
14.1	Code of Ethics of the Company	10-K	9/27/03	
21	Subsidiaries of Apple Computer, Inc.			X
23.1	Consent of Independent Registered Public Accounting Firm			X
31.1	Rule13a-14(a)/15d-14(a) Certification of Chief Executive Officer			X
31.2	Rule13a-14(a)/15d-14(a) Certification of Chief Financial Officer			X
32.1	Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer			X

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, this 30th day of November 2004.

APPLE COMPUTER, INC.
By: /s/ PETER OPPENHEIMER

Peter Oppenheimer
Senior Vice President and
Chief Financial Officer

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Steven P. Jobs and Peter Oppenheimer, jointly and severally, his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this Annual Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Name	Title	Date
/s/ STEVEN P. JOBS STEVEN P. JOBS	Chief Executive Officer and Director (Principal Executive Officer)	November 30, 2004
/s/ PETER OPPENHEIMER PETER OPPENHEIMER	Senior Vice President and Chief Financial Officer (Principal Financial and Principal Accounting Officer)	November 30, 2004
/s/ FRED ANDERSON FRED ANDERSON	Director	November 30, 2004
/s/ WILLIAM V. CAMPBELL WILLIAM V. CAMPBELL	Director	November 30, 2004
/s/ MILLARD S. DREXLER MILLARD S. DREXLER	Director	November 30, 2004
/s/ ALBERT GORE, JR. ALBERT GORE, JR.	Director	November 30, 2004
/s/ ARTHUR D. LEVINSON ARTHUR D. LEVINSON	Director	November 30, 2004
/s/ JEROME B. YORK JEROME B. YORK	Director	November 30, 2004

QuickLinks

EXHIBIT 4

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended September 24, 2005

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _______________ to _______________

Commission file number 0-10030

APPLE COMPUTER, INC.

(Exact name of registrant as specified in its charter)

CALIFORNIA	**942404110**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1 Infinite Loop Cupertino, California	**95014**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **(408) 996-1010**

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, no par value
(Titles of classes)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ☒ No ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

The aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant, as of March 26, 2005, was approximately $29,434,521,480 based upon the closing price reported for such date on the NASDAQ National Market. For purposes of this disclosure, shares of Common Stock held by persons who hold more than 5% of the outstanding shares of Common Stock and shares held by executive officers and directors of the registrant have been excluded because such persons may be deemed to be affiliates. This determination of executive officer or affiliate status is not necessarily a conclusive determination for other purposes.

842,767,948 shares of Common Stock Issued and Outstanding as of November 18, 2005

PART I

The Business section and other parts of this Annual Report on Form 10-K ("Form 10-K") contain forward-looking statements that involve risks and uncertainties. Many of the forward-looking statements are located in "Management's Discussion and Analysis of Financial Condition and Results of Operations." Forward-looking statements can also be identified by words such as "anticipates," "expects," "believes," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and the Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Factors That May Affect Future Results and Financial Condition" under Part II, Item 7 of this Form 10-K. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Item 1. Business

Company Background
Apple Computer, Inc. ("Apple" or the "Company") was incorporated under the laws of the State of California on January 3, 1977. The Company designs, manufactures, and markets personal computers and related software, services, peripherals, and networking solutions. The Company also designs, develops, and markets a line of portable digital music players along with related accessories and services including the online distribution of third-party music, audio books, music videos, short films, and television shows. The Company's products and services include the Macintosh line of desktop and notebook computers, the iPod digital music player, the Xserve G5 server and Xserve RAID storage products, a portfolio of consumer and professional software applications, the Mac OS X operating system, the iTunes Music Store, a portfolio of peripherals that support and enhance the Macintosh and iPod product lines, and a variety of other service and support offerings. The Company sells its products worldwide through its online stores, its own retail stores, its direct sales force, and third-party wholesalers, resellers, and value added resellers. The Company also sells a variety of third-party products that are compatible with the Company's Macintosh and iPod product lines, including computer printers and printing supplies, storage devices, computer memory, digital camcorders and still cameras, personal digital assistants, iPod accessories, and various other computing products and supplies through its online and retail stores. The Company's fiscal year ends on the last Saturday of September. Unless otherwise stated, all information presented in this Form 10-K is based on the Company's fiscal calendar.

Business Strategy
The Company is committed to bringing the best personal computing and music experience to students, educators, creative professionals, businesses, government agencies, and consumers through its innovative hardware, software, peripherals, services, and Internet offerings. The Company's business strategy leverages its unique ability, through the design and development of its own operating system, hardware, and many software applications and technologies, to bring to its customers new products and solutions with superior ease-of-use, seamless integration, and innovative industrial design. The Company believes continual investment in research and development is critical to facilitate innovation of new and improved products and technologies. Besides updates to its existing line of personal computers and related software, services, peripherals, and networking solutions, the Company continues to capitalize on the convergence of digital consumer electronics and the computer by creating innovations like the iPod and iTunes Music Store. The Company's strategy also includes expanding its distribution network to effectively reach more of its targeted customers and provide them a high-quality sales and after-sales support experience.

Digital Hub
The Company believes personal computing is in an era in which the personal computer functions for both professionals and consumers as the digital hub for advanced new digital devices such as the Company's

iPod digital music players, personal digital assistants, cellular phones, digital camcorders and still cameras, CD and DVD players, televisions, and other consumer electronic devices. The attributes of the personal computer include a high quality user interface, relatively inexpensive data storage, and the ability to run complex applications and easily connect to the Internet. Apple is the only company in the personal computer industry that controls the design and development of the entire personal computer—from the hardware and operating system to sophisticated applications. Additionally, the Company's products provide innovative industrial design, intuitive ease-of-use, and built-in networking, graphics and multimedia capabilities. Thus, the Company is uniquely positioned to offer integrated digital hub products and solutions.

The Company develops products and technologies that adhere to many industry standards in order to provide an optimized user experience through interoperability with peripherals and devices from other companies. The Company has played a role in the development, enhancement, promotion, and/or use of numerous of these industry standards.

Expanded Distribution
The Company believes that a high quality buying experience with knowledgeable salespersons who can convey the value of the Company's products and services is critical to attracting and retaining customers. The Company sells many of its products and resells certain third-party products in most of its major markets directly to consumers, education customers, and businesses through its retail and online stores in the U.S. and internationally. The Company has also invested in programs to enhance reseller sales, including the Apple Sales Consultant Program, which consists of the deployment of Apple employees and contractors to selected third-party reseller locations. The Company believes providing direct contact with its targeted customers is an efficient way to demonstrate the advantages of its Macintosh computer and other products over those of its competitors. The Company has significantly increased the points of distribution for the iPod product family in order to make its products available at locations where its customers shop.

From inception of the retail initiative in 2001 through 2005, the Company had opened 116 retail stores in the U.S. and 8 international stores in Canada, Japan, and the U.K. The Company opened 2 additional stores in October 2005. The Company has typically located its stores at high traffic locations in quality shopping malls and urban shopping districts.

One of the goals of the retail initiative is to bring new customers to the Company and expand its installed base through sales to computer users who currently do not own a Macintosh computer and first time personal computer buyers. By operating its own stores and building them in desirable high traffic locations, the Company is able to better control the customer retail experience and attract new customers. The stores are designed to simplify and enhance the presentation and marketing of personal computing products. To that end, retail store configurations have evolved into various sizes in order to accommodate market demands. The stores employ experienced and knowledgeable personnel who provide product advice and certain hardware support services. The stores offer a wide selection of third-party hardware, software, and various other computing products and supplies selected to complement the Company's own products. Additionally, the stores provide a forum in which the Company is able to present computing solutions to users in areas such as digital photography, digital video, music, children's software, and home and small business computing.

Education
For more than 25 years, the Company has focused on the use of technology in education and has been committed to delivering tools to help educators teach and students learn. The Company believes effective integration of technology into classroom instruction can result in higher levels of student achievement, especially when used to support collaboration, information access, and the expression and representation

of student thought and ideas. The Company creates solutions that enable new modes of curriculum delivery, better ways of conducting research, and opportunities for professional development of faculty, students, and staff. The Company has designed a range of products and services to help schools maximize their investments in technology. This is manifested in many of the Company's products and services that are designed to meet the needs of education customers. These products and services include the eMac™, iMac™, and the iBook®, video creation and editing solutions, wireless networking, student information systems, high-quality curriculum and professional development solutions, and one-to-one (1:1) learning solutions (primarily in K-12). 1:1 learning solutions typically consist of iBook portable computers for every student and teacher along with a wireless network connected to a central server.

Creative Professionals
Creative professionals constitute one of the Company's most important markets for both hardware and software products. This market is also important to many third-party developers who provide Macintosh-compatible hardware and software solutions. Creative customers utilize the Company's products for a variety of creative activities including digital video and film production and editing; digital video and film special effects, compositing, and titling; digital still photography and workflow management; graphic design, publishing, and print production; music creation and production; audio production and sound design; and web design, development, and administration.

The Company designs its high-end hardware solutions, including servers, desktops, and portable Macintosh systems, to incorporate the power, expandability, and features desired by creative professionals. The Company's operating system, Mac OS X, incorporates powerful graphics and audio technologies and features developer tools to optimize system and application performance when running powerful creative solutions provided by the Company or third-party developers. The Company also offers various software solutions to meet the needs of its creative customers.

Business Organization
The Company manages its business primarily on a geographic basis. The Company's reportable operating segments are comprised of the Americas, Europe, Japan, and Retail. The Americas, Europe, and Japan reportable segments do not include activities related to the Retail segment. The Americas segment includes both North and South America. The Europe segment includes European countries as well as the Middle East and Africa. The Retail segment currently operates Apple-owned retail stores in the U.S., Canada, Japan, and the U.K. Other operating segments include Asia-Pacific, which includes Australia and Asia except for Japan, and the Company's subsidiary, FileMaker, Inc. Each reportable geographic operating segment provides similar hardware and software products and similar services. Further information regarding the Company's operating segments may be found in Part II, Item 7 of this Form 10-K under the heading "Segment Operating Performance," and in Part II, Item 8 of this Form 10-K in the Notes to Consolidated Financial Statements at Note 11, "Segment Information and Geographic Data."

Hardware Products
The Company offers a range of personal computing products including desktop and notebook computers, server and storage products, related devices and peripherals, and various third-party hardware products. The Company's entire line of Macintosh® systems, excluding servers and storage systems, features the Company's Mac OS® X Version 10.4 Tiger™ and iLife® suite of software for digital photography, music, movies, and music creation.

Macintosh® Computers
In June 2005, the Company announced its plan to begin using Intel microprocessors in its Macintosh computers. The Company plans to begin shipping certain models with Intel microprocessors by June 2006

and to complete the transition of all of its Macintosh computers to Intel microprocessors by the end of calendar year 2007. The Company also announced its new translation technology, Rosetta™, which will allow most PowerPC-based Macintosh applications to run on new Intel-based Macintosh computers. There are potential risks and uncertainties associated with this transition, which are further discussed in Part II, Item 7 of this 10-K under the heading "Factors That May Affect Future Results and Financial Condition."

Power Mac®

The Power Mac line of desktop personal computers is targeted at business and professional users and is designed to meet the speed, expansion, and networking needs of the most demanding Macintosh user. Powered by the PowerPC G5 processor, the Power Mac G5 utilizes 64-bit processing technology for memory expansion up to 16GB and advanced 64-bit computation while also running existing 32-bit applications natively. In October 2005, the Company updated the Power Mac G5 product line, which now comes in three processor configurations—dual 2.0GHz, dual 2.3GHz, and a quad 2.5GHz that features two 2.5GHz dual processors. All Power Mac G5 desktops feature a SuperDrive™ and a NVIDIA GeForce 6600 graphics card. In addition, all Power Mac G5 desktops deliver connectivity and high-performance input/output (I/O), including dual Gigabit Ethernet, FireWire® 800 and FireWire 400 ports, USB 2.0 ports, optical digital I/O, PCI Express expansion, and optional AirPort® Extreme wireless networking and Bluetooth connectivity. The new Power Mac G5 product line also includes Mighty Mouse, the Company's next generation mouse, featuring up to four programmable buttons and a Scroll Ball that lets users scroll vertically, horizontally, and diagonally.

Xserve® and Xserve RAID Storage System

Xserve is a rack-mount server product designed for simple setup and remote management of intensive I/O applications such as digital video, high-resolution digital imagery, and large databases. In January 2005, the Company upgraded Xserve G5, which is now available with either a single 2.0GHz or dual 2.3GHz PowerPC G5 processor. Xserve G5 includes a system controller with up to 16GB of PC3200 error correcting code memory; three hot-plug Serial ATA drive modules that deliver up to 1.5TB of storage; and dual on-board Gigabit Ethernet for high-performance networking. The Company's Xserve RAID storage system was updated in September 2005 to deliver up to 7 terabytes of storage capacity and also expanded support for heterogeneous environments. The dual independent RAID controllers with 512MB cache per controller offer sustained throughput of over 385 Mbps—high enough to support media production environments using protected RAID level 5.

iMac®

The iMac line of desktop computers is targeted at consumer and education markets. In October 2005, the Company introduced the new iMac G5, featuring the PowerPC G5 processor, a built-in iSight™ video camera, and a design that integrates the entire computer into either a 17-inch or 20-inch widescreen LCD flat-panel display. The 17-inch and 20-inch models come with 1.9GHz and 2.1GHz PowerPC G5 Processors, respectively. The iMac G5 offers 512MB of 533MHz DDR2 memory expandable to 2.5GB and 7200 rpm Serial ATA drives expandable up to 500GB. The iMac G5 comes standard with ATI Radeon X600 Pro or XT graphics, video memory, a SuperDrive, built-in Airport Extreme wireless networking, an internal Bluetooth module, built-in stereo speakers and microphone, and Mighty Mouse. The iMac G5 also offers built-in Ethernet (10/100/1000BASE-T), three USB 2.0 and two FireWire 400 ports. The iMac G5 also features Front Row media experience with the Apple Remote, which allows users to play music and view photos and videos via a remote control.

eMac™

The eMac, a desktop personal computer targeted at the Company's education customers, features a PowerPC G4 processor, a high resolution 17-inch flat cathode ray tube display, and preserves the all-in-one compact design of the original iMac. The eMac offers PowerPC G4 processors running at up to 1.42GHz, 333MHz DDR memory, an optional SuperDrive, built-in modem and Ethernet (10/100BASE-T), ATI Radeon graphics, AirPort Extreme-ready, and USB 2.0 and 1.1 ports for connectivity to peripherals.

Mac® mini
In January 2005, the Company introduced Mac mini, a desktop personal computer with a starting price of $499 and weighing as little as 2.9 pounds. In July 2005, the Company updated its Mac mini lineup, expanding to three models and increasing memory to 512MB. The first model includes a 1.25GHz PowerPC G4 processor, a 40GB hard drive, and a Combo drive. The second model includes a 1.42GHz PowerPC G4 processor, an 80GB hard drive, and a Combo drive. The third model includes a 1.42GHz PowerPC G4 processor, an 80GB hard drive, and a SuperDrive. All models include ATI Radeon 9200 graphics with 32MB of dedicated DDR memory, built-in Ethernet (10/100 BASE-T), one FireWire 400 and two USB 2.0 ports, and a DVI interface that also supports VGA so consumers can connect to LCD or CRT displays. The 1.42GHz models of the Mac mini also include built-in AirPort Extreme for 54 Mbps 802.11g wireless networking along with an internal Bluetooth module.

PowerBook®
The PowerBook family of portable computers is designed to meet the mobile computing needs of professionals and advanced consumer users. In October 2005, the Company updated its PowerBook G4 notebooks with extended battery life as well as higher resolution displays, including 1440 by 960 pixels in the 15-inch model and 1680 by 1050 pixels in the 17-inch model. Both the 15-inch and 17-inch PowerBook G4 offer a 1.67GHz PowerPC G4 processor and the ATI Mobility Radeon 9700 graphics processor. The 12-inch PowerBook G4 features a 1.5GHz PowerPC processor, and the NVIDIA GeForce FX Go5200 graphics processor. Every PowerBook G4 notebook comes with a SuperDrive, 512MB of DDR memory, built-in AirPort Extreme wireless networking, an internal Bluetooth module for wireless connectivity, as well as a full complement of I/O ports including FireWire 400, USB 2.0, and a built-in 56K V.92 modem and Ethernet (10/100BASE-T), for connectivity to a wide range of peripherals. The 15-inch and 17-inch PowerBook G4 models also include built-in Gigabit Ethernet and FireWire 800.

iBook®
The iBook is designed to meet the portable computing needs of education and consumer users. In July 2005, the Company upgraded its iBook® G4 line to include faster PowerPC G4 processors running up to 1.42GHz, built-in AirPort Extreme 54 Mpbs 802.11g wireless networking and an available slot-load SuperDrive. The 12-inch model features a 1.33GHz PowerPC G4 processor and a slot-load Combo drive, while the 14-inch model includes a 1.42GHz G4 processor and a SuperDrive. All iBook G4 models offer a full complement of I/O ports including FireWire 400, USB 2.0, a built-in 56K V.92 modem and Ethernet (10/100BASE-T), as well as a built-in internal wireless Bluetooth module, for connectivity to a wide range of peripherals.

Music Products and Services
The Company offers its iPod® line of digital music players and related accessories to Macintosh and Windows users. The Company also provides an online service to distribute third-party music, audio books, music videos, short films, and television shows through its iTunes Music Store®.

iPod®
The iPod is the Company's portable digital music player, featuring the Company's patent pending Click Wheel, which combines a touch-sensitive wheel with five push buttons for one-handed navigation. In October 2005, the Company introduced the new iPod containing a 2.5-inch color screen that can display album artwork and photos and play video including music videos, video podcasts, home movies, short films, and television shows. The iPod lineup includes a 30GB model holding up to 7,500 songs, 25,000 photos, or

75 hours of video, and a 60GB model holding up to 15,000 songs, 25,000 photos, or 150 hours of video. The iPod features the Company's patent pending Auto-Sync technology that automatically downloads digital music, podcasts, photos, audio books, home movies, music videos, short films, and television shows onto the iPod and keeps it up-to-date whenever it is plugged into a Macintosh or Windows computer using USB. The iPod also features Shuffle Songs, which randomly plays songs in a selected playlist or across the entire library. All iPods work with the Company's iTunes® digital music management software on either a Macintosh or Windows computer.

The iPod's functionality extends beyond playing music, listening to audio books, and watching music videos, short films, home movies, and television shows. Other key capabilities include data storage, calendar and contact information utility, and a selection of games. With the addition of third-party iPod peripherals, the capabilities of certain iPods can be enhanced to include photo downloading directly from certain digital cameras. The Company has also entered into alliances with many automobile manufacturers to offer seamless integration of the iPod in certain automobiles. Along with the iPod, the Company has developed the iTunes software and the iTunes Music Store, a service that consumers may use to purchase third-party music, audio books, music videos, short films, and television shows over the Internet.

iPod® nano

In September 2005, the Company introduced iPod nano, a flash-memory based digital music player. The iPod nano is available in either a 2GB model holding up to 500 songs or 25,000 photos, or a 4GB model holding up to 1,000 songs or 25,000 photos. The iPod nano, which weighs as little as 1.5 ounces and is .27 inches thin, features a color screen and the Company's patent pending Click Wheel.

iPod® shuffle

In January 2005, the Company introduced iPod shuffle, a flash-memory based digital music player, which is based on iPod's shuffle feature that randomly selects songs from the user's music library or playlists. iPod shuffle works with iTunes and its patent-pending AutoFill feature that automatically selects songs to fill iPod shuffle from a user's music library on their computer. iPod shuffle can also be used as a portable USB flash drive with up to 1GB of storage space. It is available in a 512MB model holding up to 120 songs and a 1GB model holding up to 240 songs.

iTunes Music Store®

The Company's iTunes Music Store, available for both Windows-based and Macintosh computers, is a service that allows customers to find, purchase, and download third-party digital music, audio books, music videos, short films, and television shows. The iTunes Music Store also offers Podcast Directory that allows users to search for and download audio programs to their computer and automatically receive new episodes over the Internet. Users can search the contents of the store catalog to locate works by title, artist, or album, or browse the entire contents of the store by genre and artist. Users can also listen to a free 30-second preview of content available through the store. The iTunes Music Store was originally introduced in the U.S. in April 2003 and now serves customers in 21 countries.

The iTunes Music Store is fully integrated directly into the iTunes software allowing customers to preview, purchase, download, organize, share, and transfer digital content to an iPod using a single software application. Further discussion on the iTunes software may be found below under the heading "Software Products and Computer Technologies." The iTunes Music Store offers customers a broad range of personal rights to the third-party content they have purchased. Content purchased through the store may also be used in certain applications such as iPhoto®, iMovie®, and iDVD®. Additional features of the iTunes Music Store include gift certificates that can be sent via e-mail; prepaid gift cards; an "allowance" feature that enables users to automatically deposit funds into an iTunes Music Store account every month; online gift options that let customers give specific songs, albums, music videos, or their own playlists to anyone with an email address; parental controls; and album reviews.

Peripheral Products
The Company sells various Apple-branded computer hardware peripherals, including iSight™ digital video cameras and a range of high quality flat panel TFT active-matrix digital color displays. The Company also sells a variety of third-party Macintosh compatible hardware products directly to end users through both its retail and online stores, including computer printers and printing supplies, storage devices, computer memory, digital video and still cameras, personal digital assistants, and various other computing products and supplies.

iSight™
The Company's iSight digital video camera enables video conferencing over broadband connections. iSight is a small, portable aluminum alloy camera with all audio, video, and power provided by a single FireWire cable. iSight is designed to be center-mounted on the top of a computer screen and uses its integrated tilt and rotate mechanism to easily position the camera for natural, face-to-face video conferencing. iSight features an auto focusing auto exposure F/2.8 lens that captures high-quality pictures and full-motion video. With its on-board processor, iSight automatically adjusts color, white balance, sharpness and contrast to provide high-quality images with accurate color reproduction in most lighting conditions. iSight also includes a dual-element microphone that suppresses ambient noise for clear digital audio.

Displays
The Company offers a family of widescreen flat panel displays featuring the 30-inch Apple Cinema HD Display™, a widescreen active-matrix LCD with 2560-by-1600 pixel resolution, a 23-inch widescreen Apple Cinema Display with 1920-by-1200 pixel resolution and a 20-inch widescreen Apple Cinema Display® with 1680-by-1050 pixel resolution. The displays feature dual FireWire and dual USB 2.0 ports built into the display and use the industry standard DVI interface for a pure digital connection with the Company's latest Power Mac and PowerBook systems. The Cinema Displays feature an aluminum design with a very thin bezel, suspended by an aluminum stand that allows viewing angle adjustment.

Software Products and Computer Technologies
The Company offers a range of software products for education, creative, consumer and business customers, including Mac OS X, the Company's proprietary operating system software for the Macintosh; server software and related solutions; professional application software; and consumer, education and business oriented application software.

Operating System Software
In April 2005, the Company began shipping Mac OS X Tiger, the Company's fifth major version of Mac OS X. Tiger incorporates more than 200 new features and innovations including Spotlight™, a desktop search technology that lets users find items stored on their Macintosh computers, including documents, emails, contacts and images; and Dashboard, a new way to instantly access information such as weather forecasts and stock quotes, using a new class of mini-applications called widgets. The server version of the Mac OS operating system, Mac OS X Server version 10.4, also began shipping in April 2005.

Server Software and Server Solutions
Apple Remote Desktop™ 2 is the second generation of the Company's asset management, software distribution, and help desk support software. Apple Remote Desktop 2 includes more than 50 features for centrally managing Mac OS X systems. Apple Remote Desktop 2 can perform a wide range of desktop management tasks such as installing operating system and application software, running hardware and software inventory reports, and executing commands on one or more remote Mac OS X systems on the network. Remote software installation tools allow IT professionals to install single or multiple software packages immediately or at specific dates and times. Comprehensive hardware and software reports based on more than 200 system information attributes allow administrators to keep track of their Mac OS X

systems. In addition, built-in real-time screen sharing enables help desk professionals to provide online assistance by observing and controlling the desktops of any remote Macintosh or Virtual Network Computing-enabled computer, including Windows and Linux systems.

Xsan®, the Company's enterprise-class Storage Area Network (SAN) file system, began shipping in January 2005. Xsan is a 64-bit cluster file system for Mac OS X that enables organizations to consolidate storage resources and provide multiple computers with concurrent file-level read/write access to shared volumes over Fibre Channel. Advanced features such as metadata controller failover and Fibre Channel multipathing ensure high availability; file-level locking allows multiple systems to read and write concurrently to the same volume which is ideal for complex workflows; bandwidth reservation provides for effective ingestion of bandwidth-intensive data streams, such as high resolution video; and flexible volume management results in more efficient use of storage resources. Since Xsan is interoperable with ADIC's StorNext File System, it can be used in heterogeneous environments that include Windows, UNIX, and Linux server operating system platforms.

Professional Application Software

In April 2005, the Company announced Final Cut Studio™, a High Definition (HD) video production suite that features Final Cut Pro® 5, the Company's editing software for Digital Video (DV), Standard Definition (SD), HD, and film. Final Cut Studio also includes tools that complement Final Cut Pro 5 such as Soundtrack® Pro, a new application that gives audio and video professionals a way to create, control and repair audio; Motion 2, an application that allows real-time motion graphics design; and DVD Studio Pro® 4, DVD authoring software that burns DVDs, including high definition DVDs to the latest HD DVD specification. These components of Final Cut Studio are also sold separately.

Final Cut Pro® 5, the latest version of the Company's video editing software, which began shipping in April 2005, includes editing tools that work with most formats, from DV and native High Definition Video (HDV) to fully uncompressed HD. Final Cut Pro 5 acquires HDV media via FireWire and keeps it in the original format, transferring it into the system without any generation loss. With a real-time multi-stream effects architecture, multicam editing tools, and advanced color correction, Final Cut Pro 5 enables users to view and cut from multiple sources in real time, group up to 128 sources together into multi-clips, then add or subtract cameras at any time. Final Cut Pro 5 allows users to use external audio control surfaces to mix and record multiple fader automations simultaneously.

Soundtrack® Pro is a new audio editing and sound design application that gives audio and video professionals a way to create, control, and repair audio. Soundtrack Pro features a waveform editor with flexible Action Layers that allow users to re-order, bypass, or change any edit, effect, or process. Find-and-Fix features identify and repair common audio problems such as background noise, pops, clicks, and hum. An integrated multitrack mixer allows editors to apply common effects to multiple tracks and group common tracks using busses. Soundtrack Pro also features over 50 professional plug-ins for creating sounds, over 5,000 loops, an integrated mixer, and integration with Final Cut Studio.

Motion 2 is a real-time motion graphics software that enables Final Cut Pro editors to add motion graphics to their projects. Motion 2 features interactive animation of text and graphics for DVD motion menus, video or film in real time, and quick output rendering by built-in GPU acceleration at 8-bit, 16-bit, or 32-bit float film quality. With Motion 2's new design tool, Replicator, users can automatically generate and animate multiple copies of a graphic, shape, or movie.

DVD Studio Pro® 4 is the latest version of the Company's professional DVD authoring application. With DVD Studio Pro 4 and its integrated, scalable H.264 encoding, users can author SD or HD DVDs. DVD Studio Pro 4 allows users to preview HD content in real time with a second Digital Cinema Desktop and audition surround sound using S/PDIF (digital audio) out to an external DTS or Dolby Digital (AC-3) decoder. Its interactive graphical view also enables users to edit/display menus, tracks, slideshows, scripts, and stories of a DVD project in a storyboard layout. DVD Studio Pro 4 includes Compressor 2, a full-featured video and audio compression application. Compressor gives users control over encoding, including the ability to encode several clips in one batch operation to a wide variety of formats and perform advanced format conversions at the same time.

In April 2005, the Company announced Shake® 4, an upgrade to the Company's compositing software, which began shipping in June 2005. Used to create visual effects for film and television, Shake 4 features 3D multi-plane compositing, optical flow image processing and integration with Final Cut Pro 5. Users can composite live action and 3D CGI layers with added realism using OpenGL accelerated 3D multi-plane compositing node. Other features include advanced optical flow technology that uses pixel-by-pixel image analysis to create smooth retiming and automatic stabilization. Shake 4 also integrates Truelight monitor calibration to maintain color consistency between the computer screen and the final look on film.

Logic® Pro 7 is used by musicians around the world and by professionals in music production and film scoring. It combines digital music composition, notation, and audio production facilities in one comprehensive product and includes software instruments such as Sculpture, a component-modeling based synthesizer; UltraBeat™, a drum synthesizer with built-in step sequencer; and digital signal processing (DSP) plug-ins including Guitar Amp Pro, a full-featured guitar amplifier simulator. Along with workflow enhancements, mastering plug-ins, and support for Apple Loops, Logic Pro 7 adds distributed audio processing, a technology that allows professionals to utilize multiple Macintosh systems to expand available DSP power via an Ethernet network.

In October 2005, the Company announced Aperture™, began shipping in November 2005. Aperture is an application designed to provide professional photographers with post-production tools to manage, edit, and publish digital pictures. Features include compare and select tools, nondestructive image processing, color managed printing, and custom web and book publishing. Compare and select tools in Aperture allow photographers to sift through photo projects and identify their final selections. RAW images are maintained natively throughout Aperture without any intermediate conversion process, and can be retouched using a suite of adjustment tools designed especially for photographers. Print options include customizable contact sheets, high-quality local printing, and color-managed online prints. Aperture also provides a layout environment where photographers can create and order custom books and publish web galleries.

Consumer, Education and Business Oriented Application Software
iLife® '05
In January 2005, the Company introduced iLife '05, an upgrade to its digital lifestyle suite, which features iPhoto®, iMovie®, iDVD®, GarageBand™, and iTunes®.

> iPhoto® 5 is the Company's consumer-oriented digital photo software application. iPhoto 5 includes advanced editing tools, adds support for uncompressed RAW photos, and includes a slideshow builder allowing users to apply effects, transitions and durations to each individual slide. iPhoto 5 allows users to create and order hardcover and softcover photo books using a variety of book layouts with double-sided printing, directly within the application.
>
> iMovie® HD, a consumer-oriented digital video editing software application, enables users to import HDV from HDV camcorders and edit digital videos on their Macintosh computers. iMovie HD also includes Magic iMovie, which automatically imports video into separate clips and adds titles, transitions and music. iMovie HD imports video from HDV and standard DV camcorders, and from video cameras that generate MPEG-4 video.

iDVD® is a consumer-oriented software application that enables users to turn iMovie files, QuickTime® files, and digital pictures into DVDs that can be played on most consumer DVD players. iDVD 5 includes 15 new themes featuring moving drop zones that can display video clips or photos in motion across DVD menus. iDVD 5 also features OneStep DVD, which automatically creates a DVD from footage directly from a user's camcorder. With a compatible SuperDrive™, iDVD 5 supports all recordable single-layer and double-layer DVD format standards.

GarageBand™ is a consumer-oriented music creation software application. GarageBand 2 adds 8-track recording so that users can record multiple digital audio tracks at once. GarageBand 2 can improve out-of-tune notes and timing in both vocal and real-instrument recordings. GarageBand 2 displays and edits musical notation in real time for software instrument tracks for people who know how to read and write music or want to learn. With GarageBand Jam Packs, including the latest, Jam Pack 4: Symphony Orchestra, GarageBand users can create music in their favorite genres.

iLife '05 also includes iTunes, the Company's digital music jukebox software application that allows users to purchase a variety of digital content available through the Company's iTunes Music Store. iTunes organizes content using searching, browsing, and playlists, and also includes features such as iMix playlist sharing and provides integration with the complete family of iPods. In October 2005, the Company introduced iTunes 6, the latest version of its iTunes software. iTunes 6 allows users to purchase and download music videos, short films, and television shows from the iTunes Music Store, watch them on their computers, and Auto-Sync them onto their iPod.

In September 2005, the Company, Motorola Inc., and Cingular Wireless LLC announced the availability of a mobile phone with iTunes software (Motorola ROKR), enabling users to transfer up to 100 songs from the iTunes library on their Macintosh or Windows-based computers to their Motorola ROKR mobile phones.

iWork™ '05

In January 2005, the Company introduced iWork '05, productivity software designed to take advantage of both Mac OS X and iLife '05 to help users create, present, and publish documents and presentations. iWork '05 introduced Pages™, a word processor, and also features Keynote™ 2, an updated version of the Company's presentation software.

Pages™ gives users the tools to create letters, newsletters, reports, brochures and resumes with advanced typography, multiple columns, footnotes, tables of content and styles. With features like dynamic text wrapping and alignment guides, Pages lets users create free-form arrangements of text, graphics, photos, tables, and charts. An integrated iLife media browser lets users drag and drop photos from the iPhoto library directly into documents.

Keynote™ 2 is the Company's presentation software that gives users the ability to create presentations, portfolios, interactive slideshows, and storyboards. Keynote 2 contains slide animations to synchronize the movement of multiple objects and cinematic real-time animated text. The iLife media browser within Keynote allows users to insert photos, movies, and music directly into presentations, and with image masking, users can frame the exact part of the photo they want to display. Keynote 2 can also work with a second monitor to display upcoming slides, notes, and a timer.

In January 2005, the Company announced Final Cut® Express HD, an update to Final Cut Express, which began shipping in February 2005. Final Cut Express HD enables users to capture, edit, and output HDV over a single FireWire cable, and supports Digital Cinema Desktop with multiple displays. Final Cut Express HD features sound editing tools including 99 audio tracks, real-time volume and audio filter adjustment, a voice-over tool, and Soundtrack music creation software that allows users to compose musical scores for their videos. Final Cut Express HD includes LiveType™, which can add HD-quality animated text and motion graphics to videos. In addition, iMovie projects can be imported directly into Final Cut Express HD with all of their effects, transitions, and audio levels intact.

Logic® Express 7 is a streamlined version of Logic Pro 7 that provides a basic set of professional tools to compose and produce music for students, educators, and advanced hobbyists. Its high-resolution audio of up to 24-bit/96kHz, the adaptive self-configuring track mixer, and 32-bit floating-point math provide professional sound quality. Logic Express 7 comes with support for projects from GarageBand offering users a smooth migration path to high-end audio production.

FileMaker, Inc., a wholly owned subsidiary of the Company, develops, publishes, and distributes desktop-based database management application software for either a Macintosh or Windows-based computer. The FileMaker® Pro database software and related products offer relational databases and desktop-to-web publishing capabilities. FileMaker Pro 8, the newest version of the desktop database introduced in August 2005, features new ways to share and manage information of various types. FileMaker Pro 8 allows users to convert graphic-rich reports of their data into alternative file formats, which can be emailed for sharing with non-FileMaker users.

Internet Software and Services
The Company is focused on delivering seamless integration with and access to the Internet throughout the Company's products and services. The Company's Internet solutions adhere to many industry standards in order to provide an optimized user experience through interoperability.

Safari™
Safari, the Company's Mac OS X compatible web browser, uses the advanced interface technologies underlying Mac OS X and includes built-in Google search; SnapBack™ to instantly return to search results; a way to name, organize and present bookmarks; tabbed browsing; and automatic "pop-up" ad blocking.

QuickTime®
QuickTime, the Company's multimedia software for Macintosh or Windows-based computers, features streaming of live and stored video and audio over the Internet and playback of high-quality audio and video on computers. QuickTime 7 features a new video codec called H.264, which delivers high video quality at low data rates. QuickTime 7 automatically determines a user's connection speed to ensure they are getting the highest-quality content stream possible. QuickTime 7 also delivers multi-channel audio and supports audio formats, including AIFF, WAV, MOV, MP4 (AAC only), CAF, and AAC/ADTS.

The Company offers several other QuickTime products. QuickTime 7 Pro, a suite of software tools, allows creation and editing of Internet-ready audio and video files. QuickTime 7 Pro allows users to create H.264 video, capture audio and video, create multi-channel audio, and export multiple files while playing back or editing video. QuickTime Streaming Server facilitates the broadcasting of streaming digital video. QuickTime Broadcaster allows users to produce professional-quality live events for online delivery.

.Mac™
The Company's .Mac offering is a suite of Internet services that for an annual fee provides Macintosh users with a powerful set of Internet tools. .Mac services include: HomePage, for personal web sites; iDisk, a virtual hard drive accessible anywhere with Internet access; .Mac Sync, which keeps Safari bookmarks, iCal® calendars, Address Book information, Keychain® (passwords), and Mac OS X Mail preferences up-to-date across multiple Macintosh computers and available via web browser when users are away from their Mac; .Mac Mail, an ad-free email service; and Learning Center, featuring tutorials for certain software applications. The current version of .Mac includes .Mac Groups, a service that helps members communicate, coordinate schedules, and stay in sync with private groups of friends or colleagues; an

updated version of .Mac Backup software that allows members to archive the content of their iLife Home folder; and a four-fold increase in combined iDisk and email storage to 1GB for individuals and 2GB for families.

Wireless Connectivity and Networking

AirPort Extreme®
AirPort Extreme is the Company's next generation Wi-Fi wireless networking technology. AirPort Extreme is based on the 802.11g standard, which supports speeds up to 54 Mbps, and is fully compatible with most Wi-Fi devices that use the 802.11b standard. AirPort Extreme Base Stations can serve up to 50 Macintosh and Windows users simultaneously, provide wireless bridging to extend the range beyond just one base station, and support USB printer sharing to allow multiple users to wirelessly share USB printers connected directly to the base station.

AirPort® Express
AirPort® Express is the first 802.11g mobile base station that can be plugged directly into the wall for wireless Internet connections and USB printing. Airport Express also features analog and digital audio outputs that can be connected to a stereo and AirTunes™ music networking software which works with iTunes, giving users a way to wirelessly stream iTunes music from their Macintosh or Windows-based computer to any room in the house. AirPort Express features a single piece design weighing 6.7 ounces.

Other Connectivity and Networking Solutions
Mac OS X includes capabilities for Bluetooth technology. Bluetooth is an industry standard for wirelessly connecting computers and peripherals that supports transmission of data at up to 3 Mbps within a range of approximately 30 feet. The Company's Bluetooth technology for Mac OS X lets customers wirelessly share files between Macintosh systems, synchronize and share contact information with Palm-OS based PDAs, and access the Internet through Bluetooth-enabled cell phones. A Bluetooth USB adaptor can Bluetooth-enable any USB-based Macintosh computer running in Mac OS X version 10.1.4 or higher.

Bonjour™, the Company's zero configuration networking technology, is based on open Internet Engineering Task Force (IETF) Standard Protocols such as IP, ARP, and DNS and is built into Mac OS X. This technology uses industry standard networking protocols and zero configuration technology including Ethernet or 802.11-based wireless networks like the Company's AirPort products. The source code for this technology also includes software to support UNIX, Linux, and Windows-based systems and devices.

The Company developed FireWire technology, also referred to as IEEE 1394, which is a high-speed serial I/O technology for connecting digital devices such as digital camcorders and cameras to desktop and portable computers. With its high data-transfer speed and "hot plug-and-play" capability, FireWire has become an established cross-platform industry standard for both consumers and professionals. FireWire is currently integrated in all Macintosh systems.

Product Support and Services
AppleCare® offers a range of support options for the Company's customers. These options include assistance that is built into software products, printed and electronic product manuals, online support including comprehensive product information as well as technical assistance, and the AppleCare Protection Plan. The AppleCare Protection Plan is a fee-based service that typically includes three years of phone support and hardware repairs, dedicated web-based support resources, and user diagnostic tools.

Markets and Distribution
The Company's customers are primarily in the education, creative, consumer, and business markets. The Company distributes its products through wholesalers, resellers, national and regional retailers and

cataloguers. No individual customer accounted for more than 10% of net sales in 2005, 2004, or 2003. The Company also sells many of its products and resells certain third-party products in most of its major markets directly to consumers, education customers, and businesses through its retail and online stores in the U.S. and internationally. Over 12% of the Company's net sales in 2005 were through its U.S. education channel, including sales to elementary and secondary schools, higher education institutions, and individual customers.

Competition

The Company is confronted by aggressive competition in all areas of its business. The market for personal computers and related software and peripheral products is highly competitive. This market continues to be characterized by rapid technological advances in both hardware and software that have substantially increased the capabilities and use of personal computers and have resulted in the frequent introduction of new products with competitive price, feature, and performance characteristics. Over the past several years, price competition in the market for personal computers has been particularly intense. The Company's competitors who sell personal computers based on other operating systems have aggressively cut prices and lowered their product margins to gain or maintain market share. The Company's results of operations and financial condition can be adversely affected by these and other industry-wide downward pressures on gross margins.

The principal competitive factors in the market for personal computers include price, relative price/performance, product quality and reliability, design innovation, availability of software, product features, marketing and distribution capability, service and support, availability of hardware peripherals, and corporate reputation. Further, as the personal computer industry and its customers place more reliance on the Internet, an increasing number of Internet devices that are smaller, simpler, and less expensive than traditional personal computers may compete for market share with the Company's existing products.

The Company is currently taking and will continue to take steps to respond to the competitive pressures being placed on its personal computer sales as a result of innovations from competing platforms. The Company's future operating results and financial condition are substantially dependent on its ability to continue to develop improvements to the Macintosh platform in order to maintain perceived functional and design advantages over competing platforms.

The Company's services and products relating to music and other creative content have already encouraged significant competition from other companies, many of whom have greater financial, marketing, and manufacturing resources than those of the Company. The Company faces increasing competition from other companies promoting their own digital music products and distribution services, subscription services, and free peer-to-peer music services. The Company anticipates that competition will intensify as hardware, software, and content providers work more collaboratively to offer integrated products competing with the Company's offerings. However, the Company believes it currently maintains a competitive advantage by more effectively integrating an entire solution, including the hardware (iPod), software (iTunes), and distribution of third-party digital content (iTunes Music Store).

Raw Materials

Although most components essential to the Company's business are generally available from multiple sources, certain key components (including microprocessors and application-specific integrated circuits ("ASICs")) are currently obtained by the Company from single or limited sources. Some other key components, while currently available to the Company from multiple sources, are at times subject to industry-wide availability constraints and pricing pressures. In addition, the Company uses some components that are not common to the rest of the personal computer and consumer electronics industries, and new products introduced by the Company often initially utilize custom components obtained from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. If the supply of a key or single-sourced component to the Company were to be delayed or curtailed or in the event a key manufacturing vendor delays shipments of completed products to the Company, the Company's ability to ship related products in desired quantities and in a timely manner could be adversely affected. The Company did experience such delays during 2004 and 2005 related to PowerPC G5 processors, which resulted in the constrained availability of certain products. The Company's business and financial performance could also be adversely affected depending on the time required to obtain sufficient quantities from the original source, or to identify and obtain sufficient quantities from an alternative source. Continued availability of these components may be affected if producers were to decide to concentrate on the production of common components instead of components customized to meet the Company's requirements. In June 2005, the Company announced its intention to transition its Macintosh computers using the PowerPC G5 and G4 microprocessors, which are currently single-sourced, to Intel microprocessors by the end of calendar year 2007. The announcement of this transition may impact the continued availability on acceptable terms of certain components and services, including PowerPC G5 and G4 microprocessors. The Company attempts to mitigate these potential risks by working closely with these and other key suppliers on product introduction plans, strategic inventories, coordinated product introductions, and internal and external manufacturing schedules and levels. Consistent with industry practice, the Company acquires components through a combination of formal purchase orders, supplier contracts, and open orders based on projected demand information. The Company's purchase commitments typically cover its requirements for periods ranging from 30 to 150 days.

The Company believes there are several component suppliers and manufacturing vendors whose loss to the Company could have a material adverse effect upon the Company's business and financial position. At this time, such vendors include Agere Systems, Inc., Ambit Microsystems Corporation, ASUSTeK Corporation, ATI Technologies, Inc., Broadcom Corporation, Cypress Semiconductor Corporation, Freescale Semiconductor, Inc., Hitachi Global Storage Technologies, Hon Hai Precision Industry Co., Ltd., IBM Corporation, Intel Corporation, International Display Technology, Inventec Appliances Corporation, LG. Phillips Co., Ltd., Matsushita, Mitsubishi Electric Corporation, NVIDIA Corp., PortalPlayer, Inc., Quanta Computer, Inc., Samsung Electronics, Synaptics, Inc., and Toshiba Corporation.

Research and Development

Because the personal computer and consumer electronics industries are characterized by rapid technological advances, the Company's ability to compete successfully is heavily dependent upon its ability to ensure a continuing and timely flow of competitive products and technology to the marketplace. The Company continues to develop new products and technologies and to enhance existing products in the areas of hardware and peripherals, consumer electronic products, system software, applications software, networking and communications software and solutions, and the Internet. The Company may expand the range of its product offerings and intellectual property through licensing and/or acquisition of third-party business and technology. The Company's research and development expenditures totaled $534 million, $489 million, and $471 million in 2005, 2004, and 2003, respectively.

Patents, Trademarks, Copyrights and Licenses

The Company currently holds rights to patents and copyrights relating to certain aspects of its computer systems, iPods, peripherals and software. In addition, the Company has registered, and/or has applied to register, trademarks and service marks in the U.S. and a number of foreign countries for "Apple," the Apple logo, "Macintosh," "iPod," "iTunes," "iTunes Music Store," and numerous other trademarks and service marks. Although the Company believes the ownership of such patents, copyrights, trademarks and service marks is an important factor in its business and that its success does depend in part on the ownership thereof, the Company relies primarily on the innovative skills, technical competence, and marketing abilities of its personnel.

Many of the Company's products are designed to include intellectual property obtained from third-parties. While it may be necessary in the future to seek or renew licenses relating to various aspects of its products and business methods, the Company believes that, based upon past experience and industry practice, such licenses generally could be obtained on commercially reasonable terms; however, there is no guarantee that such licenses could be obtained at all. Because of technological changes in the computer industry, current extensive patent coverage, and the rapid rate of issuance of new patents, it is possible certain components of the Company's products and business methods may unknowingly infringe existing patents of others. From time to time, the Company has been notified that it may be infringing certain patents or other intellectual property rights of third-parties.

Foreign and Domestic Operations and Geographic Data

The U.S. represents the Company's largest geographic marketplace. Approximately 60% of the Company's net sales in 2005 came from sales to customers inside the U.S. Final assembly of products sold by the Company is conducted in the Company's manufacturing facility in Cork, Ireland, and by external vendors in Fremont, California, Fullerton, California, Taiwan, Korea, the People's Republic of China, and the Czech Republic. Currently, manufacture of many of the components used in the Company's products and final assembly of substantially all of the Company's portable products including PowerBooks, iBooks, and iPods are performed by third-party vendors in China. Margins on sales of the Company's products in foreign countries, and on sales of products that include components obtained from foreign suppliers, can be adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including tariffs and antidumping penalties.

Information regarding financial data by geographic segment is set forth in Part II, Item 8 of this Form 10-K in the Notes to Consolidated Financial Statements at Note 11, "Segment Information and Geographic Data."

Seasonal Business

The Company has historically experienced increased net sales in its first and fourth fiscal quarters compared to other quarters in its fiscal year due to seasonal demand related to the holiday season and the beginning of the school year. This historical pattern should not be considered a reliable indicator of the Company's future net sales or financial performance.

Warranty

The Company offers a basic limited parts and labor warranty on its hardware products. The basic warranty period for hardware products is typically one year from the date of purchase by the end-user. The Company also offers a 90-day basic warranty for its service parts used to repair the Company's hardware products. In addition, consumers may purchase extended service coverage on most of the Company's hardware products in all of its major markets.

Backlog

In the Company's experience, the actual amount of product backlog at any particular time is not a meaningful indication of its future business prospects. In particular, backlog often increases in anticipation of or immediately following new product introductions because of over-ordering by dealers anticipating shortages. Backlog often is reduced once dealers and customers believe they can obtain sufficient supply. Because of the foregoing, backlog should not be considered a reliable indicator of the Company's ability to achieve any particular level of revenue or financial performance.

Environmental Laws
Compliance with federal, state, local, and foreign laws enacted for the protection of the environment has to date had no material effect on the Company's capital expenditures, earnings, or competitive position. In the future, these laws could have a material adverse effect on the Company.

Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations including, in some instances, the requirement that the Company provide consumers with the ability to return to the Company product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have recently been passed in several jurisdictions in which the Company operates, including various European Union member states, Japan, and California. In the future, these laws could have a material adverse effect on the Company.

Employees
As of September 24, 2005, the Company had approximately 14,800 full-time equivalent employees and an additional 2,020 temporary employees and contractors.

Available Information
The Company's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available on its website at http://www.apple.com/investor when such reports are available on the U.S. Securities and Exchange Commission (SEC) website. The public may read and copy any materials filed by the Company with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at http://www.sec.gov. The contents of these websites are not incorporated into this filing. Further, the Company's references to the URLs for these websites are intended to be inactive textual references only.

Item 2. Properties

The Company's headquarters are located in Cupertino, California. The Company has manufacturing facilities in Cork, Ireland. As of September 24, 2005, the Company leased approximately 3.6 million square feet of space, primarily in the U.S., and to a lesser extent, in Europe, Japan, Canada, and the Asia Pacific region. The major facility leases are for terms of 5 to 15 years and generally provide renewal options for terms of 3 to 5 additional years. Leased space includes approximately 902,000 square feet of retail space, a majority of which is in the U.S. Lease terms for retail space range from 5 to 20 years, the majority of which are for 10 years, and often contain multi-year renewal options.

The Company owns a 352,000 square-foot manufacturing facility in Cork, Ireland that also houses a customer support call center. The Company also owns a 752,000 square-foot facility in Sacramento, California that houses warehousing and distribution operations as well as a customer support call center. In addition, the Company owns approximately 942,000 square feet of facilities located in Cupertino, California, used for research and development and corporate functions. Outside the U.S., the Company owns additional facilities totaling approximately 169,000 square feet.

The Company believes its existing facilities and equipment are well maintained and in good operating condition. The Company has invested in internal capacity and strategic relationships with outside manufacturing vendors, and therefore believes it has adequate manufacturing capacity for the foreseeable future. The Company continues to make investments in capital equipment as needed to meet anticipated demand for its products.

Item 3. Legal Proceedings

The Company is subject to various legal proceedings and claims that are discussed below. The Company is also subject to certain other legal proceedings and claims that have arisen in the ordinary course of business and which have not been fully adjudicated. In the opinion of management, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate have a material adverse effect on its financial condition, liquidity or results of operations. However, the results of legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected. The Company settled certain matters during 2005 that did not individually or in the aggregate have a material impact on the Company's results of operations.

Advanced Audio Devices LLC v. Apple Computer, Inc.
Plaintiff Advanced Audio Devices (AAD) filed this action on March 3, 2005 in the United States District Court for the Northern District of Illinois, Eastern Division, alleging infringement by the Company of U.S. Patent 6,587,403 entitled "Music Jukebox." The complaint sought unspecified damages and other relief. The Company filed an answer on May 4, 2005 denying all material allegations and asserting numerous affirmative defenses. The parties have reached a settlement. Settlement of this matter did not have a material effect on the Company's financial position or results of operation.

Apple Corps Ltd. v. Apple Computer, Inc.; Apple Computer, Inc. v. Apple Corps Ltd.
Plaintiff Apple Corps filed this action on July 4, 2003 in the High Court of Justice, Chancery Division, in London alleging that the Company has breached a 1991 agreement that resolved earlier trademark litigation between the parties regarding use of certain Apple marks. Plaintiff seeks an injunction, unspecified damages, and other relief. The Company filed a motion on October 13, 2003, challenging jurisdiction in the U.K. The Court denied this motion on April 7, 2004. The Company filed an appeal of the Court's decision but subsequently withdrew the appeal. In November 2004, Plaintiff served the Company with an Amended Bill of Particulars and on December 23, 2004 the Company filed a Defence. Plaintiff has indicated its intention to file a Re-Amended Bill of Particulars. The Company's Defence to the Re-Amended Bill of Particulars is not yet due. Trial is set for the week of March 27, 2006.

On October 8, 2003, the Company filed a lawsuit against Apple Corps in the United States District Court for the Northern District of California requesting a declaratory judgment that the Company has not breached the 1991 agreement. Apple Corps challenged jurisdiction in the California case but the Court denied that challenge on March 25, 2004. Apple Corps subsequently prevailed on a motion to stay the California case during the pendency of the U.K. action. The Company has dismissed the California lawsuit without prejudice.

Bader v. Anderson; Bader v. Apple Computer, Inc. et. al.
Plaintiff filed this purported shareholder derivative action against the Company and each of its current executive officers and members of its Board of Directors on May 19, 2005 in Santa Clara County Superior Court asserting claims for breach of fiduciary duty, material misstatements and omissions, and violations of California Businesses and Professions Code §17200 (unfair competition). Plaintiff alleges that the Company's March 14, 2005 proxy statement was false and misleading for failure to disclose certain information relating to the Apple Computer, Inc. Performance Bonus Plan which was approved by shareholders at the annual meeting held on April 21, 2005. Plaintiff, who ostensibly brings suit on the Company's behalf, has made no demand on the Board of Directors and alleges that such demand is excused. Plaintiff seeks injunctive and other relief for purported injury to the Company. On July 27, 2005, Plaintiff filed an amended complaint alleging that, in addition to the purported derivative claims, adoption of the bonus plan and distribution of the proxy statement describing that plan also inflicted injury on her

directly as an individual shareholder. Defendants filed a demurrer which is scheduled to be heard on December 6, 2005.

Baghdasarian, et al. v. Apple Computer, Inc.
Plaintiffs filed this action in Los Angeles County Superior Court on October 31, 2005, on behalf of a purported nationwide class of all purchasers of all Apple wireless products (router, modem, or adaptor) sold at any time. The complaint alleges that the Company misrepresented the transmission rates of these products. The complaint alleges causes of action for breach of express warranty and for violations of the Consumer Legal Remedies Act, California Business & Professions Code §17200 (unfair competition) and California Business & Professions Code §17500 (false advertising). The complaint seeks damages and equitable remedies. The Company's response to the complaint is not yet due.

Branning et al. v. Apple Computer, Inc.
Plaintiffs filed this purported class action in San Francisco County Superior Court on February 17, 2005. The complaint alleges violations of California Business & Professions Code §17200 (unfair competition) and violation of the Consumer Legal Remedies Act (CLRA) regarding a variety of purportedly unfair and unlawful conduct including, but not limited to, allegedly selling used computers as new and failing to honor warranties. Plantiffs also bring causes of action for misappropriation of trade secrets, breach of contract, and violation of the Song Beverly Act. Plaintiffs request unspecified damages and other relief. The Company received service of the complaint on March 12, 2005, and on March 13, 2005 the Company filed a motion to transfer the case to Santa Clara County Superior Court. On May 9, 2005, the Court granted the motion and transferred the case to Santa Clara County Superior Court. On May 2, 2005, Plaintiffs filed an amended complaint adding two new named Plaintiffs and three new causes of action including a claim for treble damages under the Cartwright Act (California Business and Professions Code §16700 et seq.) and a claim for false advertising. The Company filed a demurrer to the amended complaint which the Court sustained in its entirety on November 10, 2005. The Court granted Plaintiffs leave to amend their complaint.

Burrow v. Apple Computer, Inc.
Plaintiff filed this purported class action in Orange County Superior Court on February 17, 2005 alleging false advertising regarding the copy protection capabilities of DVD Studio Pro. The Complaint alleged violations of California Business & Professions Code §17200 (unfair competition), California Business & Professions Code §17500 (false advertising) and negligent misrepresentation. Plaintiff requested unspecified damages and other relief. The Company filed an answer on April 7, 2005 denying all allegations and asserting numerous affirmative defenses. The parties have reached a settlement. Settlement of this matter did not have a material effect on the Company's financial position or results of operation.

Butzer, et al., v. Apple Computer, Inc.
Plaintiffs filed this action on August 23, 2005, in the United States District Court for the Northern District of California, San Jose Division, on behalf of a purported nationwide class of all purchasers of the Company's PowerBook G4 portable computers. The complaint alleges defects in the memory of the computers. The complaint alleges that this purported defect extends to other series of the Company's portables and states that plaintiffs reserve the right to amend the complaint to include these other series. Plaintiffs assert claims for alleged violations of California Business & Professions Code §17200 (unfair competition), California Business & Professions Code §17500 (false advertising), the Consumer Legal Remedies Act and the Song-Beverly Consumer Warranty Act. The complaint seeks remedies including restitution and/or damages and injunctive relief. The Company filed an answer on October 19, 2005 denying the material allegations and asserting numerous affirmative defenses.

Cagney v. Apple Computer, Inc.
Plaintiff filed this purported class action on January 9, 2004 in Los Angeles County Superior Court, alleging improper collection of sales tax in transactions involving mail-in rebates. The complaint alleges violations of California Business and Professions Code §17200 (unfair competition) and seeks restitution and other relief. The Company filed an answer on February 20, 2004, denying all allegations and asserting numerous affirmative defenses. The Company filed a motion to disqualify Plaintiff's counsel, which the Court denied. The Company filed a petition for a writ of mandate with respect to this ruling and the Court of Appeal issued an order to show cause as to why the writ should not issue. Plaintiff's lead counsel subsequently withdrew. On February 17, 2005 the Court of Appeal ruled that the trial court abused its discretion in failing to grant the Company's motion to disqualify and ordered the trial court to disqualify both of Plaintiff's law firms upon remand. The trial court issued the disqualification order on May 12, 2005. On May 9, 2005 Plaintiff substituted new counsel. The Company has obtained an opinion on the tax issue from the State Board of Equalization. Discovery is stayed.

Clark v. Apple Computer, Inc.
Plaintiff filed this purported class action on February 2, 2005 in Santa Clara County Superior Court alleging defects in the Company's "yo-yo" power adapters. Plaintiffs request unspecified damages and other relief. The parties reached a tentative settlement in this matter. The Court granted preliminary approval of the settlement on April 19, 2005. On November 29, 2005, the Court continued the hearing on final settlement approval until January 10, 2006, when all claims will have been received and completely processed and relevant claim information has been reported to the Court. Settlement of this matter on the terms preliminarily approved by the Court will not have a material effect on the Company's financial position or results of operation.

Compression Labs, Inc. v. Apple Computer, Inc., et al.; Apple v. Compression Labs, Inc., et al.
Plaintiff Compression Labs, Inc. filed this patent infringement action on April 22, 2004 against the Company and twenty-seven other defendants in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement of U.S. patent 4,698,672 (the '672 patent). Plaintiff alleges that the Company infringes the patent by complying with the JPEG standard as defined by CCITT Recommendation T.81 entitled "Information Technology—Digital Compression and Coding of Continuous Tone Still Images—Requirements and Guidelines." Plaintiff seeks unspecified damages and other relief.

On July 2, 2004, the Company and several other defendants in the Texas action filed a lawsuit in the United States District Court in Delaware against Compression Labs, Inc. and two other companies, requesting a declaratory judgment of noninfringement, invalidity, implied license, and unenforceability with respect to the '672 patent. Additional actions regarding this patent have been filed in other jurisdictions. On February 16, 2005, the Panel on Multi-District Litigation (MDL) granted a petition filed by certain defendants, seeking coordination and transfer of all of these cases to one court for pre-trial proceedings. The MDL Panel has transferred all of the cases to the Northern District of California. The defendants in the Texas and Delaware actions had filed motions to dismiss prior to the transfer and both motions are still pending. A Markman hearing is set for February 13, 2006.

Contois Music Technology LLC v. Apple Computer, Inc.
Plaintiff Contois Music Technology ("Contois") filed this action on June 13, 2005 in the United States District Court for Vermont, alleging infringement by the Company of U.S. Patent No. 5,864,868, entitled "Computer Control System and User Interface for Media Playing Devices." The complaint, which was served on October 4, 2005, seeks unspecified damages and other relief. The Company filed an answer on November 23, 2005 denying all material allegations and asserting numerous affirmative defenses.

Craft v. Apple Computer, Inc. (filed December 23, 2003, Santa Clara County Superior Court); *Chin v. Apple Computer, Inc.* (filed December 23, 2003, San Mateo County Superior Court); *Hughes v. Apple Computer, Inc.* (filed December 23, 2003, Santa Clara County Superior Court); *Westley v. Apple Computer, Inc.* (filed December 26, 2003, San Francisco County Superior Court); *Keegan v. Apple Computer, Inc.* (filed December 30, 2003, Alameda County Superior Court); *Wagya v. Apple Computer, Inc.* (filed February 19, 2004, Alameda County Superior Court); *Yamin v. Apple Computer, Inc.* (filed February 24, 2004, Los Angeles County Superior Court); *Kieta v. Apple Computer, Inc.* (filed July 8, 2004, Alameda County Superior Court)
Eight separate plaintiffs filed purported class action cases in various California courts alleging misrepresentations by the Company relative to iPod battery life. The complaints include causes of action for violation of California Business and Professions Code §17200 (unfair competition), the Consumer Legal Remedies Action and claims for false advertising, fraudulent concealment, and breach of warranty. The complaints seek unspecified damages and other relief. The cases were consolidated in San Mateo County and Plaintiffs thereafter filed a consolidated complaint. On August 25, 2004, the Company filed an answer denying all allegations and asserting numerous affirmative defenses. The parties reached a tentative settlement and the Court granted preliminary approval of the settlement on May 20, 2005. The trial court entered an order granting final approval to the settlement on August 25, 2005. An appeal challenging the trial court's approval of the settlement was filed on October 24, 2005; the appeal is pending. Settlement of this matter on the terms approved by the Court will not have a material effect on the Company's financial position or results of operations.

A similar complaint relative to iPod battery life, *Mosley v. Apple Computer, Inc.* was filed in Westchester County, New York on June 23, 2004 alleging violations of New York General Business Law Sections 349 (unfair competition) and 350 (false advertising). The Company removed the case to Federal Court and Plaintiff filed a motion for remand, which the Court has not yet decided. This case is stayed and is part of the settlement, now on appeal, referred to above.

A similar complaint related to the iPod battery life, *Lenzi v. Apple Canada, Inc.*, was filed in Montreal, Quebec, Canada, on June 7, 2005, seeking authorization to institute a class action on behalf of Generations 1, 2 and 3 iPod owners in Quebec. A class certification hearing has been scheduled for January 12, 2006.

Two similar complaints relative to iPod battery life, *Wolfe v. Apple* and *Hirst v. Apple*, were filed in Toronto, Ontario, Canada on August 15, 2005 and September 12, 2005, respectively. Both actions define the class as a national class consisting of all persons in Canada who have purchased or who own an iPod. A motion for certification of the class proceeding has been scheduled for the Spring of 2006.

Davis v. Apple Computer, Inc.
Plaintiff filed this purported class action in San Francisco County Superior Court on December 5, 2002, alleging that the Company engaged in unfair and deceptive business practices relating to its AppleCare Extended Service and Warranty Plan. Plaintiff asserts causes of action for violation of the California Business and Professions Code §17200 (unfair competition) and §17500 (false advertising), breach of the Song-Beverly Warranty Act, intentional misrepresentation and concealment. Plaintiff requests unspecified damages and other relief. The Company filed a demurrer and motion to strike which were granted, in part, and Plaintiff filed an amended complaint. The Company filed an answer on April 17, 2003 denying all allegations and asserting numerous affirmative defenses. Plaintiff subsequently amended its complaint. On October 29, 2003, the Company filed a motion to disqualify Plaintiff's counsel in his role as counsel to the purported class and to the general public. The Court granted the motion but allowed Plaintiff to retain substitute counsel. Plaintiff did engage new counsel for the general public, but not for the class. The Company moved to disqualify Plaintiff's new counsel and to have the Court dismiss the general public claims for equitable relief. The Court declined to disqualify Plaintiff's new counsel or to dismiss the equitable claims, but did confirm that the class action claims are dismissed. The Company appealed the ruling and the case was stayed pending the outcome of the appeal. The Court of Appeal denied the appeal

on August 17, 2005, affirming the trial court's decision. The Company filed a Petition for review with the California Supreme Court which was denied on November 23, 2005.

European Commission Investigation
The European Commission has notified the Company that it is investigating certain matters relating to the iTunes Music Store in the European Union (EU). The European Commission is investigating claims made by Which?, a United Kingdom (UK) consumer association, that the Company is violating EU competition law by charging more for online music in the UK than in Eurozone countries and preventing UK consumers from purchasing online music from the iTunes Music Store for Eurozone countries. The Which? claims were originally lodged with the UK Office of Fair Trading, which subsequently referred them to the European Commission. The European Commission is investigating the charges under Articles 81 and 82 of the European Commission Treaty.

Gobeli Research Ltd. v. Apple Computer, Inc., et al.
Plaintiff Gobeli Research Ltd. filed this patent infringement action against the Company and Sun Microsystems, Inc. on April 15, 2004 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement of U.S. patent 5,418,968 related to a "System and Method of Controlling Interrupt Processing." Plaintiff alleges that the Company's Mac OS 9 and Mac OS X operating systems infringe Plaintiff's patent. Plaintiff seeks unspecified damages and other relief. The Company filed an answer on June 9, 2004, denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims requesting declaratory judgment of non-infringement and invalidity. A Markman hearing took place August 9, 2005, and the Court issued a ruling on August 26, 2005 invalidating one of Plantiff's two claims. On October 18, 2005, a Stipulation entered into by the parties was filed removing Mac OS 9 from the case. The trial is scheduled for February 6, 2006.

Goldberg, et al. v. Apple Computer, Inc., et al. (f.k.a. "Dan v. Apple Computer, Inc.")
Plaintiffs filed this purported class action on September 22, 2003 in Los Angeles County Superior Court against the Company and other members of the computer industry on behalf of an alleged nationwide class of purchasers of certain computer hard drives. The case alleges violations of California Business and Professions Code §17200 (unfair competition), the Consumer Legal Remedies Act and false advertising related to the size of the drives. Plaintiffs allege that calculation of hard drive size using the decimal method misrepresents the actual size of the drive. The complaint seeks restitution and other relief. Plaintiff filed an amended complaint on March 30, 2004 and the Company filed an answer on September 23, 2004, denying all allegations and asserting numerous affirmative defenses. Defendants filed a motion to strike portions of the complaint based on sales by resellers and filed a motion for judgment on the pleadings based upon Proposition 64. The Court granted both motions at a hearing on April 6, 2005. Plaintiff filed an amended complaint on May 6, 2005. The Defendants filed a demurrer on June 6, 2005, which was heard on August 22, 2005. The Court granted the demurrer in part and denied it in part. Plaintiff filed an amended complaint. The Company's response is not yet due.

Honeywell International, Inc., et al. v. Apple Computer, Inc., et al.
Plaintiffs Honeywell International, Inc. and Honeywell Intellectual Properties, Inc. filed this action on October 6, 2004 in the United States District Court in Delaware alleging infringement by the Company and other defendants of U.S. patent 5,280,371 entitled "Directional Diffuser for a Liquid Crystal Display." Plaintiffs seek unspecified damages and other relief. The Company filed an answer on December 21, 2004 denying all material allegations and asserting numerous affirmative defenses. The Company has tendered the case to several suppliers. On May 18, 2005 the Court stayed the case against the Company and the other supplier defendants. Plantiffs filed an amended complaint on November 7, 2005 adding additional defendants and expanding the scope of the accused products. Given the stay, the Company's response to the amended complaint is not yet due.

MacTech Systems v. Apple Computer, Inc.; Macadam v. Apple Computer, Inc.; Computer International, Inc. v. Apple Computer, Inc.; Elite Computers and Software, Inc. v. Apple Computer, Inc.; The Neighborhood Computer Store v. Apple Computer, Inc. MacAccessory Center, Inc. v. Apple Computer, Inc.; MacAccessory Center, Inc. v. Apple Computer, Inc. (all in Santa Clara County Superior Court)
Six resellers have filed similar lawsuits against the Company for various causes of action including breach of contract, fraud, negligent and intentional interference with economic relationship, negligent misrepresentation, trade libel, unfair competition and false advertising. Plaintiffs request unspecified damages and other relief. The Company answered the Computer International complaint on November 12, 2003, denying all allegations and asserting numerous affirmative defenses. The Company filed an answer in the Macadam case on December 3, 2004 denying all allegations and asserting numerous defenses. Three of the other plaintiffs filed amended complaints on February 7, 2005, and on March 16, 2005 the Company filed answers to these claims denying all allegations and asserting numerous affirmative defenses. A sixth Plaintiff, MacAccessory Center, filed a complaint on February 23, 2005. The Company filed an answer to this complaint on April 20, 2005 denying all allegations and asserting numerous affirmative defenses. These cases are in discovery.

On October 1, 2003, one of the reseller Plaintiffs, Macadam, was deauthorized as an Apple reseller. Macadam filed a motion for a temporary order to reinstate it as a reseller, which the Court denied. The Court denied Macadam's motion for a preliminary injunction on December 19, 2003. On December 6, 2004 Macadam filed for Chapter 11 Bankruptcy in the Northern District of California, which placed a stay on the litigation as to Macadam only. The Company filed a claim in the bankruptcy proceedings on February 16, 2005. The Company took Macadam's debtor examination in April 2005. The Company, joined by another creditor of Macadam, filed a motion to convert the bankruptcy to Chapter 7 (liquidation) on April 29, 2005 and that motion was granted. Plantiffs' counsel in four of the six other reseller cases, was recently appointed litigation counsel for the Macadam Estate by the bankruptcy court. The Company has moved for reconsideration of that decision.

Premier International Associates LLC v. Apple Computer, Inc.
Plaintiff Premier International Associates LLC (Premier) filed this action on November 3, 2005 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement by the Company of U.S. Patents 6,243,725 and 6,763,345 both entitled "List Building System." The complaint seeks unspecified damages and other relief. The Company's response is not yet due.

Slattery v. Apple Computer, Inc.
Plaintiff filed this purported class action on January 3, 2005 in the United States District Court for the Northern District of California alleging various claims including alleged unlawful tying of music purchased on the iTunes Music Store with the purchase of iPods and vice versa and unlawful acquisition or maintenance of monopoly market power. Plaintiff's complaint alleged violations of §§1 and 2 of the Sherman Act (15 U.S.C. §§1 and 2), California Business and Professions Code §16700 et seq. (the Cartwright Act), California Business and Professions Code §17200 (unfair competition), common law unjust enrichment and common law monopolization. Plaintiff seeks unspecified damages and other relief. The Company filed a motion to dismiss on February 10, 2005. On September 9, 2005, the Court denied the motion in part and granted it in part. Plaintiff filed an amended complaint on September 23, 2005 and the Company filed an answer on October 11, 2005. The case is in discovery.

Stamm v. Apple Computer, Inc./Allen v. Apple Computer, Inc.
Plaintiff Stamm filed a purported class action on November 12, 2004 in Circuit Court, Cook County, Illinois alleging that a defect in Apple's 17-inch Studio Display monitors results in dimming of half of the screen and constant blinking of the power light. The Company removed the case to Federal Court on December 22, 2004. The Court remanded it to State Court on March 22, 2005 on Plaintiff's motion. The Company had filed a motion to dismiss on January 27, 2005 which was taken off calendar due to the

remand. On January 28, 2005 a second plaintiff, Allen, filed a purported nationwide class action in Los Angeles Superior Court alleging identical claims. Plaintiff Stamm dismissed the Stamm case on September 2, 2005. An amended complaint in the Allen case was filed on October 24, 2005, adding additional named plaintiffs and expanding the alleged class to include purchasers of the 20-inch Apple Cinema Display and the 23-inch Apple Cinema HD Display. The amended complaint alleges that the displays have a purported defect that causes dimming of one-half of the screen, and that the Company misrepresented the quality of the displays and/or concealed the purported defect. Plaintiffs assert claims under California Business & Professions Code §17200 (unfair competition); California Business & Professions Code §17500 (false advertising) and the Consumer Legal Remedies Act. The amended complaint seeks remedies including damages and equitable relief. On November 14, 2005, the Company filed an answer to the amended complaint as to the allegations regarding the 17-inch display and a demurrer/motion to strike as to the allegations regarding the 20-inch and 23-inch displays on the ground that plaintiffs failed to allege that they purchased those displays. At a status conference on November 21, 2005, the Court ordered Plantiffs to amend their complaint. The Company's demurrer is off calendar pending this amendment.

St-Germain v. Apple Canada, Inc.
Plaintiff filed this case in Montreal, Quebec, Canada, on August 5, 2005, seeking authorization to institute a class action for the refund by the Company of the Canadian Private Copying Levy that was applied to the iPod purchase price in Quebec between December 12, 2003 and December 14, 2004 but later declared invalid by the Canadian Court. A class certification hearing is scheduled for January 13, 2006. The Company has already begun a refund program for this levy.

Teleshuttle Technologies, LLC and BTG International Inc. v. Microsoft and Apple Computer, Inc.
Plaintiffs filed this case on July 20, 2004 in United States District Court for the Northern District of California alleging infringement of U.S. patent 6,557,054, entitled "Method and System for Distributing Updates by Presenting Directory of Software Available for User Installation That is Not Already Installed on User Station." Plaintiffs filed an amended complaint on September 7, 2004, adding a second patent, U.S. patent 6,769,009 entitled "Method and System for Selecting a Personalized Set of Information Channels." Plaintiffs seek unspecified damages and other relief. The Company filed an answer on October 18, 2004, denying all material allegations and asserting numerous affirmative defenses. On August 22, 2005, the Company filed an amended answer to add charges of inequitable conduct. The case is in discovery. Markman briefing is completed. A technology tutorial and Markman hearing are tentatively scheduled for January 13, 20, and 27, 2006.

Tiger Direct, Inc. v. Apple Computer, Inc.
Plaintiff Tiger Direct, Inc. filed this trademark infringement action in the United States District Court for the Southern District of Florida on April 26, 2005 alleging infringement of the word mark TIGER. Plaintiff claims to have a valid registration in the mark TIGER and alleges that the Company's use of TIGER in reference to the latest version of Mac OS X infringes the mark allegedly owned by Plaintiff. Plaintiff attempted to obtain an ex parte preliminary injunction barring the Company's use of the TIGER mark on April 27, 2005 but the motion was denied. Plaintiff served the Company on April 27, 2005 and again moved for a preliminary injunction. Plaintiff's motion was heard on May 3, 2005. On May 11, 2005, the Court denied Plaintiff's motion. The Company filed a response to the complaint on May 17, 2005, denying all material allegations and asserting counterclaims for cancellation of certain marks registered to Tiger Direct. On June 10, 2005, Plaintiff filed an appeal, but subsequently withdrew it. Plaintiff filed a response to the Company's counterclaims. The parties have reached a settlement. Settlement of this matter did not have a material effect on the Company's financial position or results of operation.

Tse v. Apple Computer, Inc. et al.
Plaintiff Ho Keung Tse filed this action against the Company and other defendants on August 5, 2005 in the United States District Court for the District of Maryland alleging infringement by the Company of U.S. Patent 6,665,797 entitled "Protection of Software Again [sic] Against Unauthorized Use." The complaint seeks unspecified damages and other relief. The Company filed an answer on October 31, 2005 denying all material allegations and asserting numerous affirmative defenses. On October 28, 2005, the Company and the other defendants filed a motion to transfer the case to the Northern District of California.

Wimmer v. Apple Computer, Inc. (originally filed as *Tomczak v. Apple Computer, Inc.* on October 19, 2005 in the United States District Court for the Northern District of California, San Jose Division; amended complaint filed October 26, 2005); *Moschella, et al., v. Apple Computer, Inc.* (filed October 26, 2005 United States District Court for the Northern District of California, San Jose Division); *Calado, et al. v. Apple Computer, Inc.* (filed October 26, 2005, Los Angeles County Superior Court); *Kahan, et al., v. Apple Computer, Inc.* (filed October 31, 2005, United States District Court for the Southern District of New York); *Jennings, et al., v. Apple Computer, Inc.* (filed November 4, 2005, United States District Court for the Northern District of California, San Jose Division).
These federal and state court complaints allege that the Company's iPod nano was defectively designed so that it scratches excessively during normal use which renders the screen unreadable. The Wimmer and Moschella actions were brought on behalf of purported nationwide classes of iPod nano purchasers, with the exception of California purchasers, and allege violations of the consumer protection, express and implied warranty statutes of each state covered by the putative class definition, as well as negligent misrepresentation and unjust enrichment under the common laws of these jurisdictions. The Calado action was brought on behalf of a purported California class of iPod nano purchasers and asserts claims for alleged violation of California Business & Professions Code §17200 (unfair competition), California Business & Professions Code §17500 (false advertising), the Consumer Legal Remedies Act, breaches of express and implied warranties, negligent misrepresentation and unjust enrichment. The Jennings action was filed on behalf of a purported class of all iPod nano purchasers outside of the United States, based upon alleged violations of the same California statutes as in the Calado complaint. The Kahan action was brought on behalf of a purported New York class of iPod nano purchasers and alleges claims under the New York unfair competition law, breach of express warranty and unjust enrichment. The complaints seek damages and various other remedies. The Company's responses to these complaints are not yet due.

Two similar complaints, *Carpentier v. Apple Canada, Inc.*, and *Royer- Brennan v. Apple Computer, Inc. and Apple Canada, Inc.* were filed in Montreal, Quebec, Canada, on October 27, 2005 and November 9, 2005, respectively, seeking authorization to institute a class action on behalf of iPod nano purchasers in Quebec.

Union Federale des Consummateurs—Que Choisir v. Apple Computer France S.A.R.L. and iTunes S.A.R.L.
Plaintiff, a consumer association in France, filed this complaint on February 9, 2005 alleging that the entities above are violating consumer law by 1) omitting to mention that the iPod is allegedly not compatible with music from online music services other than the iTunes Music Store and that the music from the iTunes Music Store is only compatible with the iPod and 2) allegedly tying the sales of iPods to the iTunes Music Store and vice versa. Plaintiff seeks damages, injunctive relief and other relief. The first hearing on the case took place on May 24, 2005. The Company's response to the complaint was served on November 8, 2005.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of the Company's fiscal year ended September 24, 2005.

PART II

Item 5. Market for the Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities

(a) Stock Market Information

The Company's common stock is traded on the over-the-counter market and is quoted on the NASDAQ National Market under the symbol AAPL and on the Frankfurt Stock Exchange under the symbol APCD. In December 2004, the Company delisted its shares from trading on the Tokyo Stock Exchange. As of November 18, 2005, there were 28,333 shareholders of record.

The Company did not pay cash dividends in either 2005 or 2004. The Company anticipates that, for the foreseeable future, it will retain any earnings for use in the operation of its business. The price range per share of common stock presented below represents the highest and lowest closing prices for the Company's common stock on the NASDAQ National Market during each quarter.

On February 28, 2005, the Company effected a two-for-one stock split to shareholders of record as of February 18, 2005. All share and per share information has been retroactively adjusted to reflect the stock split.

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Fiscal 2005 price range per common share	$53.20-$36.37	$ 43.74-$34.13	$45.06-$31.58	$34.22-$18.65
Fiscal 2004 price range per common share	$ 19.00-$14.57	$ 16.85-$12.89	$13.84-$10.57	$12.41-$ 9.85

(b) Related Shareholder Matters

None.

(c) Issuer Purchases of Equity Securities

None.

Item 6. Selected Financial Data

The following selected financial information has been derived from the audited consolidated financial statements. The information set forth below is not necessarily indicative of results of future operations, and should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and related notes thereto included in Item 8 of this Form 10-K in order to fully understand factors that may affect the comparability of the information presented below.

Five fiscal years ended September 24, 2005 (In millions, except share and per share amounts)	2005	2004	2003	2002	2001
Net sales	$ 13,931	$ 8,279	$ 6,207	$ 5,742	$ 5,363
Net income (loss)	$ 1,335	$ 276	$ 69	$ 65	$ (25)
Earnings (loss) per common share:					
Basic	$ 1.65	$ 0.37	$ 0.10	$ 0.09	$ (0.04)
Diluted	$ 1.56	$ 0.36	$ 0.09	$ 0.09	$ (0.04)
Cash dividends declared per common share	$ —	$ —	$ —	$ —	$ —
Shares used in computing earnings (loss) per share (in thousands):					
Basic	808,439	743,180	721,262	710,044	691,226
Diluted	856,780	774,622	726,932	723,570	691,226
Cash, cash equivalents, and short-term investments	$ 8,261	$ 5,464	$ 4,566	$ 4,337	$ 4,336
Total assets	$ 11,551	$ 8,050	$ 6,815	$ 6,298	$ 6,021
Long-term debt (including current maturities)	$ —	$ —	$ 304	$ 316	$ 317
Total liabilities	$ 4,085	$ 2,974	$ 2,592	$ 2,203	$ 2,101
Shareholders' equity	$ 7,466	$ 5,076	$ 4,223	$ 4,095	$ 3,920

Net gains before taxes related to the Company's non-current debt and equity investments of $4 million, $10 million, and $75 million were recognized in 2004, 2003, and 2001, respectively. A net loss before taxes related to the Company's non-current debt and equity investments of $42 million was recognized in 2002. In 2002, the Company acquired Emagic resulting in a charge of approximately $1 million for acquired in-process technologies with no alternative future use. The Company recognized a similar charge of $11 million in 2001 related to its acquisition of PowerSchool. Net charges related to Company restructuring actions of $23 million, $26 million, and $30 million were recognized in 2004, 2003, and 2002, respectively. In 2003, settlement of the Company's forward stock purchase agreement resulted in a gain of $6 million. Net income during 2005 benefited by $81 million from the reversal of certain tax contingency reserves and adjustments to net deferred tax assets, including reductions to valuation allowances. Favorable cumulative-effect type adjustments from the adoption of new accounting standards, net of taxes, of $1 million and $12 million were recognized in 2003 and 2001, respectively.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This section and other parts of this Form 10-K contain forward-looking statements that involve risks and uncertainties. Forward-looking statements can also be identified by words such as "anticipates," "expects," "believes," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and the Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Factors That May Affect Future Results and Financial Condition" below. The following discussion should be read in conjunction with the consolidated financial statements and notes thereto included in Item 8 of this Form 10-K. All information presented herein is based on the Company's fiscal *calendar. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.*

Executive Overview

The Company designs, manufactures, and markets personal computers and related software, services, peripherals, and networking solutions. The Company also designs, develops, and markets a line of portable digital music players along with related accessories and services including the online distribution of third-party music, audio books, music videos, short films, and television shows. The Company's products and services include the Macintosh line of desktop and notebook computers, the iPod digital music player, the Xserve G5 server and Xserve RAID storage products, a portfolio of consumer and professional software applications, the Mac OS X operating system, the iTunes Music Store, a portfolio of peripherals that support and enhance the Macintosh and iPod product lines, and a variety of other service and support offerings. The Company sells its products worldwide through its online stores, its own retail stores, its direct sales force, and third-party wholesalers, resellers, and value added resellers. In addition, the Company sells a variety of third-party Macintosh compatible products, including computer printers and printing supplies, storage devices, computer memory, digital camcorders and still cameras, personal digital assistants, and various other computing products and supplies through its online and retail stores. The Company sells to education, consumer, creative professional, business, and government customers. A further description of the Company's products may be found in Part I, Item 1 of this document under the heading "Business."

The Company's business strategy leverages its ability, through the design and development of its own operating system, hardware, and many software applications and technologies, to bring to its customers around the world compelling new products and solutions with superior ease-of-use, seamless integration, and innovative industrial design.

The Company participates in several highly competitive markets, including personal computers with its Macintosh line of computers, consumer electronics with its iPod line of digital music players, and distribution of third-party digital content through its online iTunes Music Store. While the Company is widely recognized as an innovator in the personal computer and consumer electronic markets as well as a leader in the emerging market for distribution of digital content, these are all highly competitive markets that are subject to aggressive pricing and increased competition. To remain competitive, the Company believes that increased investment in research and development (R&D) and marketing and advertising is necessary to maintain and extend its position in the markets where it competes. The Company's R&D spending is focused on delivering timely updates and enhancements to its existing line of personal computers, displays, operating systems, software applications, and portable music players; developing new digital lifestyle consumer and professional software applications; and investing in new product areas such as rack-mount servers, RAID storage systems, and wireless technologies. The Company also believes investment in marketing and advertising programs is critical to increasing product and brand awareness.

In June 2005, the Company announced its plan to begin using Intel microprocessors in its Macintosh computers. The Company plans to begin shipping certain models with Intel microprocessors by June 2006 and to complete the transition of all of its Macintosh computers to Intel microprocessors by the end of calendar year 2007. There are potential risks and uncertainties that may occur during this transition, which are further discussed under the heading "Factors That May Affect Future Results and Financial Condition."

The Company utilizes a variety of direct and indirect distribution channels. The Company believes that sales of its innovative and differentiated products are enhanced by knowledgeable salespersons who can convey the value of the hardware, software, and peripheral integration, demonstrate the unique digital lifestyle solutions that are available only on Macintosh computers, and demonstrate the compatibility of the Macintosh with the Windows platform and networks. The Company further believes that providing a high-quality sales and after-sales support experience is critical to attracting and retaining customers. To ensure a high-quality buying experience for its products in which service and education are emphasized, the Company has expanded and improved its distribution capabilities by opening its own retail stores in the U.S. and internationally. The Company had 124 stores open as of September 24, 2005.

The Company also staffs selected third-party stores with the Company's own employees to improve the buying experience through reseller channels. The Company has deployed Apple employees and contractors in reseller locations around the world including the U.S., Europe, Japan, and Australia. The Company also sells to customers directly through its online stores around the world.

To improve access to the iPod product line, the Company has significantly expanded the number of distribution points where iPods are sold. The iPod product line can be purchased in certain department stores, member-only warehouse stores, large retail chains, and specialty retail stores, as well as through the channels listed above.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles and the Company's discussion and analysis of its financial condition and results of operations require the Company's management to make judgments, assumptions, and estimates that affect the amounts reported in its consolidated financial statements and accompanying notes. Note 1 of the Notes to Consolidated Financial Statements of this Form 10-K describes the significant accounting policies and methods used in the preparation of the Company's consolidated financial statements. Management bases its estimates on historical experience and on various other assumptions it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates and such differences may be material.

Management believes the Company's critical accounting policies and estimates are those related to revenue recognition, allowance for doubtful accounts, inventory valuation and inventory purchase commitments, warranty costs, and income taxes. Management believes these policies to be critical because they are both important to the portrayal of the Company's financial condition and results, and they require management to make judgments and estimates about matters that are inherently uncertain. The Company's senior management has reviewed these critical accounting policies and related disclosures with the Audit and Finance Committee of the Company's Board of Directors.

Revenue Recognition

Net sales consist primarily of revenue from the sale of hardware, software, peripherals, digital content, and service and support contracts. The Company recognizes revenue pursuant to applicable accounting standards, including Statement of Position (SOP) No. 97-2, *Software Revenue Recognition*, as amended, and Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition.*

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection is probable. Product is considered delivered to the customer once it has been shipped, and title and risk of loss have been transferred. For most of the Company's product sales, these criteria are met at the time the product is shipped. For online sales to individuals, for some sales to education customers in the U.S., and for certain other sales, the Company defers revenue until the customer receives the product because the Company legally retains a portion of the risk of loss on these sales during transit. If at the outset of an arrangement the Company determines the arrangement fee is not, or is presumed not to be, fixed or determinable, revenue is deferred and subsequently recognized as amounts become due and payable.

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end-user rebates, and other sales programs and volume-based incentives. The estimated cost of these programs is accrued as a reduction to revenue in the period the Company has sold the product and committed to the relevant program. The Company also records reductions to revenue for expected future product returns based on the Company's historical experience. Future market conditions and product transitions may require the Company to increase customer incentive programs and incur incremental price protection obligations that could result in additional reductions to revenue at the time such programs are offered. Additionally, certain customer incentive programs require management to estimate the number of customers who will actually redeem the incentive based on historical experience and the specific terms and conditions of particular incentive programs. If a greater than estimated proportion of customers redeem such incentives, the Company would be required to record additional reductions to revenue, which could have a material adverse impact on the Company's results of operations.

Allowance for Doubtful Accounts

The Company distributes its products through third-party resellers and directly to certain education, consumer, and commercial customers. The Company generally does not require collateral from its customers. However, when possible the Company does attempt to limit credit risk on trade receivables with credit insurance for certain customers in Latin America, Europe, and Asia and by arranging with third-party financing companies to provide flooring arrangements and other loan and lease programs to the Company's direct customers. These credit-financing arrangements are directly between the third-party financing company and the end customer. As such, the Company generally does not assume any recourse or credit risk sharing related to any of these arrangements. However, considerable trade receivables that are not covered by collateral, third-party flooring arrangements, or credit insurance are outstanding with the Company's distribution and retail channel partners.

The allowance for doubtful accounts is based on management's assessment of the collectibility of specific customer accounts and includes consideration of the credit worthiness and financial condition of those specific customers. The Company records an allowance to reduce the specific receivables to the amount that is reasonably believed to be collectible. The Company also records an allowance for all other trade receivables based on multiple factors including historical experience with bad debts, the general economic environment, the financial condition of the Company's distribution channels, and the aging of such receivables. If there is a deterioration of a major customer's financial condition, if the Company becomes aware of additional information related to the credit worthiness of a major customer, or if future actual default rates on trade receivables in general differ from those currently anticipated, the Company may have to adjust its allowance for doubtful accounts, which would affect earnings in the period the adjustments are made.

Inventory Valuation and Inventory Purchase Commitments

The Company must order components for its products and build inventory in advance of product shipments. The Company records a write-down for inventories of components and products, including third-party products held for resale, which have become obsolete or are in excess of anticipated demand or net realizable value. The Company performs a detailed review of inventory each fiscal quarter that considers multiple factors including demand forecasts, product life cycle status, product development plans, current sales levels, and component cost trends. The personal computer and consumer electronic industries are subject to a rapid and unpredictable pace of product and component obsolescence and demand changes. If future demand or market conditions for the Company's products are less favorable than forecasted or if unforeseen technological changes negatively impact the utility of component inventory, the Company may be required to record additional write-downs which would negatively affect gross margins in the period when the write-downs are recorded.

The Company accrues necessary reserves for cancellation fees related to component orders that have been cancelled. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. These commitments typically cover the Company's requirements for periods ranging from 30 to 150 days. If there is an abrupt and substantial decline in demand for one or more of the Company's products or an unanticipated change in technological requirements for any of the Company's products, the Company may be required to record additional reserves for cancellation fees that would negatively affect gross margins in the period when the cancellation fees are identified.

Warranty Costs

The Company provides currently for the estimated cost for product warranties at the time the related revenue is recognized based on historical and projected warranty claim rates, historical and projected cost-per-claim, and knowledge of specific product failures that are outside of the Company's typical experience. Each quarter, the Company reevaluates its estimates to assess the adequacy of its recorded warranty liabilities considering the size of the installed base of products subject to warranty protection, and adjusts the amounts as necessary. If actual product failure rates or repair costs differ from estimates, revisions to the estimated warranty liability would be required and could negatively affect the Company's results of operations.

Income Taxes

The Company records a tax provision for the anticipated tax consequences of the reported results of operations. In accordance with Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes*, the provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. The Company records a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized. The Company is currently evaluating the repatriation provisions of the American Jobs Creation Act of 2004, which, if implemented by the Company, would affect the Company's tax provision and deferred tax assets and liabilities.

Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets. In the event that all or part of the net deferred tax assets are determined not to be realizable in the future, an adjustment to the valuation allowance would be charged to earnings in the period such determination is made. Similarly, if the Company subsequently realizes deferred tax assets that were previously determined to be unrealizable, the respective valuation allowance would be reversed, resulting in a positive adjustment to earnings or a decrease in goodwill in the period such determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with management's expectations could have a material impact on the Company's results of operations and financial position.

Net Sales

Net sales and Macintosh unit sales by operating segment and net sales and unit sales by product follow (net sales in millions and unit sales in thousands):

	September 24, 2005	Change	September 25, 2004	Change	September 27, 2003
Net Sales by Operating Segment:					
Americas net sales	$ 6,590	64 %	$ 4,019	26 %	$ 3,181
Europe net sales	3,073	71 %	1,799	37 %	1,309
Japan net sales	920	36 %	677	(3)%	698
Retail net sales	2,350	98 %	1,185	91 %	621
Other Segments net sales (a)	998	67 %	599	51 %	398
Total net sales	$ 13,931	68 %	$ 8,279	33 %	$ 6,207
Unit Sales by Operating Segment:					
Americas Macintosh unit sales	2,184	30 %	1,682	4 %	1,620
Europe Macintosh unit sales	1,138	47 %	773	13 %	684
Japan Macintosh unit sales	313	8 %	291	(14)%	339
Retail Macintosh unit sales	609	94 %	314	68 %	187
Other Segments Macintosh unit sales (a)	290	26 %	230	26 %	182
Total Macintosh unit sales	4,534	38 %	3,290	9 %	3,012
Net Sales by Product:					
Desktops (b)	$ 3,436	45 %	$ 2,373	(4)%	$ 2,475
Portables (c)	2,839	11 %	2,550	26 %	2,016
Total Macintosh net sales	6,275	27 %	4,923	10 %	4,491
iPod	4,540	248 %	1,306	279 %	345
Other music related products and services (d)	899	223 %	278	672 %	36
Peripherals and other hardware (e)	1,126	18 %	951	38 %	691
Software, service, and other sales (f)	1,091	33 %	821	27 %	644
Total net sales	$ 13,931	68 %	$ 8,279	33 %	$ 6,207
Unit Sales by Product:					
Desktops (b)	2,520	55 %	1,625	(8)%	1,761
Portables (c)	2,014	21 %	1,665	33 %	1,251
Total Macintosh unit sales	4,534	38 %	3,290	9 %	3,012
Net sales per Macintosh unit sold (g)	$ 1,384	(7)%	$ 1,496	0 %	$ 1,491
iPod unit sales	22,497	409 %	4,416	370 %	939
Net sales per iPod unit sold (h)	$ 202	(32)%	$ 296	(19)%	$ 367

Notes:

(a) Other Segments include Asia Pacific and FileMaker.

(b) Includes iMac, eMac, Mac mini, Power Mac and Xserve product lines.

(c) Includes iBook and PowerBook product lines.

(d) Consists of iTunes Music Store sales, iPod services, and Apple-branded and third-party iPod accessories.

(e) Includes sales of Apple-branded and third-party displays, wireless connectivity and networking solutions, and other hardware accessories.

(f) Includes sales of Apple-branded operating system, application software, third-party software, AppleCare, and Internet services.

(g) Derived by dividing total Macintosh net sales by total Macintosh unit sales.

(h) Derived by dividing total iPod net sales by total iPod unit sales.

Fiscal Year 2005 versus 2004
During 2005, net sales increased 68% or $5.7 billion from 2004. Several factors contributed favorably to net sales during 2005:

- Net sales of iPods rose $3.2 billion or 248% during 2005 compared to 2004. Unit sales of iPods totaled 22.5 million in 2005, which represents an increase of 409% from the 4.4 million iPod units sold in 2004. Strong sales of iPods during 2005 continued to be experienced in all of the Company's operating segments and was driven by strong demand for the iPod shuffle introduced in January 2005, the release of an updated version of the iPod mini in February 2005, the release of the iPod nano in September 2005, and expansion of the iPod's distribution network. Net sales per iPod unit sold decreased 32% primarily due to the introduction of the lower priced iPod shuffle in January 2005 and iPod mini pricing reductions in February 2005. From the introduction of the iPod in 2002 through 2005, the Company has sold approximately 28 million iPods.

- Other music related products and services consists of sales associated with the iTunes Music Store and iPod services and accessories. Net sales of other music related products and services increased $621 million or 223% during 2005 compared to 2004. The Company has experienced strong growth in sales of iPod services and accessories consistent with the increase in overall iPod unit sales for 2005. The increased sales from the iTunes Music Store is primarily due to substantial growth of net sales in the U.S. and expansion in Europe, Canada, and Japan.

- Total Macintosh net sales increased $1.4 billion or 27% during 2005 compared to 2004. Unit sales of Macintosh systems increased 1.2 million units or 38% during 2005 compared to 2004. The increases in Macintosh net sales and unit sales relate primarily to strong demand for the Company's desktop products, which was experienced in all of the Company's operating segments. The Company believes that the success of the iPod is having a positive impact on Macintosh net sales by introducing new customers to the Company's other products. Desktop demand was stimulated in 2005 due to the new iMac G5 and the introduction of the Mac mini in January 2005. Net sales and unit sales of desktop products increased 45% and 55%, respectively, during 2005 compared to 2004. Macintosh net sales and unit sales also include sales of the Company's portable products, which increased 11% and 21%, respectively, compared to 2004.

  Net sales per Macintosh unit sold decreased 7% on a year-over-year basis. The decrease was the result of changes in the overall unit mix towards relatively lower-priced consumer products, specifically the impact of the Mac mini product, and desktop and portable price reductions. This decrease was partially offset by an increase in the proportion of direct sales.

- The Retail segment's net sales grew 98% to $2.4 billion during 2005 compared to 2004. This increase is largely attributable to the increase in total stores from 86 at the end of 2004 to 124 at the end of 2005, as well as 44% year-over-year increase in average revenue per store. While the Company's customers in areas where the Retail segment has opened stores may elect to purchase from the Retail segment stores rather than the Company's preexisting sales channels in the U.S., Canada, Japan, and the U.K., the Company believes that a substantial portion of the Retail segment's net sales is incremental to the Company's total net sales. See additional comments below related to the Retail segment under the heading "Segment Operating Performance."

- Net sales of peripherals and other hardware rose by 18% during 2005 compared to 2004 primarily due to an increase in net sales of displays and other computer accessories. Net sales of other hardware include AirPort cards and base stations, Xserve RAID storage, iSight digital video cameras, and third-party hardware products.

- The Company's U.S. education channel experienced year-over-year growth in both net sales and unit sales of approximately 21% for 2005. The increase in U.S. education net sales for 2005 relates primarily to a 32% year-over-year increase in higher education net sales due to increased iMac shipments, portable system shipments, and online sales. The Company also experienced 11% growth in K-12 net sales due to increased iBook sales and education 1:1 sales. While net sales to the K-12 market were slightly higher during 2005 than 2004, the Company believes this market continues to be subject to budget constraints and competitive pressures.

- Net sales of software, service and other sales rose $270 million or 33% during 2005 compared to 2004. This growth was primarily attributable to increased net sales in AppleCare Protection Plan (APP) extended service and support contracts, driven primarily by higher associated Macintosh computer sales. Additionally, the Company experienced increases in net sales of .Mac Internet service, professional and consumer applications, third-party software, and Mac OS X that was primarily attributable to the release of version 10.4 Tiger in April 2005.

Fiscal Year 2004 versus 2003

During 2004, net sales increased 33% or $2.1 billion from 2003. Several factors contributed favorably to net sales during 2004:

- Net sales of Macintosh systems increased $432 million or 10% during 2004 compared to 2003 while net sales per Macintosh unit sold remained relatively flat on a year-over-year basis. Unit sales of Macintosh systems increased 278,000 units or 9% during 2004 compared to 2003. These increases in net sales and unit sales were a result of strong demand for all of the Company's Macintosh systems, except the iMac. The Company's portable systems, consisting of the PowerBook and iBook, produced the strongest revenue and unit growth during 2004 compared to 2003 of approximately 26% and 33%, respectively. Unit sales of portable systems accounted for 51% of all Macintosh systems sold during 2004 compared to only 42% during 2003. The Company believes that these results reflected an overall trend in the industry towards portable systems. Performance of the Company's Power Macintosh systems also yielded positive results in 2004 over 2003, including a 15% and 6% increase in net sales and unit sales, respectively. The increase in Power Macintosh sales in 2004 was due primarily to the introduction of the Power Mac G5, which began shipping at the end of 2003. Although Power Macintosh sales increased from 2003, sales of this product were constrained in the second half of 2004 as a result of manufacturing problems at IBM, the Company's sole supplier of the PowerPC G5 processor.

- Net sales of iPods rose $961 million or 279% during 2004 compared to 2003. Unit sales of iPods totaled 4.4 million in 2004, which represents an increase of 370% from the 939,000 iPod units sold in 2003. Strong demand for the iPods during 2004 were experienced in all of the Company's operating segments and was driven by enhancements to the iPod, the introduction of the iPod mini, increased expansion of the Company's iPod distribution network, and continued success of the iTunes Music Store due largely to making it available to both Macintosh and Windows users in the U.S., U.K., France, and Germany.

- The Retail segment's net sales grew 91% to $1.2 billion during 2004 compared to 2003. This increase was largely attributable to the increase in total stores from 65 at the end of 2003 to 86 at the end of 2004, as well as a 36% year-over-year increase in average revenue per store. While the Company's customers in areas where the Retail segment has opened stores may have elected to purchase from the Retail segment stores rather than the Company's preexisting sales channels in the U.S. and Japan, the Company believes that a substantial portion of the Retail segment's net sales is incremental to the Company's total net sales. See additional comments below related to the Retail segment under the heading "Segment Operating Performance."

- Net sales of peripherals and other hardware rose by 38% during 2004 compared to 2003 primarily due to an increase in net sales of displays and other computer accessories. Net sales of other computer accessories include AirPort cards and base stations, iSight digital video cameras, and third-party hardware products. The increase in total net sales of peripherals and other hardware was related to the overall increase in Macintosh unit sales and the introduction of new and updated peripheral products and was experienced predominantly by the Company's Americas, Europe, and Retail segments.

- Net sales of other music related products and services increased $242 million or 672% during 2004 compared to 2003. The Company experienced strong growth in sales of iPod services and accessories consistent with the increase in overall iPod unit sales for 2004. The increased sales from the iTunes Music Store, which was originally introduced in April 2003, was primarily due to making the service available for Windows in October 2003 and the introduction of the service in the U.K., France, and Germany in June 2004.
- Net sales of software rose $140 million or 39% during 2004 compared to 2003 due primarily to higher net sales of the Company's Apple-branded software and in particular, higher net sales of the Company's operating system software, including Mac OS X version 10.3 "Panther," which was released in October 2003. Net sales of Panther accounted for approximately $74 million or over 50% of the increase in software net sales for 2004 compared to 2003.
- The Company's U.S. education channel experienced year-over-year growth in net sales of approximately 19% for 2004 compared to 2003. Unit sales also increased by 10% during 2004 compared to 2003. The increase in U.S. education net sales for 2004 related primarily to a 40% year-over-year increase in higher education net sales and to a lesser extent the Company's 3% growth in K-12 net sales.
- Service and other sales increased $37 million or 13% during 2004 compared to 2003. These increases were the result of significant year-over-year increases in net sales associated with APP extended maintenance and support services, as well as increased net sales associated with the Company's .Mac Internet service. Increased net sales associated with APP were primarily the result of higher Macintosh unit sales and higher attach rates on APP over the last several years.

Offsetting the favorable factors discussed above, the Company's net sales during 2004 were negatively impacted by the following:

- Net sales and unit sales of iMac systems were down 23% and 16%, respectively, during 2004 versus 2003. The decrease in iMac net sales and unit sales was largely due to the delay in the introduction of the new iMac, based on the PowerPC G5 processor, primarily as a result of manufacturing problems experienced by IBM. The delays in the new iMac resulted in the depletion of inventory of the old iMac flat panel prior to availability of the new iMac G5. The old flat panel iMac form factor, which was available during most of 2004, was nearly 3 years old by the time the new iMac G5 began shipping in September 2004 and had experienced declines in sales as a result of the age of this product. The Company believes that sales of iMac systems have also declined due to a shift in consumer preference to portable systems and desktop models from competitors with price points below $1,000.
- Net sales and unit sales in the Company's Japan segment decreased 3% and 14%, respectively, during 2004 versus 2003. The Company believes these declines related to a shift in sales from the Japan segment to the Retail segment as a result of the Tokyo and Osaka store openings in 2004. Declines in net sales in Japan may have also related to delays in computer upgrades by certain professional and creative customers pending release in Japan of certain Mac OS X native applications, such as Quark Xpress 6, which did not become available until September 2004. When sales from the Japan retail stores are included in the results for the Japan segment, the combined revenue in Japan resulted in a 3% year-over-year increase in 2004 as compared to 2003. See

additional comments below related to the Japan segment under the heading "Segment Operating Performance."

Segment Operating Performance

The Company manages its business primarily on a geographic basis. The Company's reportable operating segments are comprised of the Americas, Europe, Japan, and Retail. The Americas, Europe, and Japan reportable segments do not include activities related to the Retail segment. The Americas segment includes both North and South America. The Europe segment includes European countries as well as the Middle East and Africa. The Retail segment operated Apple-owned retail stores in the U.S., Canada, Japan, and the U.K. during 2005. Each reportable geographic operating segment provides similar hardware and software products and similar services. Further information regarding the Company's operating segments may be found in Item 8 of this Form 10-K in the Notes to Consolidated Financial Statements at Note 11, "Segment Information and Geographic Data."

Americas

During 2005, net sales in the Americas segment grew 64% or $2.6 billion compared to 2004. The increase in net sales during 2005 was primarily attributable to the significant year-over-year increase in iPod sales, sales of other music related products and services, and strong sales of desktop and portable Macintosh systems. This increase was partially offset by a shift in sales to the Retail segment, which had 117 stores in the U.S. and Canada as of the end of 2005. Macintosh unit sales also increased by 30% in 2005 compared to 2004, driven primarily by strong sales of desktop systems largely attributable to strong sales from the new iMac, which began shipping in September 2004, and the Mac mini, which was introduced in January 2005. During 2005 and 2004, the Americas segment represented approximately 47% and 49%, respectively, of the Company's total net sales and represented approximately 48% and 51%, respectively, of total Macintosh unit sales. As noted above, the Company experienced an increase in both U.S. education channel net sales and unit sales of 21% for 2005 compared to 2004. Strength in higher education sales related primarily to strong iMac shipments, portable system shipments, and online sales. This strength drove year-over-year growth in net sales of 32% for the higher education channel during 2005. Despite challenges in the K-12 market from continued budget constraints and competitive pressures, the Company's K-12 net sales grew year-over-year by 11% during 2005 due to increased iBook sales and 1:1 education sales.

During 2004, net sales in the Americas segment grew 26% or $838 million compared to 2003. The increase in net sales during 2004 was primarily attributable to the significant year-over-year increase in iPod sales as well as strong sales of peripherals, software, and services. This increase was partially offset by a shift in sales to the Retail segment, which had 84 stores in the U.S. as of the end of 2004. Macintosh unit sales also increased by 4% in 2004 compared to 2003, driven primarily by strong sales of portable and Power Macintosh systems, partially offset by weakness in iMac sales. During 2004 and 2003, the Americas segment represented approximately 49% and 51%, respectively, of the Company's total net sales and represented approximately 51% and 54%, respectively, of total Macintosh unit sales. The Company experienced an increase in U.S. education channel net sales of 19% for 2004 compared to 2003. Strong U.S. education net sales for 2004 related primarily to strength in higher education net sales that resulted from a successful back-to-school selling season with strong demand for the Company's portables. This strength drove year-over-year growth in net sales of 40% for the higher education channel during 2004. The Company's K-12 net sales grew year-over-year by 3% during 2004, despite the challenges in the K-12 market from continued budget constraints and increased competition.

Europe

During 2005, net sales in the Europe segment grew $1.3 billion or 71% from 2004. Total Macintosh unit sales in Europe also experienced growth during the current year by increasing 47% in 2005 compared to

2004. Consistent with the Americas segment, Europe experienced strong net sales of desktop products, iPod, other music related products and services, and software and service sales. Demand in Europe during 2005 was particularly strong for the Company's desktop computers, which experienced a year-over-year increase of 56%. Similar to the results of the Company's other segments, net sales of iPods, peripherals and software were strong in 2005.

Net sales in Europe rebounded in 2004 increasing $490 million or 37% from 2003. Total Macintosh unit sales in Europe also experienced growth in 2004 by increasing 13% compared to 2003. Consistent with the Americas segment, Europe experienced strong net sales across all product lines, except the iMac systems. Demand in Europe during 2004 was particularly strong for the Company's Power Macintosh systems and portable Macintosh systems, which experienced year-over-year increases of 29% and 42%, respectively. Similar to the results of the Company's other segments, net sales of iPods, peripherals and software were strong in 2004 over 2003.

Japan

Japan's net sales and Macintosh unit sales were up 36% and 8%, respectively, during 2005 compared to 2004. Japan experienced increased net sales in desktop products, iPod, and other music related products and services. Desktop net sales and unit sales increased by 31% and 41%, respectively, and iPod sales increased by 220% during 2005 compared to 2004. The overall increase in net sales was partially offset by a decline in portable system net sales during 2005 compared to 2004, which the Company believes might be attributable to a shift in sales from portables to the new iMac G5 and Mac mini, and a shift to the Retail segment as a result of opening two additional stores in Japan during 2005.

Japan's net sales and Macintosh unit sales were down 3% and 14%, respectively, during 2004 compared to 2003, which lagged behind all of the Company's other operating segments. These decreases in net sales and unit sales were believed to be attributable in part to a shift in sales from the Japan segment to the Retail segment as a result of the opening of two stores in Japan in 2004. In addition, such decreases may have been related to delayed computer system upgrades by some professional and creative customers who were awaiting the release of Quark XPress 6 for Mac OS X, which did not occur until September 2004. The decrease in net sales was partially offset by strong iPod and iBook sales during 2004 compared to 2003.

Retail

The Company opened 38 new retail stores during 2005, including 6 international stores in the U.K, Japan, and Canada, bringing the total number of open stores to 124 as of September 24, 2005. This compares to 86 open stores as of September 25, 2004 and 65 open stores as of September 27, 2003.

Net sales of the Retail segment grew to $2.4 billion during 2005 from $1.2 billion and $621 million in 2004 and 2003, respectively. The increases in net sales during both 2005 and 2004 reflect the impact of new store openings for each year, including the opening of 38 new stores in 2005 and 21 new stores in 2004. An increase in average revenue per store also contributed to the segment's strong sales in 2005. With an average of 105 stores open during 2005, the Retail segment achieved annualized revenue per store of approximately $22.4 million, as compared to $15.6 million in 2004 with a 76 store average, and $11.5 million in 2003 with a 54 store average.

As measured by the Company's operating segment reporting, the Retail segment reported operating income of $151 million during 2005 as compared to operating income of $39 million during 2004 and an operating loss of $5 million during 2003. This improvement is primarily attributable to the segment's year-over-year increase in average revenue per store, the impact of opening new stores, and the segment's year-over-year increase in net sales, which resulted in higher leverage on occupancy, depreciation, and other fixed costs.

Expansion of the Retail segment has required and will continue to require a substantial investment in fixed assets and related infrastructure, operating lease commitments, personnel, and other operating expenses. Capital expenditures associated with the Retail segment were $132 million in 2005, bringing the total capital expenditures since inception of the Retail segment to approximately $529 million. As of September 24, 2005, the Retail segment had approximately 3,673 employees and had outstanding operating lease commitments associated with retail store space and related facilities of approximately $606 million. The Company would incur substantial costs should it choose to terminate its Retail segment or close individual stores. Such costs could adversely affect the Company's results of operations and financial condition.

Gross Margin

Gross margin for each of the last three fiscal years are as follows (in millions, except gross margin percentages):

	September 24, 2005	September 25, 2004	September 27, 2003
Net sales	$ 13,931	$ 8,279	$ 6,207
Cost of sales	9,888	6,020	4,499
Gross margin	$ 4,043	$ 2,259	$ 1,708
Gross margin percentage	29.0 %	27.3 %	27.5 %

Gross margin increased in 2005 to 29.0% of net sales from 27.3% of net sales in 2004. The Company's gross margin during 2005 increased due to more favorable pricing on certain commodity components including LCD flat-panel displays and DRAM memory; an increase in higher margin software sales; a favorable shift in direct sales related primarily to the Company's Retail and online stores; and higher overall revenue that provided for more leverage on fixed production costs. These increases to gross margin were partially offset by an increase in lower margin iPod sales.

The Company anticipates that its gross margin and the gross margin of the overall personal computer and consumer electronics industries will remain under pressure in light of price competition, especially for the iPod product line. The Company expects gross margin percentage to decline in the first quarter of 2006 primarily as a result of a shift in the mix of revenue toward lower margin products such as the iPod and content from the iTunes Music Store.

The foregoing statements regarding the Company's expected gross margin are forward-looking. There can be no assurance that current gross margins will be maintained or targeted gross margin levels will be achieved. In general, gross margins and margins on individual products, including iPods, will remain under significant downward pressure due to a variety of factors, including continued industry wide global pricing pressures, increased competition, compressed product life cycles, potential increases in the cost and availability of raw material and outside manufacturing services, and potential changes to the Company's product mix, including higher unit sales of consumer products with lower average selling prices and lower gross margins. In response to these downward pressures, the Company expects it will continue to take pricing actions with respect to its products. Gross margins could also be affected by the Company's ability to effectively manage product quality and warranty costs and to stimulate demand for certain of its products. Due to the Company's significant international operations, financial results can be significantly affected in the short-term by fluctuations in exchange rates.

The Company orders components for its products and builds inventory in advance of product shipments. Because the Company's markets are volatile and subject to rapid technology and price changes, there is a risk the Company will forecast incorrectly and produce or order from third-parties excess or insufficient inventories of particular products or components. The Company's operating results and financial condition in the past have been and may in the future be materially adversely affected by the Company's ability to manage its inventory levels and outstanding purchase commitments and to respond to short-term shifts in customer demand patterns.

Gross margin declined in 2004 to 27.3% of net sales from 27.5% of net sales in 2003. The Company's gross margin during 2004 declined due to an increase in mix towards lower margin iPod and iBook sales, pricing actions on certain Power Macintosh G5 models that were transitioned during the beginning of 2004, higher warranty costs on certain portable Macintosh products, and higher freight and duty costs during 2004. These unfavorable factors were partially offset by an increase in direct sales and a 39% year-over-year increase in higher margin software sales.

Operating Expenses
Operating expenses for each of the last three fiscal years are as follows (in millions, except for percentages):

	September 24, 2005	September 25, 2004	September 27, 2003
Research and development	$ 534	$ 489	$ 471
Percentage of net sales	4%	6%	8%
Selling, general, and administrative expenses	$ 1,859	$ 1,421	$ 1,212
Percentage of net sales	13%	17%	20%
Restructuring costs	$ —	$ 23	$ 26

Research and Development (R&D)
The Company recognizes that focused investments in R&D are critical to its future growth and competitive position in the marketplace and are directly related to timely development of new and enhanced products that are central to the Company's core business strategy. The Company has historically relied upon innovation to remain competitive. R&D expense amounted to approximately 4% of total net sales during 2005 down from 6% and 8% of total net sales in 2004 and 2003, respectively. This decrease is due to the significant increase of 68% in total net sales of the Company for 2005. Although R&D expense decreased as a percentage of total net sales in 2005, actual expense for R&D in 2005 increased $45 million or 9% from 2004, which follows an $18 million or 4% increase in 2004 compared to 2003. The overall increase in R&D expense relates primarily to increased headcount and support for new product development activities and the impact of employee salary increases in 2005. R&D expense does not include capitalized software development costs of approximately $29.7 million related to the development of Mac OS X Tiger during 2005; $4.5 million related to the development of Mac OS X Tiger and $2.3 million related to the development of FileMaker Pro 7 in 2004; and $14.7 million related to the development of Mac OS X Panther in 2003. Further information related to the Company's capitalization of software development costs may be found in Part II, Item 8 of this Form 10-K at Note 1 of Notes to Consolidated Financial Statements.

Selling, General, and Administrative Expense (SG&A)
Expenditures for SG&A increased $438 million or 31% during 2005 compared to 2004. These increases are due primarily to the Company's continued expansion of its Retail segment in both domestic and international markets, a current year increase in discretionary spending on marketing and advertising, and higher direct and channel selling expenses resulting from the increase in net sales and employee salary

merit increases. SG&A as a percentage of total net sales in 2005 was 13%, down from 17% in 2004, which is due to the increase in total net sales of 68% for the Company during 2005.

Expenditures for SG&A increased $209 million or 17% during 2004 compared to 2003. These increases were due primarily to the Company's continued expansion of its Retail segment in both domestic and international markets, an increase in discretionary spending on marketing and advertising, an increase in amortization costs associated with restricted stock compensation, and higher direct and channel selling expenses resulting from the increase in net sales and employee salary merit increases. SG&A as a percentage of total net sales in 2004 was 17%, down from 20% in 2003 due to the increase in total net sales for the Company of 33% during 2004.

Fiscal 2004 Restructuring Actions
The Company recorded total restructuring charges of approximately $23 million during 2004, including approximately $14 million in severance costs, $5.5 million in asset impairments, and a $3.5 million charge for lease cancellations in conjunction with the vacating of a leased sales facility in Europe during the fourth quarter of 2004 related to a European workforce reduction. Of the $23 million charge, $19.7 million had been utilized by the end of 2005, with the remaining $3.3 million consisting of $0.7 million for employee severance benefits and $2.6 million for lease cancellations. These actions will result in the termination of 461 employees, 448 of which had been terminated prior to the end of 2005.

Fiscal 2003 Restructuring Actions
The Company recorded total restructuring charges of approximately $26.8 million during 2003, including approximately $7.4 million in severance costs, a $5.0 million charge to write-off deferred compensation, $7.1 million in asset impairments, and a $7.3 million charge for lease cancellations primarily related to the closure of the Company's Singapore manufacturing operations during the first quarter of 2003. Of the $26.8 million charge, all had been utilized by the end of 2005, except for approximately $1.7 million related to operating lease costs on abandoned facilities. These actions resulted in the termination of 353 employees.

Other Income and Expense
Other income and expense for each of the last three fiscal years are as follows (in millions):

	September 24, 2005	September 25, 2004	September 27, 2003
Gains on non-current investments, net	$ —	$ 4	$ 10
Interest income	$ 183	$ 64	$ 69
Interest expense	—	(3)	(8)
Gains on sales of short term investments, net	—	1	21
Other income (expense), net	(18)	(9)	1
Interest and Other Income, net	$ 165	$ 53	$ 83
Total other income and expense	$ 165	$ 57	$ 93

Gains and Losses on Non-current Investments
The Company previously held significant investments in ARM Holdings plc (ARM), Akamai Technologies, Inc. (Akamai), and EarthLink Network, Inc. (EarthLink). The Company sold all of the remaining holdings in these non-current investments in 2004 and 2003. Pretax gains recorded upon the sale of these non-current investments were $4 million and $10 million in 2004 and 2003, respectively.

Interest and Other Income, Net
Total interest and other income, net increased $112 million or 211% to $165 million during 2005 compared to $53 million in 2004 and $83 million in 2003. These increases are attributable primarily to increasing investment yields on the Company's cash and short-term investments and higher invested balances. The weighted average interest rate earned by the Company on its cash, cash equivalents, and short-term investments increased to 2.70% in 2005 compared to the 1.38% and 1.89% rates earned during 2004 and 2003, respectively. The Company occasionally sells short-term investments prior to their stated maturities. As a result of such sales, the Company recognized net losses of $137,000 in 2005 and net gains of $1 million and $21 million during 2004 and 2003, respectively. Partially offsetting the increase in other income were higher foreign currency hedging expenses.

Interest expense consisted primarily of interest on the Company's $300 million aggregate principal amount unsecured notes, which were repaid upon their maturity in February 2004. The unsecured notes were sold at 99.925% of par for an effective yield to maturity of 6.51%. Total deferred gain resulting from the closure of debt swaps of approximately $23 million was fully amortized as of the notes' maturity in February 2004.

Provision for Income Taxes
The Company's effective tax rate for the year ended September 24, 2005 was approximately 26%. The Company's effective rate differs from the statutory federal income tax rate of 35% due primarily to certain undistributed foreign earnings for which no U.S. taxes are provided because such earnings are intended to be indefinitely reinvested outside the U.S., research and development tax credits, and a reduction of certain tax contingency reserves and adjustments to net deferred tax assets. The benefit from adjustments to tax contingency reserves and net deferred tax assets was $67 million. In addition, the Company recorded a $25 million reduction of the valuation allowance associated with deferred tax assets that, in management's opinion, are now more likely than not to be realized in the future. $14 million of the valuation allowance reduction was recorded as a credit to income tax expense, and the remainder was recorded as a credit to goodwill.

As of September 24, 2005, the Company had deferred tax assets arising from deductible temporary differences, tax losses, and tax credits of $767 million before being offset against certain deferred tax liabilities and a valuation allowance for presentation on the Company's balance sheet. Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, will be sufficient to fully recover the remaining net deferred tax assets. As of September 24, 2005 and September 25, 2004, a valuation allowance of $5 million and $30 million, respectively, was recorded against the deferred tax asset for the benefits of tax loss carryforwards that may not be realized. The remaining valuation allowance at September 24, 2005 relates principally to certain state operating loss carryforwards. The Company will continue to evaluate the realizability of the deferred tax assets quarterly by assessing the need for and amount of the valuation allowance.

The Internal Revenue Service (IRS) has completed its field audit of the Company's federal income tax returns for all years prior to 2002 and proposed certain adjustments. Certain of these adjustments are being contested through the IRS Appeals Office. Substantially all IRS audit issues for these years have been resolved. In addition, the Company is also subject to audits by state, local, and foreign tax authorities. Management believes that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. Should any issues addressed in the Company's tax audits be resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs.

On October 22, 2004, the American Jobs Creation Act (AJCA) was signed into law. The AJCA includes a provision for the deduction of 85% of certain foreign earnings that are repatriated, as defined in the

AJCA. The legislation provided the Company with the option to apply this provision to repatriations of qualifying earnings in either 2005 or 2006. The Company is continuing to evaluate the effects of the repatriation provision and expects to complete the evaluation in 2006. A maximum of $755 million may be eligible for repatriation under the reduced tax rate provided by AJCA. However, given the uncertainties and complexities of the repatriation provision and the Company's continuing evaluation, the Company has not yet determined the amount that may be repatriated or the related potential income tax effects of such repatriation.

Recent Accounting Pronouncements

In November 2005, the FASB issued FASB Staff Position (FSP) Nos. FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments*. FSP Nos. FAS 115-1 and FAS 124-1 amend SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* SFAS No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations,* as well as APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock.* This guidance nullifies certain requirements of EITF 03-1, *The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments*. FSP Nos. FAS 115-1 and FAS 124-1 include guidance for evaluating and recording impairment losses on debt and equity investments, as well as new disclosure requirements for investments that are deemed to be temporarily impaired. FSP Nos. FAS 115-1 and FAS 124-1 also require other-than-temporary impaired debt securities to be written down to its impaired value, which becomes the new cost basis. FSP Nos. FAS 115-1 and FAS 124-1 are effective for fiscal years beginning after December 15, 2005. Although the Company will continue to evaluate the application of FSP Nos. FAS 115-1 and FAS 124-1, management does not currently believe adoption will have a material impact on the Company's results of operations or financial position.

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs*, which amends the guidance in Accounting Research Bulletin (ARB) No. 43, Chapter 4, *Inventory Pricing*, to clarify the accounting for abnormal amounts of facility expense, freight, handling costs, and wasted material (spoilage). ARB 43, Chapter 4, previously stated that "under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges." SFAS 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal." In addition, SFAS 151 requires that allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the production facilities. SFAS 151 is effective for fiscal years beginning after June 15, 2005. Although the Company will continue to evaluate the application of SFAS 151, management does not currently believe adoption will have a material impact on the Company's results of operations or financial position.

In December 2004, the FASB issued FSP 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004*. FSP 109-2 provides additional time to companies beyond the financial reporting period of enactment to evaluate the effects of the AJCA on their plans for repatriation of foreign earnings for purposes of applying SFAS 109, *Accounting for Income Taxes*. The Company is currently evaluating the repatriation provisions of AJCA, which if implemented by the Company would affect the Company's tax provision and deferred tax assets and liabilities. However, given the uncertainties and complexities of the repatriation provision and the Company's continuing evaluation, it is not possible at this time to determine the amount, if any, that will be repatriated or the related potential income tax effects of such repatriation. The Company expects to complete the evaluation in 2006.

In December 2004, the FASB issued SFAS No. 123 (revised 2004) (SFAS No. 123R), *Share-Based Payment*, that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. SFAS No. 123R eliminates the ability to account for share-based compensation transactions using the intrinsic value method under Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and instead requires such transactions be accounted for using a fair-value-based method. The Company will recognize stock-based compensation expense on all awards on a straight-line basis over the requisite service period using the modified prospective method. In January 2005, the SEC issued SAB No. 107, which provides supplemental implementation guidance for SFAS No. 123R. SFAS No. 123R will be effective for the Company beginning in the first quarter of fiscal 2006. The Company expects the adoption of SFAS No. 123R will result in a reduction of diluted earnings per common share of approximately $0.03 for the first quarter of fiscal 2006.

In March 2005, the FASB issued Interpretation No. (FIN) 47, *Accounting for Conditional Asset Retirement Obligations,* to clarify the requirement to record liabilities stemming from a legal obligation to perform an asset retirement activity in which the timing or method of settlement is conditional on a future event. The Company plans to adopt FIN 47 in the first quarter of fiscal 2006, and does not expect the application of FIN 47 to have a material impact on its results of operations, cash flows or financial position.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* which replaces APB Opinion No. 20 *Accounting Changes* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements—An Amendment of APB Opinion No. 28*. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principal unless it is not practicable. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005 and is required to be adopted by the Company in the first quarter of fiscal 2007. Although the Company will continue to evaluate the application of SFAS No. 154, management does not currently believe adoption will have a material impact on the Company's results of operations or financial position.

Liquidity and Capital Resources

The following table presents selected financial information and statistics for each of the last three fiscal years (dollars in millions):

	September 24, 2005	September 25, 2004	September 27, 2003
Cash, cash equivalents, and short-term investments	$ 8,261	$ 5,464	$ 4,566
Accounts receivable, net	$ 895	$ 774	$ 766
Inventory	$ 165	$ 101	$ 56
Working capital	$ 6,816	$ 4,404	$ 3,530
Days sales in accounts receivable (DSO) (a)	22	30	41
Days of supply in inventory (b)	6	5	4
Days payables outstanding (DPO) (c)	62	76	82
Annual operating cash flow	$ 2,535	$ 934	$ 289

(a) DSO is based on ending net trade receivables and most recent quarterly net sales for each period.

(b) Days supply of inventory is based on ending inventory and most recent quarterly cost of sales for each period.

(c) DPO is based on ending accounts payable and most recent quarterly cost of sales adjusted for the change in inventory.

As of September 24, 2005, the Company had $8.261 billion in cash, cash equivalents, and short-term investments, an increase of $2.797 billion over the same balances at the end of 2004. The principal components of this increase were cash generated by operating activities of $2.535 billion and proceeds of $543 million from the issuance of common stock under stock plans, partially offset by cash used to purchase property, plant, and equipment of $260 million. The Company's short-term investment portfolio is primarily invested in high credit quality, liquid investments. As of September 24, 2005, approximately $4.3 billion of the Company's cash, cash equivalents, and short-term investments were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S. The Company is currently assessing the impact of the one-time favorable foreign dividend provisions recently enacted as part of the American Jobs Creation Act of 2004, and may decide to repatriate earnings from some of its foreign subsidiaries.

The Company believes its existing balances of cash, cash equivalents, and short-term investments will be sufficient to satisfy its working capital needs, capital expenditures, stock repurchase activity, outstanding commitments, and other liquidity requirements associated with its existing operations over the next 12 months.

Capital Expenditures

The Company's total capital expenditures were $260 million during 2005, $132 million of which were for retail store facilities and equipment related to the Company's Retail segment and $128 million of which were primarily for corporate infrastructure, including information systems enhancements and operating facilities enhancements and expansions. The Company currently anticipates it will utilize approximately $390 million for capital expenditures during 2006, approximately $210 million of which is expected to be utilized for further expansion of the Company's Retail segment and the remainder utilized to support normal replacement of existing capital assets and enhancements to general information technology infrastructure.

Stock Repurchase Plan

In July 1999, the Company's Board of Directors authorized a plan for the Company to repurchase up to $500 million of its common stock. This repurchase plan does not obligate the Company to acquire any specific number of shares or acquire shares over any specified period of time. Since inception of the stock repurchase plan, the Company had repurchased a total of 13.1 million shares at a cost of $217 million. The Company has not engaged in any transactions to repurchase its common stock during 2005 or 2004. The Company was authorized to repurchase up to an additional $283 million of its common stock as of September 24, 2005.

On February 28, 2005, the Company effected a two-for-one stock split to shareholders of record as of February 18, 2005. All share and per share information has been retroactively adjusted to reflect the stock split.

Off-Balance Sheet Arrangements and Contractual Obligations

The Company has not entered into any transactions with unconsolidated entities whereby the Company has financial guarantees, subordinated retained interests, derivative instruments, or other contingent arrangements that expose the Company to material continuing risks, contingent liabilities, or any other obligation under a variable interest in an unconsolidated entity that provides financing, liquidity, market risk, or credit risk support to the Company.

The following table presents certain payments due by the Company under contractual obligations with minimum firm commitments as of September 24, 2005 and excludes amounts already recorded on the Company's balance sheet as current liabilities (in millions):

	Total	Payments Due in Less Than 1 year	Payments Due in 1-3 years	Payments Due in 4-5 years	Payments Due in More Than 5 years
Operating Leases	$ 865	$ 108	$ 211	$ 192	$ 354
Purchase Obligations	1,994	1,994	—	—	—
Asset Retirement Obligations	14	—	2	2	10
Other Obligations	4	4	—	—	—
Total	$ 2,877	$ 2,106	$ 213	$ 194	$ 364

Lease Commitments

As of September 24, 2005, the Company had total outstanding commitments on noncancelable operating leases of approximately $865 million, $606 million of which related to the lease of retail space and related facilities. Lease terms on the Company's existing major facility operating leases range from 5 to 20 years.

Purchase Commitments with Contract Manufacturers and Component Suppliers

The Company utilizes several contract manufacturers to manufacture sub-assemblies for the Company's products and to perform final assembly and test of finished products. These contract manufacturers acquire components and build product based on demand information supplied by the Company, which typically covers periods ranging from 30 to 150 days. The Company also obtains individual components for its products from a wide variety of individual suppliers. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. Such purchase commitments typically cover the Company's forecasted component and manufacturing requirements for periods ranging from 30 to 150 days. As of September 24, 2005, the Company had outstanding third-party manufacturing commitments and component purchase commitments of approximately $2.0 billion.

Subsequent to September 24, 2005, the Company entered into long-term supply agreements with Hynix Semiconductor, Inc., Intel Corporation, Micron Technology, Inc., Samsung Electronics Co., Ltd., and Toshiba Corporation to secure supply of NAND flash memory through calendar year 2010. As part of these agreements, the Company intends to prepay a total of $1.25 billion for flash memory components by the end of the second quarter of 2006.

Asset Retirement Obligations

The Company's asset retirement obligations are associated with commitments to return property subject to operating leases to original condition upon lease termination. As of September 24, 2005, the Company estimates that gross expected future cash flows of approximately $14 million will be required to fulfill these obligations.

Other Obligations

The Company's other obligations of approximately $4 million are primarily related to Internet and telecommunications services.

Indemnifications

The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against itself or an indemnified third-party and, in the opinion of management, does not have a liability related to unresolved infringement claims subject to indemnification that would have a material adverse effect on its financial condition, liquidity or results of operations.

Factors That May Affect Future Results and Financial Condition

Because of the following factors, as well as other factors affecting the Company's operating results and financial condition, past financial performance should not be considered to be a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

General economic conditions and current economic and political uncertainty could adversely affect the demand for the Company's products and the financial health of its suppliers, distributors, and resellers.

The Company's operating performance depends significantly on general economic conditions in the U.S. and abroad. At times in the past, demand for the Company's products has been negatively impacted by difficult global economic conditions. Additionally, some of the Company's education customers appeared to be delaying technology purchases due to concerns about the overall impact of the weaker economy and state budget deficits on their available funding. Although recent macroeconomic trends seem to indicate an economic recovery, continued uncertainty about future economic conditions makes it difficult to forecast future demand for the Company's products and related operating results. Should global and/or regional economic conditions deteriorate, demand for the Company's products could be adversely affected, as could the financial health of its suppliers, distributors, and resellers.

War, terrorism, public health issues or other business interruptions could disrupt supply, delivery or demand of products, which could negatively affect the Company's operations and performance.

War, terrorism, public health issues and other business interruptions whether in the U.S. or abroad, have caused and could cause damage or disruption to international commerce by creating economic and political uncertainties that may have a strong negative impact on the global economy, the Company, and the Company's suppliers or customers. The Company's major business operations are subject to interruption by earthquake, other natural disasters, fire, power shortages, terrorist attacks and other hostile acts, labor disputes, public health issues, and other events beyond its control. The majority of the Company's research and development activities, its corporate headquarters, information technology systems, and other critical business operations, including certain component suppliers and manufacturing vendors, are located near major seismic faults. Because the Company does not carry earthquake insurance for direct quake-related losses, the Company's operating results and financial condition could be materially adversely affected in the event of a major earthquake or other natural or manmade disaster.

Although it is impossible to predict the occurrences or consequences of any such events, such events could result in a decrease in demand for the Company's products, make it difficult or impossible for the Company to deliver products to its customers or to receive components from its suppliers, and could create delays and inefficiencies in the Company's supply chain. In addition, should major public health issues, including pandemics, arise, the Company could be negatively impacted by the need for more stringent employee travel restrictions, additional limitations in the availability of freight services, governmental actions limiting the movement of products between various regions, delays in production ramps of new products, and disruptions in the operations of the Company's manufacturing vendors and component suppliers. The Company's operating results and financial condition have been, and in the future may be, adversely affected by these events.

The market for personal computers and related peripherals and services, as well as digital music devices and related services, is highly competitive. If the Company is unable to effectively compete in these markets, its results of operations could be adversely affected.
The personal computer industry is highly competitive and is characterized by aggressive pricing practices, downward pressure on gross margins, frequent introduction of new products, short product life cycles, evolving industry standards, continual improvement in product price/performance characteristics, rapid adoption of technological and product advancements by competitors, price sensitivity on the part of consumers, and a large number of competitors. Over the past several years, price competition in the market for personal computers and related peripherals has been particularly intense as competitors who sell Windows and Linux based personal computers have aggressively cut prices and lowered their product margins for personal computing products. The Company's results of operations and financial condition have been, and in the future may continue to be, adversely affected by these and other industry-wide pricing pressures and downward pressures on gross margins.

The personal computer industry has also been characterized by rapid technological advances in software functionality, hardware performance, and features based on existing or emerging industry standards. Further, as the personal computer industry and its customers place more reliance on the Internet, an increasing number of Internet devices that are smaller and simpler than traditional personal computers may compete for market share with the Company's existing products. Several competitors of the Company have either targeted or announced their intention to target certain of the Company's key market segments, including consumer, education, professional and consumer digital video editing, and design and publishing. Several of the Company's competitors have introduced or announced plans to introduce digital music products and/or online stores offering digital music distribution that mimic many of the unique design, technical features, and solutions of the Company's products. The Company has a significant number of competitors, many of whom have greater financial, marketing, manufacturing, and technological resources, as well as broader product lines and larger installed customer bases than those of the Company. Additionally, there has been a trend towards consolidation in the personal computer industry that has resulted in larger and potentially stronger competitors in the Company's markets.

The Company is currently the only maker of hardware using the Mac OS. The Mac OS has a minority market share in the personal computer market, which is dominated by makers of computers utilizing other competing operating systems, including Windows and Linux. The Company's future operating results and financial condition are substantially dependent on its ability to continue to develop improvements to the Macintosh platform in order to maintain perceived design and functional advantages over competing platforms. Additionally, if unauthorized copies of the Mac OS are used on other companies' hardware products and result in decreased demand for the Company's hardware products, the Company's results of operations may be adversely affected.

The Company is currently focused on market opportunities related to digital music distribution and related consumer electronic devices, including iPods. The Company faces increasing competition from other companies promoting their own digital music products, including music enabled cell phones, distribution services, and free peer-to-peer music services. These competitors include both new entrants with different market approaches, such as subscription services models, and also larger companies that may have greater technical, marketing, distribution, and other resources than those of the Company, as well as established hardware, software, and digital content supplier relationships. Failure to effectively compete could negatively affect the Company's operating results and financial position. There can be no assurance that the Company will be able to continue to provide products and services that effectively compete in these markets or successfully distribute and sell digital music outside the U.S. The Company may also have to respond to price competition by lowering prices and/or increasing features which could adversely affect the Company's music product gross margins as well as overall Company gross margins.

The Company also faces increased competition in the U.S. education market. U.S. elementary and secondary schools, as well as college and university customers, remain a core market for the Company. Uncertainty in this channel remains as several competitors of the Company have either targeted or announced their intention to target the education market for personal computers, which could negatively affect the Company's market share. In an effort to regain market share and remain competitive, the Company has been and will continue to pursue one-to-one (1:1) learning solutions in education. 1:1 learning solutions typically consist of iBook portable systems for every student and teacher along with a wireless network connected to a central server. These 1:1 learning solutions and other strategic sales are generally priced more aggressively and could result in significantly less profitability or even in financial losses, particularly for larger deals. Although the Company believes it has taken certain steps to strengthen its position in the education market, there can be no assurance that the Company will be able to increase or maintain its share of the education market or execute profitably on large strategic arrangements. Failure to do so may have an adverse impact on the Company's operating results and financial condition.

The Company's transition from PowerPC microprocessors used by Macintosh computers to microprocessors built by Intel is subject to numerous risks.

In June 2005, the Company announced its intention to transition from the use of PowerPC microprocessors to the use of Intel microprocessors in all of its Macintosh computers by the end of calendar year 2007. This transition is subject to numerous risks and uncertainties, including the Company's ability to timely develop and deliver new products using Intel microprocessors, the timely innovation and delivery of related hardware and software products, including the Company's applications, to support Intel microprocessors, market acceptance of Intel-based Macintosh computers, the development and availability on acceptable terms of components and services essential to enable the Company to timely deliver Intel-based Macintosh computers, and the effective management of inventory levels in line with anticipated product demand for both PowerPC and Intel-based Macintosh computers. In addition, the Company is dependent on third-party software developers such as Microsoft and Adobe continuing to support current applications that run on PowerPC-based computers and timely developing versions of current and future applications that run on Intel and PowerPC-based Macintosh computers. The Company's inability to timely deliver new Intel-based products or obtain developer commitment both to continue supporting applications that run on PowerPC microprocessors and timely transition their applications to run natively on Intel-based products may have an adverse impact on the Company's results of operations. The Company's announcement of its intention to transition to Intel microprocessors may negatively impact sales of current and future Macintosh products containing PowerPC microprocessors, as customers may elect to delay purchases until the Intel-based products are available. Additionally, there can be no assurance that the Company will be able to maintain its historical gross margin percentages on its products, including Intel-based Macintosh computers, which may adversely impact the Company's results of operations.

Future operating results are dependent upon the Company's ability to obtain a sufficient supply of components, including microprocessors, some of which are in short supply or available only from limited sources.

Although most components essential to the Company's business are generally available from multiple sources, certain key components including microprocessors and ASICs are currently obtained by the Company from single or limited sources. Some key components (including without limitation DRAM, NAND flash-memory, and TFT-LCD flat-panel displays), while currently available to the Company from multiple sources, are at times subject to industry-wide availability and pricing pressures. In addition, new products introduced by the Company often initially utilize custom components obtained from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. In situations where a component or product utilizes new technologies, initial capacity constraints may exist until such time as the suppliers' yields have matured. The Company and other producers in the personal computer industry also compete for various components with other industries that have experienced increased demand for their products. The Company uses some components that are not common to the rest of the personal computer industry including certain microprocessors and ASICs. Continued availability of these components may be affected if producers were to decide to concentrate on the production of components other than those customized to meet the Company's requirements. If the supply of a key component were to be delayed or constrained on a new or existing product, the Company's results of operations and financial condition could be adversely affected.

The Company's ability to produce and market competitive products is dependent on the ability and desire of IBM and Freescale Semiconductor, Inc. (Freescale) to supply PowerPC microprocessors and Intel to supply its microprocessors for the Company's Macintosh computers and to provide the Company with a sufficient supply of microprocessors with price/performance features that compare favorably to those supplied to the Company's competitors. While the Company has supply agreements with IBM and Freescale, the Company's recent announcement of plans to transition to Intel microprocessors may impact the continued availability on acceptable terms of certain components and services, including PowerPC G4 and G5 microprocessors, which are essential to the Company's business and are currently obtained by the Company from sole or limited sources. Additionally, there have been instances in recent years where the inability of the Company's suppliers to provide advanced PowerPC microprocessors in sufficient quantity has had significant adverse effects on the Company's results of operations. In addition, IBM is currently the Company's sole supplier of the PowerPC G5 processor, which is used in the Company's current Power Mac, Xserve, and iMac G5 products. Freescale is the sole supplier of the G4 processor, which is used in the Company's eMac, Mac mini, and portable products. IBM experienced manufacturing problems with the PowerPC G5 processor, which resulted in the Company delaying the shipment of various products and constrained certain product shipments during the second half of 2004 and the first quarter of 2005. Manufacturing problems experienced by any of the Company's suppliers in the future or failure by them to deliver components to the Company in sufficient quantities with competitive price/performance features could adversely affect the Company's results of operations and financial condition.

The Company must successfully manage frequent product introductions and transitions to remain competitive and effectively stimulate customer demand.

Due to the highly volatile and competitive nature of the personal computer and consumer electronics industries, which are characterized by dynamic customer demand patterns and rapid technological advances, the Company must continually introduce new products and technologies, enhance existing products in order to remain competitive, and effectively stimulate customer demand for new products and upgraded versions of the Company's existing products. The success of new product introductions is dependent on a number of factors, including market acceptance; the Company's ability to manage the risks associated with product transitions, including the transition to Intel-based Macintosh computers, and production ramp issues; the availability of application software for new products; the effective management of inventory levels in line with anticipated product demand, including anticipated demand for PowerPC-based and Intel-based Macintosh computers; the availability of products in appropriate quantities to meet anticipated demand; and the risk that new products may have quality or other defects in the early stages of introduction. Accordingly, the Company cannot determine in advance the ultimate effect that new products will have on its sales or results of operations.

The Company's products from time to time experience quality problems that can result in decreased net sales and operating profits.

The Company sells highly complex hardware and software products that can contain defects in design and manufacture. Sophisticated operating system software and applications, such as those sold by the Company, often contain "bugs" that can unexpectedly interfere with the operation of the software. Defects may also occur in components and products the Company purchases from third-parties. There can be no assurance that the Company will be able to detect and fix all defects in the hardware and software it sells.

Failure to do so could result in lost revenue, loss of reputation, and significant warranty and other expense to remedy.

Because orders for components, and in some cases commitments to purchase components, must be placed in advance of customer orders, the Company faces substantial inventory risk.
The Company records a write-down for inventories of components and products that have become obsolete or are in excess of anticipated demand or net realizable value and accrues necessary reserves for cancellation fees of orders for inventories that have been cancelled. Although the Company believes its inventory and related provisions are currently adequate, given the rapid and unpredictable pace of product obsolescence in the computer and consumer electronics industries and the transition to Intel-based Macintosh computers, no assurance can be given that the Company will not incur additional inventory and related charges. In addition, such charges have had, and may have, a material effect on the Company's financial position and results of operations.

The Company must order components for its products and build inventory in advance of product shipments. Because the Company's markets are volatile and subject to rapid technology and price changes, and because of the transition to Intel-based Macintosh computers, there is a risk the Company will forecast incorrectly and produce or order from third parties excess or insufficient inventories of particular products. Consistent with industry practice, components are normally acquired through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. Such purchase commitments typically cover the Company's forecasted component and manufacturing requirements for periods ranging from 30 to 150 days. The Company's operating results and financial condition have been in the past and may in the future be materially adversely affected by the Company's ability to manage its inventory levels and respond to short-term shifts in customer demand patterns.

The Company is dependent on manufacturing and logistics services provided by third parties, many of whom are located outside of the U.S.
Most of the Company's products are manufactured in whole or in part by third-party manufacturers. In addition, the Company has outsourced much of its transportation and logistics management. While outsourcing arrangements may lower the cost of operations, they also reduce the Company's direct control over production and distribution. It is uncertain what effect such diminished control will have on the quality or quantity of the products manufactured or services rendered, or the flexibility of the Company to respond to changing market conditions. Moreover, although arrangements with such manufacturers may contain provisions for warranty expense reimbursement, the Company may remain at least initially responsible to the consumer for warranty service in the event of product defects. Any unanticipated product defect or warranty liability, whether pursuant to arrangements with contract manufacturers or otherwise, could adversely affect the Company's future operating results and financial condition.

Final assembly of products sold by the Company is currently performed in the Company's manufacturing facility in Cork, Ireland, and by external vendors in Fremont, California, Fullerton, California, Taiwan, Korea, the People's Republic of China, and the Czech Republic. Currently, manufacturing of many of the components used in the Company's products is performed by third-party vendors in Taiwan, China, Japan, Korea, and Singapore. Final assembly of substantially all of the Company's portable products including PowerBooks, iBooks, and iPods is performed by third-party vendors in China. If for any reason manufacturing or logistics in any of these locations is disrupted by regional economic, business, labor, environmental, public health, or political issues, as well as information technology system failures or military actions, the Company's results of operations and financial condition could be adversely affected.

The Company's future operating performance is dependent on the performance of distributors and other resellers of the Company's products.

The Company distributes its products through wholesalers, resellers, national and regional retailers, and cataloguers, many of whom distribute products from competing manufacturers. In addition, the Company sells many of its products and resells certain third-party products in most of its major markets directly to end users, certain education customers, and certain resellers through its online stores around the world and its retail stores. Many of the Company's resellers operate on narrow product margins and have been negatively affected by weak economic conditions over the last several years. Considerable trade receivables that are not covered by collateral or credit insurance are outstanding with the Company's distribution and retail channel partners. The Company's business and financial results could be adversely affected if the financial condition of these resellers weakens, if resellers within consumer channels were to cease distribution of the Company's products, or if uncertainty regarding demand for the Company's products caused resellers to reduce their ordering and marketing of the Company's products. The Company has invested and will continue to invest in various programs to enhance reseller sales, including staffing selected resellers' stores with Company employees and contractors. These programs could require a substantial investment from the Company, while providing no assurance of return or incremental revenue to offset this investment.

Over the past several years, an increasing proportion of the Company's net sales has been made by the Company directly to end-users through its online stores around the world and through its retail stores in the U.S., Canada, Japan, and the U.K. Some of the Company's resellers have perceived this expansion of the Company's direct sales as conflicting with their own businesses and economic interests as distributors and resellers of the Company's products. Perception of such a conflict could discourage the Company's resellers from investing additional resources in the distribution and sale of the Company's products or lead them to limit or cease distribution of the Company's products. The Company's business and financial results could be adversely affected if expansion of its direct sales to end-users causes some or all of its resellers to cease or limit distribution of the Company's products.

Further information regarding risks associated with Marketing and Distribution may be found in Part I, Item 1 of this Form 10-K under the heading "Markets and Distribution."

The Company relies on third-party digital content, which may not be available to the Company on commercially reasonable terms or at all.

The Company contracts with third parties to offer their digital content to customers through the Company's iTunes Music Store. The Company pays substantial fees to obtain the rights to offer to its customers this third-party digital content. The Company's licensing arrangements with these third-party content providers are short-term in nature and do not guarantee the future renewal of these arrangements at commercially reasonable terms, if at all. Certain parties in the music industry have consolidated and formed alliances, which could limit the availability and increase the fees required to offer digital content to customers through the iTunes Music Store. Further, some third-party content providers currently, or may in the future, offer music products and services that compete with the Company's music products and services, and could take action to make it more difficult or impossible for the Company to license their digital content in the future. If the Company is unable to continue to offer a wide variety of digital content at reasonable prices with acceptable usage rules, or continue to expand its geographic reach outside the U.S., then sales and gross margins of the Company's iTunes Music Store as well as related hardware and peripherals, including iPods, may be adversely affected.

Third-party content providers and artists require that the Company provide certain digital rights management solutions and other security mechanisms. If the requirements from content providers or artists change, then the Company may be required to further develop or license technology to address such new rights and requirements. There is no assurance that the Company will be able to develop or license such solutions at a reasonable cost and in a timely manner, if at all, which could have a materially adverse effect on the Company's operating results and financial position.

The Company's future performance is dependent upon support from third-party software developers. If third-party software applications cease to be developed or available for the Company's hardware products, then customers may choose not to buy the Company's products.

The Company believes that decisions by customers to purchase the Company's personal computers, as opposed to Windows-based systems, are often based on the availability of third-party software for particular applications such as Microsoft Office. The Company also believes the availability of third-party application software for the Company's hardware products depends in part on third-party developers' perception and analysis of the relative benefits of developing, maintaining, and upgrading such software for the Company's products versus software for the larger Windows market or growing Linux market. This analysis may be based on factors such as the perceived strength of the Company and its products, the anticipated potential revenue that may be generated, continued acceptance by customers of Mac OS X, and the costs of developing such software products. To the extent the minority market share held by the Company in the personal computer market has caused software developers to question the Company's prospects in the personal computer market, developers could be less inclined to develop new application software or upgrade existing software for the Company's products and more inclined to devote their resources to developing and upgrading software for the larger Windows market or growing Linux market. Moreover, there can be no assurance software developers will continue to develop software for Mac OS X, the Company's operating system, on a timely basis or at all.

In June 2005, the Company announced its plan to begin using Intel microprocessors in its Macintosh computers. The Company plans to begin shipping certain models with Intel microprocessors by June 2006 and to complete this transition to Intel microprocessors for all of its Macintosh computers by the end of calendar year 2007. The Company depends on third-party software developers to timely develop current and future applications that run on Intel and PowerPC microprocessors. The Company's inability to timely deliver new Intel-based products, or a decline in available applications that run on the Company's PowerPC products or the lack of applications that run on Intel-based Macintosh systems could have a materially adverse effect on the Company's operating results and financial position.

In addition, past and future development by the Company of its own software applications and solutions may negatively impact the decision of software developers, such as Microsoft and Adobe, to develop, maintain, and upgrade similar or competitive software for the Company's products. The Company currently markets and sells a variety of software applications for use by professionals, consumers, and education customers that could influence the decisions of third-party software developers to develop or upgrade Macintosh-compatible software products. Software applications currently marketed by the Company include software for professional film and video editing, professional compositing and visual effects for large format film and video productions, professional music production and music post production, professional and consumer DVD encoding and authoring, professional digital photo editing and workflow management, consumer digital video and digital photo editing and management, digital music management, desktop-based database management, word processing, and high-quality presentations. The Company also markets an integrated productivity application that incorporates word processing, page layout, image manipulation, spreadsheets, databases, and presentations in a single application. Discontinuance of third-party products for the Macintosh platform, including Microsoft Office could have an adverse effect on the Company's net sales and results of operations.

The Company's business relies on access to patents and intellectual property obtained from third parties, and the Company's future results could be adversely affected if it is alleged or found to have infringed on the intellectual property rights of others.
Many of the Company's products are designed to include intellectual property obtained from third parties. While it may be necessary in the future to seek or renew licenses relating to various aspects of its products and business methods, the Company believes that based upon past experience and industry practice, such licenses generally could be obtained on commercially reasonable terms. However, there can be no assurance that the necessary licenses would be available or available on acceptable terms.

Because of technological changes in the computer and consumer electronics industries, current extensive patent coverage, and the rapid rate of issuance of new patents, it is possible certain components of the Company's products and business methods may unknowingly infringe existing patents of others. The Company has from time to time been notified that it may be infringing certain patents or other intellectual property rights of others. Responding to such claims, regardless of their merit, can be time-consuming, result in significant expenses, and cause the diversion of management and technical personnel. Several pending claims are in various stages of evaluation. The Company may consider the desirability of entering into licensing agreements in certain of these cases. However, no assurance can be given that such licenses can be obtained on acceptable terms or that litigation will not occur. In the event there is a temporary or permanent injunction entered prohibiting the Company from marketing or selling certain of its products or a successful claim of infringement against the Company requiring it to pay royalties to a third-party, the Company's future operating results and financial condition could be adversely affected. Information regarding certain claims and litigation involving the Company related to alleged patent infringement and other matters is set forth in Part I, Item 3 of this Form 10-K. In the opinion of management, the Company does not have a potential liability for damages or royalties from any current legal proceedings or claims related to the infringement of patent or other intellectual property rights of others that would individually or in the aggregate have a material adverse effect on its results of operations, or financial condition. However, the results of such legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of the matters related to infringement of patent or other intellectual property rights of others described in Part I, Item 3 of this Form 10-K or should several of these matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

The Company's retail initiative has required and will continue to require a substantial investment and commitment of resources and is subject to numerous risks and uncertainties.
Through October 2005, the Company had opened 126 retail stores. The Company's retail initiative has required substantial investment in equipment and leasehold improvements, information systems, inventory, and personnel. The Company has also entered into substantial operating lease commitments for retail space with lease terms ranging from 5 to 20 years, the majority of which are for 10 years. The Company could incur substantial costs should it choose to terminate this initiative or close individual stores. Such costs could adversely affect the Company's results of operations and financial condition. Additionally, a relatively high proportion of the Retail segment's costs are fixed because of depreciation on store construction costs and lease expense. As a result, significant losses would result should the Retail segment experience a significant decline in sales for any reason.

Certain of the Company's stores have been designed and built to serve as high profile venues that function as vehicles for general corporate marketing, corporate events, and brand awareness. Because of their unique design elements, locations and size, these stores require substantially more investment in equipment and leasehold improvements than the Company's more typical retail stores. The Company has opened seven such stores through October 2005. Because of their location and size, these high profile stores also require the Company to enter into substantially larger operating lease commitments compared to those required for its more typical stores. Current leases on such locations have terms ranging from 10 to 14 years with total remaining commitments per location ranging from $4 million to $46 million. Closure or poor performance of one of these high profile stores could have a particularly significant negative impact on the Company's results of operations and financial condition.

Many of the general risks and uncertainties the Company faces could also have an adverse impact on its Retail segment. Also, many factors unique to retail operations present risks and uncertainties, some of which are beyond the Company's control, that could adversely affect the Retail segment's future results, cause its actual results to differ from those currently expected, and/or have an adverse effect on the Company's consolidated results of operations. Potential risks and uncertainties unique to retail operations that could have an adverse impact on the Retail segment include, among other things, macro-economic factors that have a negative impact on general retail activity; inability to manage costs associated with store construction and operation; failure to attract new users to the Macintosh platform; inability to sell third-party hardware and software products at adequate margins; failure to manage relationships with existing retail channel partners; lack of experience in managing retail operations outside the U.S.; costs associated with unanticipated fluctuations in the value of Apple-branded and third-party retail inventory; and inability to obtain quality retail locations at reasonable cost.

Investment in new business strategies and initiatives could disrupt the Company's ongoing business and may present risks not originally contemplated.
The Company has and may in the future invest in new business strategies or engage in acquisitions that complement the Company's strategic direction and product roadmap. Such endeavors may involve significant risks and uncertainties, including distraction of management's attention away from normal business operations; insufficient revenue generation to offset liabilities assumed and expenses associated with the strategy; and unidentified issues not discovered in the Company's due diligence process. Because these new ventures are inherently risky, no assurance can be given that such strategies and initiatives will be successful and will not materially adversely affect the Company's business, operating results or financial condition.

Declines in the sales of the Company's professional products, software, accessories, or service and support contracts, or increases in sales of consumer products, including iPods, may negatively impact the Company's gross margin and operating margin percentages.
The Company's professional products, including Power Macintosh and PowerBook systems, software, accessories, and service and support contracts, generally have higher gross margins than the Company's consumer products, including iMacs, iBooks, iPods, and content from the iTunes Music Store. A shift in sales mix away from higher margin professional products towards lower margin consumer products could adversely affect the Company's future gross margin and operating margin percentages. The Company's traditional professional customers may choose to buy consumer products, specifically the iMac G5 and iBook, instead of professional products. Professional users may choose to buy the iMac G5 due to its relative price performance, use of the same PowerPC G5 processor used in the Company's Power Macs, and unique design featuring a flat panel screen. Potential PowerBook customers may also choose to purchase iBooks instead due to their price performance and screen size. Additionally, significant future growth in iPod sales without corresponding growth in higher margin product sales could also reduce gross margin and operating margin percentages.

It is likely that some of the Company's current and potential professional, creative, and small business customers, who are most likely to utilize professional systems, believe that the relatively slower MHz rating or clock speed of the microprocessors the Company utilizes in its Macintosh systems compares unfavorably to those utilized by other computer manufacturers and translates to slower overall system performance. These factors may result in an adverse impact to sales of the Company's professional products as well as to gross margin and operating margin percentages.

The Company expects its quarterly revenue and operating results to fluctuate for a variety of reasons.
The Company's profit margins vary among its products and its distribution channels. The Company's direct sales, primarily through its retail and online stores, generally have higher associated profitability than its indirect sales. Additionally, the Company's direct channels have traditionally had more sales of software and higher priced hardware products, which generally have higher gross margins, than its indirect channels. As a result, the Company's gross margin and operating margin percentages as well as overall profitability may be adversely impacted as a result of a shift in product, geographic, or channel mix, or new product announcements, including the transition to Intel-based Macintosh computers. In addition, the Company generally sells more products during the third month of each quarter than it does during either of the first two months, a pattern typical in the personal computer industry. This sales pattern can produce pressure on the Company's internal infrastructure during the third month of a quarter and may adversely impact the Company's ability to predict its financial results accurately. Developments late in a quarter, such as lower-than-anticipated demand for the Company's products, an internal systems failure, or failure of one of the Company's key logistics, components suppliers, or manufacturing partners, can have significant adverse impacts on the Company and its results of operations and financial condition.

The Company has higher research and development and selling, general and administrative costs, as a percentage of revenue, than many of its competitors.
The Company's ability to compete successfully and maintain attractive gross margins and revenue growth is heavily dependent upon its ability to ensure a continuing and timely flow of innovative and competitive products and technologies to the marketplace. As a result, the Company incurs higher research and development costs as a percentage of revenue than its competitors who sell personal computers based on other operating systems. Many of these competitors seek to compete aggressively on price and maintain very low cost structures. Further, as a result of the expansion of the Company's Retail segment and costs associated with marketing the Company's brand including its unique operating system, the Company incurs higher selling costs as a percentage of revenue than many of its competitors. If the Company is unable to continue to develop and sell innovative new products with attractive gross margins, its results of operations may be materially adversely affected by its operating cost structure.

The Company is exposed to credit risk on its accounts receivable and prepayments related to long-term supply agreements. This risk is heightened during periods when economic conditions worsen.
The Company distributes its products through third-party computer resellers and retailers and directly to certain educational institutions and commercial customers. A substantial majority of the Company's outstanding trade receivables are not covered by collateral or credit insurance. The Company also has unsecured non-trade receivables from certain of its manufacturing vendors resulting from the sale by the Company of raw material components to these manufacturing vendors who manufacture sub-assemblies or assemble final products for the Company. In addition, the Company has entered into long-term supply agreements to secure supply of NAND flash-memory and intends to prepay a total of $1.25 billion under these agreements. While the Company has procedures in place to monitor and limit exposure to credit risk on its trade and non-trade receivables as well as long-term prepayments, there can be no assurance that such procedures will be effective in limiting its credit risk and avoiding losses. Additionally, if the global economy and regional economies fail to improve or continue to deteriorate, it becomes more likely that the Company will incur a material loss or losses as a result of the weakening financial condition of one or more of its customers or manufacturing vendors.

The Company's success depends largely on its ability to attract and retain key personnel.
Much of the future success of the Company depends on the continued service and availability of skilled personnel, including its Chief Executive Officer, members of its executive team, and those in technical, marketing and staff positions. Experienced personnel in the information technology industry are in high demand and competition for their talents is intense, especially in the Silicon Valley, where the majority of

the Company's key employees are located. The Company has relied on its ability to grant stock options as one mechanism for recruiting and retaining this highly skilled talent. Recent accounting regulations requiring the expensing of stock options will impair the Company's future ability to provide these incentives without incurring significant compensation costs. There can be no assurance that the Company will continue to successfully attract and retain key personnel.

The Company is subject to risks associated with the selection, availability, and cost of insurance.
The Company has observed rapidly changing conditions in the insurance markets relating to nearly all areas of traditional commercial insurance. Such conditions have and may continue to result in higher premium costs, higher policy deductibles, lower coverage limits and may also yield possible policy form exclusions. For some risks, because of cost and/or availability, the Company does not have insurance coverage. Because the Company retains some portion of its insurable risks, and in some cases self insures completely, unforeseen or catastrophic losses in excess of insured limits may have a material adverse effect on the Company's results of operations and financial position.

Failure of information technology systems and breaches in the security of data upon which the Company relies could adversely affect the Company's future operating results.
Information technology system failures and breaches of data security could disrupt the Company's ability to function in the normal course of business by potentially causing delays or cancellation of customer orders, impeding the manufacture or shipment of products, or resulting in the unintentional disclosure of customer or Company information. Management has taken steps to address these concerns for its own systems by implementing sophisticated network security and internal control measures. However, there can be no assurance that a system failure or data security breach of the Company or a third-party vendor will not have a material adverse effect on the Company's results of operations.

The Company's business is subject to the risks of international operations.
A large portion of the Company's revenue is derived from its international operations. As a result, the Company's operating results and financial condition could be significantly affected by risks associated with international activities, including economic and labor conditions, political instability, tax laws (including U.S. taxes on foreign subsidiaries), and changes in the value of the U.S. dollar versus the local currency in which the products are sold and goods and services are purchased. The Company's primary exposure to movements in foreign currency exchange rates relate to non-dollar denominated sales in Europe, Japan, Australia, Canada, and certain parts of Asia and non-dollar denominated operating expenses incurred throughout the world. Weaknesses in foreign currencies, particularly the Japanese Yen and the Euro, can adversely impact consumer demand for the Company's products and the U.S. dollar value of the Company's foreign currency denominated sales. Conversely, a strengthening in these and other foreign currencies can cause the Company to modify international pricing and affect the value of the Company's foreign denominated sales, and in some cases, may also increase the cost to the Company of some product components.

Margins on sales of the Company's products in foreign countries, and on sales of products that include components obtained from foreign suppliers, can be adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including tariffs and antidumping penalties.

Derivative instruments, such as foreign exchange forward and option positions have been utilized by the Company to hedge exposures to fluctuations in foreign currency exchange rates. The use of such hedging activities may not offset more than a portion of the adverse financial impact resulting from unfavorable movements in foreign exchange rates.

Further information related to the Company's global market risks may be found in Part II, Item 7A of this Form 10-K under the subheading "Foreign Currency Risk" and may be found in Part II, Item 8 of this Form 10-K at Notes 1 and 2 of Notes to Consolidated Financial Statements.

The Company is subject to risks associated with environmental regulations.
Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations including, in some instances, the requirement to provide customers the ability to return product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have recently been passed in several jurisdictions in which the Company operates, including various European Union member countries, Japan, and certain states within the U.S. In the future, these laws could have a material adverse effect on the Company's results of operations.

Changes in accounting rules could affect the Company's future operating results.
Financial statements are prepared in accordance with U.S. generally accepted accounting principles. These principles are subject to interpretation by various governing bodies, including the FASB and the SEC, who create and interpret appropriate accounting standards. A change from current accounting standards could have a significant effect on the Company's results of operations. In December 2004, the FASB issued new guidance that addresses the accounting for share-based payments, SFAS No. 123R. In April 2005, the SEC deferred the effective date of SFAS No. 123R to years beginning after June 15, 2005. Therefore, SFAS No. 123R will be effective for the Company beginning in its first quarter of fiscal 2006. The Company expects the adoption of SFAS No. 123R will result in a reduction of diluted earnings per common share of approximately $0.03 for the first quarter of fiscal 2006. Although the effect from the adoption of SFAS No. 123R is expected to have a material impact on the Company's results of operations, future changes to various assumptions used to determine the fair-value of awards issued or the amount and type of equity awards granted create uncertainty as to the amount of future stock-based compensation expense.

Changes in the Company's tax rates could affect its future results.
The Company's future effective tax rates could be favorably or unfavorably affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of the Company's deferred tax assets and liabilities, or by changes in tax laws or their interpretation. In addition, the Company is subject to the continuous examination of its income tax returns by the Internal Revenue Service and other tax authorities. The Company regularly assesses the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of its provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse affect on the Company's net income and financial condition.

The Company's stock price may be volatile.
The Company's stock has at times experienced substantial price volatility as a result of variations between its actual and anticipated financial results and as a result of announcements by the Company and its competitors. The stock market has experienced extreme price and volume fluctuations that have affected the market price of many technology companies in ways that may have been unrelated to the operating performance of these companies. These factors, including lack of positive general economic and political conditions and investors' concerns regarding the credibility of corporate financial reporting and integrity of financial markets, may materially adversely affect the market price of the Company's stock in the future. In addition, increases in the Company's stock price may result in greater dilution of earnings per share.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate and Foreign Currency Risk Management

The Company regularly reviews its foreign exchange forward and option positions and its interest rate swap and option positions, both on a stand-alone basis and in conjunction with its underlying foreign currency and interest rate related exposures. However, given the effective horizons of the Company's risk management activities and the anticipatory nature of the exposures, there can be no assurance the hedges will offset more than a portion of the financial impact resulting from movements in either foreign exchange or interest rates. In addition, the timing of the accounting for recognition of gains and losses related to mark-to-market instruments for any given period may not coincide with the timing of gains and losses related to the underlying economic exposures and, therefore, may adversely affect the Company's operating results and financial position.

Interest Rate Risk

While the Company is exposed to interest rate fluctuations in many of the world's leading industrialized countries, the Company's interest income and expense is most sensitive to fluctuations in the general level of U.S. interest rates. In this regard, changes in U.S. interest rates affect the interest earned on the Company's cash, cash equivalents, and short-term investments as well as costs associated with foreign currency hedges.

The Company's short-term investment policy and strategy is to ensure the preservation of capital, meet liquidity requirements, and optimize return in light of the current credit and interest rate environment. The Company benchmarks its performance by utilizing external money managers to manage a small portion of the aggregate investment portfolio. The external managers adhere to the Company's investment policies and also provide occasional research and market information that supplements internal research used to make credit decisions in the investment process.

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's investment portfolio. The Company places its short-term investments in highly liquid securities issued by high credit quality issuers and, by policy, limits the amount of credit exposure to any one issuer. The Company's general policy is to limit the risk of principal loss and ensure the safety of invested funds by limiting market and credit risk. All highly liquid investments with maturities of three months or less are classified as cash equivalents; highly liquid investments with maturities greater than three months are classified as short-term investments. As of September 24, 2005, approximately $287 million of the Company's short-term investments had underlying maturities ranging from 1 to 5 years. As of September 25, 2004, $180 million of the Company's investment portfolio classified as short-term investments had maturities ranging from 1 to 5 years. The remainder all had underlying maturities between 3 and 12 months. The Company may sell its investments prior to their stated maturities, due to liquidity needs, in anticipation of credit deterioration, or for duration management. The Company recognized a net loss before taxes of $137,000 in 2005, and net gains before taxes of $1 million and $21 million in 2004, and 2003, respectively as a result of such sales.

In order to provide a meaningful assessment of the interest rate risk associated with the Company's investment portfolio, the Company performed a sensitivity analysis to determine the impact that a change in interest rates would have on the value of the investment portfolio assuming a 100 basis point parallel shift in the yield curve. Based on investment positions as of September 24, 2005, a hypothetical 100 basis point increase in interest rates across all maturities would result in a $19.9 million decline in the fair market value of the portfolio. As of September 25, 2004, a similar 100 basis point shift in the yield curve would have resulted in a $14.4 million decline in fair value. Such losses would only be realized if the Company sold the investments prior to maturity. Except in instances noted above, the Company's policy is to hold investments to maturity.

From time to time, the Company has entered into interest rate derivative transactions with financial institutions in order to better match the Company's floating-rate interest income on its cash equivalents and short-term investments with its fixed-rate interest expense on its debt, and/or to diversify a portion of the Company's exposure away from fluctuations in short-term U.S. interest rates. The Company did not enter into any interest rate derivatives during 2005 or 2004 and had no open interest rate derivatives at September 24, 2005.

Foreign Currency Risk

In general, the Company is a net receiver of currencies other than the U.S. dollar. Accordingly, changes in exchange rates, and in particular a strengthening of the U.S. dollar, may negatively affect the Company's net sales and gross margins as expressed in U.S. dollars. There is also a risk that the Company will have to adjust local currency product pricing due to competitive pressures when there has been significant volatility in foreign currency exchange rates.

The Company may enter into foreign currency forward and option contracts with financial institutions to protect against foreign exchange risks associated with existing assets and liabilities, certain firmly committed transactions, forecasted future cash flows, and net investments in foreign subsidiaries. Generally, the Company's practice is to hedge a majority of its existing material foreign exchange transaction exposures. However, the Company may not hedge certain foreign exchange transaction exposures due to immateriality, prohibitive economic cost of hedging particular exposures, and limited availability of appropriate hedging instruments.

In order to provide a meaningful assessment of the foreign currency risk associated with certain of the Company's foreign currency derivative positions, the Company performed a sensitivity analysis using a value-at-risk (VAR) model to assess the potential impact of fluctuations in exchange rates. The VAR model consisted of using a Monte Carlo simulation to generate 3000 random market price paths. The VAR is the maximum expected loss in fair value, for a given confidence interval, to the Company's foreign exchange portfolio due to adverse movements in rates. The VAR model is not intended to represent actual losses but is used as a risk estimation and management tool. The model assumes normal market conditions. Forecasted transactions, firm commitments, and assets and liabilities denominated in foreign currencies were excluded from the model. Based on the results of the model, the Company estimates with 95% confidence a maximum one-day loss in fair value of $10.0 million as of September 24, 2005 compared to a maximum one-day loss of $3.2 million as of September 25, 2004. Because the Company uses foreign currency instruments for hedging purposes, losses incurred on those instruments are generally offset by increases in the fair value of the underlying exposures.

Actual future gains and losses associated with the Company's investment portfolio and derivative positions may differ materially from the sensitivity analyses performed as of September 24, 2005 due to the inherent limitations associated with predicting the changes in the timing and amount of interest rates, foreign currency exchanges rates, and the Company's actual exposures and positions.

Item 8. Financial Statements and Supplementary Data

All financial statement schedules have been omitted, since the required information is not applicable or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Consolidated Financial Statements and Notes thereto.

CONSOLIDATED BALANCE SHEETS
(In millions, except share amounts)

	September 24, 2005	September 25, 2004
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 3,491	$ 2,969
Short-term investments	4,770	2,495
Accounts receivable, less allowances of $46 and $47, respectively	895	774
Inventories	165	101
Deferred tax assets	331	231
Other current assets	648	485
Total current assets	10,300	7,055
Property, plant, and equipment, net	817	707
Goodwill	69	80
Acquired intangible assets, net	27	17
Other assets	338	191
Total assets	$ 11,551	$ 8,050
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	$ 1,779	$ 1,451
Accrued expenses	1,705	1,200
Total current liabilities	3,484	2,651
Non-current liabilities	601	323
Total liabilities	4,085	2,974
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value; 1,800,000,000 shares authorized; 835,019,364 and 782,887,234 shares issued and outstanding, respectively	3,521	2,514
Deferred stock compensation	(60)	(93)
Retained earnings	4,005	2,670
Accumulated other comprehensive income (loss)	—	(15)
Total shareholders' equity	7,466	5,076
Total liabilities and shareholders' equity	$ 11,551	$ 8,050

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions, except share and per share amounts)

Three fiscal years ended September 24, 2005	2005	2004	2003
Net sales	$ 13,931	$ 8,279	$ 6,207
Cost of sales	9,888	6,020	4,499
Gross margin	4,043	2,259	1,708
Operating expenses:			
Research and development	534	489	471
Selling, general, and administrative	1,859	1,421	1,212
Restructuring costs	—	23	26
Total operating expenses	2,393	1,933	1,709
Operating income (loss)	1,650	326	(1)
Other income and expense:			
Gains on non-current investments, net	—	4	10
Interest and other income, net	165	53	83
Total other income and expense	165	57	93
Income before provision for income taxes	1,815	383	92
Provision for income taxes	480	107	24
Income before accounting changes	1,335	276	68
Cumulative effects of accounting changes, net of income taxes	—	—	1
Net income	$ 1,335	$ 276	$ 69
Earnings per common share before accounting changes:			
Basic	$ 1.65	$ 0.37	$ 0.09
Diluted	$ 1.56	$ 0.36	$ 0.09
Earnings per common share:			
Basic	$ 1.65	$ 0.37	$ 0.10
Diluted	$ 1.56	$ 0.36	$ 0.09
Shares used in computing earnings per share (in thousands):			
Basic	808,439	743,180	721,262
Diluted	856,780	774,622	726,932

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(In millions, except share amounts which are in thousands)

	Common Stock		Deferred Stock	Retained	Accumulated Other Comprehensive	Total Shareholders'
	Shares	Amount	Compensation	Earnings	Income (Loss)	Equity
Balances as of September 28, 2002	717,918	$ 1,826	$ (7)	$ 2,325	$ (49)	$ 4,095
Components of comprehensive income:						
Net income	—	—	—	69	—	69
Change in foreign currency translation	—	—	—	—	31	31
Change in unrealized gain on available-for-sale securities, net of tax	—	—	—	—	(12)	(12)
Change in unrealized gain on derivative investments, net of tax	—	—	—	—	(5)	(5)
Total comprehensive income						83
Amortization of deferred stock compensation	—	—	15	—	—	15
Write-off of deferred stock compensation	—	—	5	—	—	5
Common stock issued under stock plans	18,598	128	(75)	—	—	53
Settlement of forward purchase agreement	(3,062)	(35)	—	—	—	(35)
Tax benefit related to stock options	—	7	—	—	—	7
Balances as of September 27, 2003	733,454	$ 1,926	$ (62)	$ 2,394	$ (35)	$ 4,223
Components of comprehensive income:						
Net income	—	—	—	276	—	276
Change in foreign currency translation	—	—	—	—	13	13
Change in unrealized gain on available-for-sale securities, net of tax	—	—	—	—	(5)	(5)
Change in unrealized loss on derivative investments, net of tax	—	—	—	—	12	12
Total comprehensive income						296
Issuance of restricted stock units	—	64	(64)	—	—	—
Adjustment to common stock related to a prior year acquisition	(159)	(2)	—	—	—	(2)
Amortization of deferred stock compensation	—	—	33	—	—	33
Common stock issued under stock plans	49,592	427	—	—	—	427
Tax benefit related to stock options	—	99	—	—	—	99
Balances as of September 25, 2004	782,887	$ 2,514	$ (93)	$ 2,670	$ (15)	$ 5,076
Components of comprehensive income:						
Net income	—	—	—	1,335	—	1,335
Change in foreign currency translation	—	—	—	—	7	7
Change in unrealized gain on derivative investments, net of tax	—	—	—	—	8	8
Total comprehensive income						1,350
Issuance of restricted stock units, net	—	7	(7)	—	—	—
Amortization of deferred stock compensation	—	—	40	—	—	40
Common stock issued under stock plans	52,132	547	—	—	—	547
Tax benefit related to stock options	—	453	—	—	—	453
Balances as of September 24, 2005	835,019	$ 3,521	$ (60)	$ 4,005	$ —	$ 7,466

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

Three fiscal years ended September 24, 2005	2005	2004	2003
Cash and cash equivalents, beginning of the year	$ 2,969	$ 3,396	$ 2,252
Operating Activities:			
Net income	1,335	276	69
Cumulative effects of accounting changes, net of taxes	—	—	(1)
Adjustments to reconcile net income to cash generated by operating activities:			
Depreciation, amortization and accretion	179	150	113
Stock-based compensation expense	42	33	16
Non-cash restructuring	—	5	12
Provision for (benefit from) deferred income taxes	52	20	(11)
Tax benefit from stock options	453	99	7
Loss on disposition of property, plant, and equipment	9	7	2
Gains on sales of short-term investments, net	—	(1)	(21)
Gains on non-current investments, net	—	(4)	(10)
Gain on forward purchase agreement	—	—	(6)
Changes in operating assets and liabilities:			
Accounts receivable	(121)	(8)	(201)
Inventories	(64)	(45)	(11)
Other current assets	(150)	(176)	(34)
Other assets	(61)	(39)	(30)
Accounts payable	328	297	243
Other liabilities	533	320	152
Cash generated by operating activities	2,535	934	289
Investing Activities:			
Purchases of short-term investments	(11,470)	(3,270)	(2,648)
Proceeds from maturities of short-term investments	8,609	1,141	2,446
Proceeds from sales of short-term investments	586	801	1,116
Proceeds from sales of non-current investments	—	5	45
Purchases of property, plant, and equipment	(260)	(176)	(164)
Other	(21)	11	33
Cash (used for) generated by investing activities	(2,556)	(1,488)	828
Financing Activities:			
Payment of long-term debt	—	(300)	—
Proceeds from issuance of common stock	543	427	53
Cash used for repurchase of common stock	—	—	(26)
Cash generated by financing activities	543	127	27
Increase (decrease) in cash and cash equivalents	522	(427)	1,144
Cash and cash equivalents, end of the year	$ 3,491	$ 2,969	$ 3,396
Supplemental cash flow disclosures:			
Cash paid during the year for interest	$ —	$ 10	$ 20
Cash paid (received) for income taxes, net	$ 17	$ (7)	$ 45

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1—Summary of Significant Accounting Policies

Apple Computer, Inc. and its subsidiaries (the Company) designs, manufactures, and markets personal computers and related software, services, peripherals, and networking solutions. The Company also designs, develops, and markets a line of portable digital music players along with related accessories and services including the online distribution of third-party music, audio books, music videos, short films, and television shows. The Company sells its products worldwide through its online stores, its own retail stores, its direct sales force, and third-party wholesalers, resellers, and value-added resellers. In addition to its own hardware, software, and peripheral products, the Company sells a variety of third-party hardware and software products through its online and retail stores. The Company sells to education, consumer, creative professional, business, and government customers.

Basis of Presentation and Preparation

The accompanying consolidated financial statements include the accounts of the Company. Intercompany accounts and transactions have been eliminated. The preparation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in these consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates. Certain prior year amounts in the consolidated financial statements and notes thereto have been reclassified to conform to the current year presentation.

Typically, the Company's fiscal year ends on the last Saturday of September. Fiscal years 2005, 2004, and 2003 were each 52-week years. However, approximately every six years, the Company reports a 53-week fiscal year to align its fiscal quarters with calendar quarters by adding a week to its first fiscal quarter. The Company will add this additional week in the first fiscal quarter of its fiscal year 2006. All information presented herein is based on the Company's fiscal calendar.

Common Stock Split

On February 28, 2005, the Company effected a two-for-one stock split to shareholders of record as of February 18, 2005. All share and per share information has been retroactively adjusted to reflect the stock split.

Financial Instruments

Cash Equivalents and Short-term Investments

All highly liquid investments with maturities of three months or less at the date of purchase are classified as cash equivalents. Highly liquid investments with maturities greater than three months are classified as short-term investments. The Company's debt and marketable equity securities have been classified and accounted for as available-for-sale. Management determines the appropriate classification of its investments in debt and marketable equity securities at the time of purchase and reevaluates available-for-sale designation as of each balance sheet date. These securities are carried at fair value, with the unrealized gains and losses, net of taxes, reported as a component of shareholders' equity. The cost of securities sold is based upon the specific identification method.

Derivative Financial Instruments

The Company accounts for its derivative instruments as either assets or liabilities and carries them at fair value. Derivatives that are not defined as hedges in SFAS 133, *Accounting for Derivative Instruments and Hedging Activities,* must be adjusted to fair value through earnings. If the derivative is a hedge, depending on the nature of the hedge, changes in fair value will either be offset against the change in fair value of the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

hedged assets, liabilities, or firm commitments through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings.

For derivative instruments that hedge the exposure to variability in expected future cash flows that are designated as cash flow hedges, the net gain or loss on the derivative instrument is reported as a component of accumulated other comprehensive income in shareholders' equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. To receive hedge accounting treatment, cash flow hedges must be highly effective in offsetting changes to expected future cash flows on hedged transactions. For derivative instruments that hedge the exposure to changes in the fair value of an asset or a liability and that are designated as fair value hedges, the net gain or loss on the derivative instrument as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in earnings in the current period. The net gain or loss on the effective portion of a derivative instrument that is designated as an economic hedge of the foreign currency translation exposure of the net investment in a foreign operation is reported in the same manner as a foreign currency translation adjustment. For forward contracts designated as net investment hedges, the Company excludes changes in fair value relating to changes in the forward carry component from its definition of effectiveness. Accordingly, any gains or losses related to this component are recognized in current earnings.

The Company may enter into foreign currency forward contracts to hedge the translation and economic exposure of a net investment position in a foreign subsidiary. For such contracts, hedge effectiveness is measured based on changes in the fair value of the contract attributable to changes in the spot exchange rate. The effective portion of the net gain or loss on a derivative instrument designated as a hedge of the net investment position in a foreign subsidiary is reported in the same manner as a foreign currency translation adjustment. Any residual changes in fair value of the forward contract, including changes in fair value based on the differential between the spot and forward exchange rates, are recognized in current earnings in other income and expense.

Inventories

Inventories are stated at the lower of cost, computed using the first-in, first-out method, or market. If the cost of the inventories exceeds their market value, provisions are made currently for the difference between the cost and the market value. The Company's inventories consist primarily of finished goods for all periods presented.

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. Depreciation is computed by use of the straight-line method over the estimated useful lives of the assets, which are 30 years for buildings, up to 5 years for equipment, and the shorter of lease terms or 10 years for leasehold improvements. The Company capitalizes eligible costs to acquire or develop internal-use software that are incurred subsequent to the preliminary project stage. Capitalized costs related to internal-use software are amortized using the straight-line method over the estimated useful lives of the assets, which range from 3 to 5 years. Depreciation and amortization expense on property and equipment was $141 million, $126 million, and $108 million during 2005, 2004, and 2003, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

Asset Retirement Obligations
The Company records obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs in accordance with SFAS No. 143, *Accounting for Asset Retirement Obligations*. The Company reviews legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the assets. If it is determined that a legal obligation exists, the fair value of the liability for an asset retirement obligation is recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset and this additional carrying amount is depreciated over the life of the asset. The difference between the gross expected future cash flow and its present value is accreted over the life of the related lease as an operating expense. All of the Company's existing asset retirement obligations are associated with commitments to return property subject to operating leases to original condition upon lease termination.

The following table reconciles changes in the Company's asset retirement liabilities for fiscal 2004 and 2005 (in millions):

Asset retirement liability as of September 27, 2003	$ 7.2
Additional asset retirement obligations recognized	0.5
Accretion recognized	0.5
Asset retirement liability as of September 25, 2004	$ 8.2
Additional asset retirement obligations recognized	2.8
Accretion recognized	0.7
Asset retirement liability as of September 24, 2005	$ 11.7

Cumulative Effects of Accounting Changes
In 2003, the Company recognized a net favorable cumulative effect type adjustment of approximately $1 million from the adoption of SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristic of Both Liabilities and Equity* and SFAS No. 143.

Long-Lived Assets Including Goodwill and Other Acquired Intangible Assets
The Company reviews property, plant, and equipment and certain identifiable intangibles, excluding goodwill, for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of these assets is measured by comparison of its carrying amount to future undiscounted cash flows the assets are expected to generate. If property, plant, and equipment and certain identifiable intangibles are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the assets exceeds its fair market value. For the three fiscal years ended September 24, 2005, the Company had no material impairment of its long-lived assets, except for the impairment of certain assets in connection with the restructuring actions described in Note 5 of these Notes to Consolidated Financial Statements.

SFAS No. 142, *Goodwill and Other Intangible Assets* requires that goodwill and intangible assets with indefinite useful lives should not be amortized but rather be tested for impairment at least annually or sooner whenever events or changes in circumstances indicate that they may be impaired. The Company performs its goodwill impairment tests on or about August 30 of each year. The Company did not recognize any goodwill or intangible asset impairment charges in 2005, 2004, or 2003. The Company established reporting units based on its current reporting structure. For purposes of testing goodwill for

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

impairment, goodwill has been allocated to these reporting units to the extent it relates to each reporting unit.SFAS No. 142 also requires that intangible assets with definite lives be amortized over their estimated useful lives and reviewed for impairment in accordance with SFAS No. 144, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*. The Company is currently amortizing its acquired intangible assets with definite lives over periods ranging from 3 to 10 years.

Foreign Currency Translation

The Company translates the assets and liabilities of its international non-U.S. functional currency subsidiaries into U.S. dollars using exchange rates in effect at the end of each period. Revenue and expenses for these subsidiaries are translated using rates that approximate those in effect during the period. Gains and losses from these translations are credited or charged to foreign currency translation included in "accumulated other comprehensive income (loss)" in shareholders' equity. The Company's foreign manufacturing subsidiaries and certain other international subsidiaries that use the U.S. dollar as their functional currency remeasure monetary assets and liabilities at exchange rates in effect at the end of each period, and inventories, property, and nonmonetary assets and liabilities at historical rates. Gains and losses from these translations were insignificant and have been included in the Company's results of operations.

Revenue Recognition

Net sales consist primarily of revenue from the sale of hardware, software, peripherals, digital content, and service and support contracts. The Company recognizes revenue pursuant to applicable accounting standards, including Statement of Position (SOP) No. 97-2, *Software Revenue Recognition*, as amended, and Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition*.

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection is probable. Product is considered delivered to the customer once it has been shipped and title and risk of loss have been transferred. For most of the Company's product sales, these criteria are met at the time the product is shipped. For online sales to individuals, for some sales to education customers in the U.S., and for certain other sales, the Company defers revenue until the customer receives the product because the Company legally retains a portion of the risk of loss on these sales during transit. If at the outset of an arrangement the Company determines the arrangement fee is not, or is presumed to not be, fixed or determinable, revenue is deferred and subsequently recognized as amounts become due and payable.

Revenue from service and support contracts is deferred and recognized ratably over the service coverage periods. These contracts typically include extended phone support, repair services, web-based support resources, diagnostic tools, and extend the service coverage offered under the Company's one-year limited warranty.

The Company sells software and peripheral products obtained from other companies. The Company establishes its own pricing and retains related inventory risk, is the primary obligor in sales transactions with its customers, and assumes the credit risk for amounts billed to its customers. Accordingly, the Company recognizes revenue for the sale of products obtained from other companies at the gross amount billed.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

Revenue on arrangements that include multiple elements such as hardware, software, and services is allocated to each element based on the relative fair value of each element. Each element's allocated revenue is recognized when revenue recognition criteria for that element has been met. Fair value is generally determined by vendor specific objective evidence (VSOE), which is based on the price charged when each element is sold separately. If the Company cannot objectively determine the fair value of any undelivered element included in a multiple-element arrangement, the Company defers revenue until all elements are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered elements. When the fair value of a delivered element has not been established, the Company uses the residual method to recognize revenue if the fair value of all undelivered elements is determinable. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is allocated to the delivered elements and is recognized as revenue.

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end user rebates, and other sales programs and volume-based incentives. The estimated cost of these programs is accrued as a reduction to revenue in the period the Company has sold the product and committed to a plan. The Company also records reductions to revenue for expected future product returns based on the Company's historical experience.

Generally, the Company does not offer specified or unspecified upgrade rights to its customers in connection with software sales or the sale of extended warranty and support contracts. When the Company does offer specified upgrade rights, the Company defers revenue for the fair value of the specified upgrade right until the future obligation is fulfilled or when the right to the specified upgrade expires. Additionally, a limited number of the Company's software products are available with maintenance agreements that grant customers rights to unspecified future upgrades over the maintenance term on a when and if available basis. Revenue associated with such maintenance is recognized ratably over the maintenance term.

Allowance for Doubtful Accounts

The Company records its allowance for doubtful accounts based upon its assessment of various factors. The Company considers historical experience, the age of the accounts receivable balances, credit quality of the Company's customers, current economic conditions and other factors that may affect customers' ability to pay.

Shipping Costs

The Company's shipping and handling costs are included in cost of sales for all periods presented.

Warranty Expense

The Company provides currently for the estimated cost for product warranties at the time the related revenue is recognized. The Company assesses the adequacy of its preexisting warranty liabilities and adjusts the amounts as necessary based on actual experience and changes in future estimates.

Software Development Costs

Research and development costs are expensed as incurred. Development costs of computer software to be sold, leased, or otherwise marketed are subject to capitalization beginning when a product's technological feasibility has been established and ending when a product is available for general release to customers

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

pursuant to SFAS No. 86, *Computer Software to be Sold, Leased, or Otherwise Marketed.* In most instances, the Company's products are released soon after technological feasibility has been established. Therefore, costs incurred subsequent to achievement of technological feasibility are usually not significant, and generally all software development costs have been expensed.

In the fourth quarter of 2004, the Company began incurring substantial development costs associated with Mac OS X version 10.4 Tiger subsequent to achievement of technological feasibility as evidenced by public demonstration in August 2004 and the subsequent release of a developer beta version of the product. The Company capitalized approximately $29.7 and $4.5 million during 2005 and 2004, respectively, of costs associated with the development of Tiger. In accordance with SFAS No. 86, amortization of this asset to cost of sales began in April 2005 when the Company began shipping Tiger and is being recognized on a straight-line basis over a 3 year estimated useful life.

During the second quarter of 2004, the Company incurred substantial development costs associated with FileMaker Pro 7 subsequent to achievement of technological feasibility as evidenced by public demonstration and release of a developer beta version, and prior to the release of the final version of the product in March 2004. Therefore, during the second quarter of 2004, the Company capitalized approximately $2.3 million of costs associated with the development of FileMaker Pro 7. In accordance with SFAS No. 86, amortization of this asset to cost of sales began in March 2004 when the Company began shipping FileMaker Pro 7 and is being recognized on a straight-line basis over a 3 year estimated useful life.

During the third and fourth quarters of 2003, the Company incurred substantial development costs associated with the development of Mac OS X version 10.3 (code-named "Panther"), subsequent to achievement of technological feasibility as evidenced by public demonstration and release of a developer beta in June 2003, and prior to release of the final version of the product in the first quarter of 2004. Therefore, during 2003 the Company capitalized approximately $14.7 million of development costs associated with the development of Panther. Amortization of this asset began in the first quarter of 2004 when Panther was shipped and is being recognized on a straight-line basis in accordance with SFAS No. 86 over a 3 year estimated useful life.

Total amortization related to capitalized software development costs was $15.7 million, $10.7 million, and $5.8 million in 2005, 2004, and 2003, respectively.

Advertising Costs
Advertising costs are expensed as incurred. Advertising expense was $287 million, $206 million, and $193 million for 2005, 2004, and 2003, respectively.

Stock-Based Compensation
The Company currently measures compensation expense for its employee stock-based compensation plans using the intrinsic value method prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*. The Company applies the disclosure provisions of SFAS No. 123, *Accounting for Stock-based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-based Compensation—Transition and Disclosure* as if the fair-value-based method had been applied in measuring compensation expense. Under APB Opinion No. 25, when the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of the grant, no compensation expense is recognized.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

As required under SFAS No. 123, the pro forma effects of stock-based compensation on net income and earnings per common share for employee stock options granted and employee stock purchase plan share purchases have been estimated at the date of grant and beginning of the period, respectively, using a Black-Scholes option pricing model. For purposes of pro forma disclosures, the estimated fair value of the options and shares is amortized to pro forma net income over the options' vesting period and the shares' plan period.

The Company's pro forma information for each of the last three fiscal years follows (in millions, except per share amounts):

	2005	2004	2003
Net income—as reported	$ 1,335	$ 276	$ 69
Add: Stock-based employee compensation expense included in reported net income, net of tax	38	33	15
Deduct: Stock-based employee compensation expense determined under the fair value based method for all awards, net of tax	(114)	(141)	(181)
Net income (loss)—pro forma	$ 1,259	$ 168	$ (97)
Net income per common share—as reported			
Basic	$ 1.65	$ 0.37	$ 0.10
Diluted	$ 1.56	$ 0.36	$ 0.09
Net income (loss) per common share—pro forma			
Basic	$ 1.56	$ 0.23	$ (0.13)
Diluted	$ 1.47	$ 0.22	$ (0.13)

In December 2004, the FASB issued SFAS No. 123 (revised 2004) (SFAS No. 123R), *Share-Based Payment*, which addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. SFAS No. 123R eliminates the ability to account for share-based compensation transactions using the intrinsic value method under APB Opinion No. 25, and requires instead that such transactions be accounted for using a fair-value-based method. In January 2005, the SEC issued SAB No. 107, which provides supplemental implementation guidance for SFAS No. 123R. SFAS No. 123R will be effective for the Company beginning in the first quarter of its fiscal 2006. The Company's assessment of the estimated stock-based compensation expense is affected by the Company's stock price as well as assumptions regarding a number of complex variables and the related tax impact. These variables include, but are not limited to, the Company's stock price, volatility, and employee stock option exercise behaviors and the related tax impact. The Company will recognize stock-based compensation expense on all awards on a straight-line basis over the requisite service period using the modified prospective method. Although the adoption of SFAS No. 123R is expected to have a material effect on the Company's results of operations, future changes to various assumptions used to determine the fair-value of awards issued or the amount and type of equity awards granted create uncertainty as to whether future stock-based compensation expense will be similar to the historical SFAS No. 123 pro forma expense.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

Earnings Per Common Share

Basic earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the dilutive potential shares of common stock had been issued. The dilutive effect of outstanding options, restricted stock and restricted stock units is reflected in diluted earnings per share by application of the treasury stock method. Under the treasury stock method, an increase in the fair market value of the Company's common stock can result in a greater dilutive effect from outstanding options, restricted stock and restricted stock units. Additionally, the exercise of employee stock options and the vesting of restricted stock and restricted stock units can result in a greater dilutive effect on earnings per share.

The following table sets forth the computation of basic and diluted earnings per share:

	2005	2004	2003
Numerator (in millions):			
Income before accounting changes	$ 1,335	$ 276	$ 68
Cumulative effects of accounting changes, net of tax	—	—	1
Net income	$ 1,335	$ 276	$ 69
Denominator (in thousands):			
Weighted-average shares outstanding, excluding unvested restricted stock	808,439	743,180	721,262
Effect of dilutive options, restricted stock units and restricted stock	48,341	31,442	5,670
Denominator for diluted earnings per share	856,780	774,622	726,932
Basic earnings per share before accounting changes	$ 1.65	$ 0.37	$ 0.09
Basic earnings per share after accounting changes	$ 1.65	$ 0.37	$ 0.10
Diluted earnings per share before accounting changes	$ 1.56	$ 0.36	$ 0.09
Diluted earnings per share after accounting changes	$ 1.56	$ 0.36	$ 0.09

Potentially dilutive securities representing approximately 12.4 million, 8.7 million, and 101.6 million shares of common stock for the years ended September 24, 2005, September 25, 2004, and September 27, 2003, respectively, were excluded from the computation of diluted earnings per share for these periods because their effect would have been antidilutive. These potentially dilutive securities include stock options, restricted stock, and restricted stock units.

Comprehensive Income

Comprehensive income consists of two components, net income and other comprehensive income. Other comprehensive income refers to revenue, expenses, gains and losses that under generally accepted accounting principles are recorded as an element of shareholders' equity but are excluded from net income. The Company's other comprehensive income is comprised of foreign currency translation adjustments from those subsidiaries not using the U.S. dollar as their functional currency, unrealized gains and losses on marketable securities categorized as available-for-sale, and net deferred gains and losses on certain derivative instruments accounted for as cash flow hedges.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

Segment Information
The Company reports segment information based on the "management" approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of the Company's reportable segments. Information about the Company's products, major customers, and geographic areas on a company-wide basis is also disclosed.

Note 2—Financial Instruments

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses approximate their fair value due to the short maturities of those instruments.

Cash, Cash Equivalents and Short-Term Investments
The following table summarizes the fair value of the Company's cash and available-for-sale securities held in its short-term investment portfolio, recorded as cash and cash equivalents or short-term investments (in millions):

	September 24, 2005	September 25, 2004
Cash	$ 127	$ 200
U.S. Treasury and Agency securities	89	87
U.S. corporate securities	2,030	1,795
Foreign securities	1,245	887
Total cash equivalents	3,364	2,769
U.S. Treasury and Agency securities	216	1,080
U.S. corporate securities	3,662	1,352
Foreign securities	892	63
Total short-term investments	4,770	2,495
Total cash, cash equivalents, and short-term investments	$ 8,261	$ 5,464

The Company's U.S. corporate securities consist primarily of commercial paper, certificates of deposit, time deposits and corporate debt securities. Foreign securities consist primarily of foreign commercial paper, certificates of deposit and time deposits with foreign institutions, most of which are denominated in U.S. dollars. The Company had net unrealized losses totaling $5.9 million on its investment portfolio, approximately half of which related to investments with stated maturities less than 1 year as of September 24, 2005 and net unrealized losses of $6.3 million on its investment portfolio, primarily related to investments with stated maturities less than 1 year as of September 25, 2004. The Company occasionally sells short-term investments prior to their stated maturities. The Company recognized a net loss before taxes of $137,000 in 2005 and net gains before taxes of $1 million and $21 million in 2004 and 2003, respectively, as a result of such sales. These net gains were included in interest and other income, net.

As of September 24, 2005, approximately $287 million of the Company's short-term investments had underlying maturities ranging from 1 to 5 years. The remaining short-term investments as of September 24, 2005 had maturities of 3 to 12 months. As of September 25, 2004, approximately $180 million of the Company's short-term investments had underlying maturities ranging from 1 to 5 years. The remaining short-term investments as of September 25, 2004 had maturities of 3 to 12 months.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2—Financial Instruments (Continued)

In accordance with EITF 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, the following table shows gross unrealized losses and fair value for those investments that were in an unrealized loss position as of September 24, 2005 and September 25, 2004, aggregated by investment category and the length of time that individual securities have been in a continuous loss position (in millions):

	2005					
	Less than 12 Months		12 Months or Greater		Total	
Security Description	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and Agencies	$ 160	$ (1)	$ 2	$ —	$ 162	$ (1)
Corporate bonds	468	(3)	26	—	494	(3)
Certificate of deposits	288	—	—	—	288	—
Asset backed securities	60	(1)	—	—	60	(1)
Commercial paper	4,526	(1)	—	—	4,526	(1)
Total	$ 5,502	$ (6)	$ 28	$ —	$ 5,530	$ (6)

	2004					
	Less than 12 Months		12 Months or Greater		Total	
Security Description	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and Agencies	$ 1,126	$ (4)	$ —	$ —	$ 1,126	$ (4)
Corporate bonds	134	—	144	(1)	278	(1)
Certificate of deposits	420	(1)	—	—	420	(1)
Asset backed securities	426	—	—	—	426	—
Commercial paper	2,407	(1)	—	—	2,407	(1)
Total	$ 4,513	$ (6)	$ 144	$ (1)	$ 4,657	$ (7)

Market values were determined for each individual security in the investment portfolio. The decline in value of these investments is primarily related to changes in interest rates and is considered to be temporary in nature. Investments are reviewed periodically to identify possible impairment. When evaluating the investments, the Company reviews factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer, and the Company's ability and intent to hold the investment for a period of time which may be sufficient for anticipated recovery in market value.

Accounts Receivable

Trade Receivables

The Company distributes its products through third-party resellers and directly to certain education, consumer, and commercial customers. The Company generally does not require collateral from its customers. However, when possible the Company does attempt to limit credit risk on trade receivables with credit insurance for certain customers in Latin America, Europe, and Asia and by arranging with third-party financing companies to provide flooring arrangements and other loan and lease programs to the Company's direct customers. These credit financing arrangements are directly between the third-party financing company and the end customer. As such, the Company generally does not assume any recourse or credit risk sharing related to any of these arrangements. However, considerable trade receivables that

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2—Financial Instruments (Continued)

are not covered by collateral, third-party flooring arrangements, or credit insurance are outstanding with the Company's distribution and retail channel partners. No customer accounted for more than 10% of trade receivables as of September 24, 2005 or September 25, 2004.

The following table summarizes the activity in the allowance for doubtful accounts (in millions):

	September 24, 2005	September 25, 2004	September 27, 2003
Beginning allowance balance	$ 47	$ 49	$ 51
Charged to costs and expenses	8	3	4
Deductions (a)	(9)	(5)	(6)
Ending allowance balance	$ 46	$ 47	$ 49

(a) Represents amounts written off against the allowance, net of recoveries.

Vendor Non-Trade Receivables
The Company has non-trade receivables from certain of its manufacturing vendors resulting from the sale of raw material components to these manufacturing vendors who manufacture sub-assemblies or assemble final products for the Company. The Company purchases these raw material components directly from suppliers. These non-trade receivables, which are included in the consolidated balance sheets in other current assets, totaled $417 million and $276 million as of September 24, 2005 and September 25, 2004, respectively. The Company does not reflect the sale of these components in net sales and does not recognize any profits on these sales until the products are sold through to the end customer at which time the profit is recognized as a reduction of cost of sales.

Derivative Financial Instruments
The Company uses derivatives to partially offset its business exposure to foreign exchange and interest rate risk. Foreign currency forward and option contracts are used to offset the foreign exchange risk on certain existing assets and liabilities and to hedge the foreign exchange risk on expected future cash flows on certain forecasted revenue and cost of sales. From time to time, the Company enters into interest rate derivative agreements to modify the interest rate profile of certain investments and debt. The Company's accounting policies for these instruments are based on whether the instruments are designated as hedge or non-hedge instruments. The Company records all derivatives on the balance sheet at fair value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2—Financial Instruments (Continued)

The following table shows the notional principal, net fair value, and credit risk amounts of the Company's foreign currency instruments as of September 24, 2005 and September 25, 2004 (in millions):

	September 24, 2005			September 25, 2004		
	Notional Principal	Fair Value	Credit Risk Amounts	Notional Principal	Fair Value	Credit Risk Amounts
Foreign exchange instruments qualifying as accounting hedges:						
Spot/Forward contracts	$ 662	$ 10	$ 10	$ 598	$ (3)	$ 3
Purchased options	$ 1,668	$ 17	$ 17	$ 482	$ 4	$ 4
Sold options	$ 1,087	$ (5)	$ —	$ 521	$ (3)	$ —
Foreign exchange instruments other than accounting hedges:						
Spot/Forward contracts	$ 833	$ (3)	$ 1	$ 609	$ 3	$ 4
Purchased options	$ 115	$ —	$ —	$ —	$ —	$ —
Sold options	$ —	$ —	$ —	$ —	$ —	$ —

The notional principal amounts for derivative instruments provide one measure of the transaction volume outstanding as of year-end, and do not represent the amount of the Company's exposure to credit or market loss. The credit risk amount shown in the table above represents the Company's gross exposure to potential accounting loss on these transactions if all counterparties failed to perform according to the terms of the contract, based on then-current currency exchange rates at each respective date. The Company's exposure to credit loss and market risk will vary over time as a function of currency exchange rates.

The estimates of fair value are based on applicable and commonly used pricing models and prevailing financial market information as of September 24, 2005 and September 25, 2004. Although the table above reflects the notional principal, fair value, and credit risk amounts of the Company's foreign exchange instruments, it does not reflect the gains or losses associated with the exposures and transactions that the foreign exchange instruments are intended to hedge. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

Foreign Exchange Risk Management

The Company may enter into foreign currency forward and option contracts with financial institutions to protect against foreign exchange risk associated with existing assets and liabilities, certain firmly committed transactions, forecasted future cash flows, and net investments in foreign subsidiaries. Generally, the Company's practice is to hedge a majority of its existing material foreign exchange transaction exposures. However, the Company may not hedge certain foreign exchange transaction exposures due to immateriality, prohibitive economic cost of hedging particular exposures, or limited availability of appropriate hedging instruments.

To help protect gross margins from fluctuations in foreign currency exchange rates, the Company's U.S. dollar functional subsidiaries hedge a portion of forecasted foreign currency revenues, and the Company's non-U.S. dollar functional subsidiaries selling in local currencies hedge a portion of forecasted inventory purchases not denominated in the subsidiaries' functional currency. Other comprehensive income associated with hedges of foreign currency revenues is recognized as a component of net sales in the same

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2—Financial Instruments (Continued)

period as the related sales are recognized, and other comprehensive income related to inventory purchases is recognized as a component of cost of sales in the same period as the related costs are recognized. Typically, the Company hedges portions of its forecasted foreign currency exposure associated with revenues and inventory purchases over a time horizon of 3 to 6 months.

Derivative instruments designated as cash flow hedges must be de-designated as hedges when it is probable that the forecasted hedged transaction will not occur in the initially identified time period or within a subsequent 2 month time period. Deferred gains and losses in other comprehensive income associated with such derivative instruments are immediately reclassified into earnings in other income and expense. Any subsequent changes in fair value of such derivative instruments are also reflected in current earnings unless they are re-designated as hedges of other transactions. The Company recognized net losses of $1.6 million and $2.8 million in 2005 and 2004, respectively, in other income and expense related to the loss of hedge designation on discontinued cash flow hedges due to changes in the Company's forecast of future net sales and cost of sales and due to prevailing market conditions. No net gains, or losses, of a similar nature were recorded in 2003. As of September 24, 2005, the Company had a net deferred gain associated with cash flow hedges of approximately $3.6 million, net of taxes, substantially all of which is expected to be reclassified to earnings by the end of the second quarter of fiscal 2006.

The net gain or loss on the effective portion of a derivative instrument designated as a net investment hedge is included in the cumulative translation adjustment account of accumulated other comprehensive income within shareholders' equity. As of September 24, 2005 and September 25, 2004, the Company had a net gain of $673,000 and a net loss of $1.8 million, respectively, included in the cumulative translation adjustment.

The Company may also enter into foreign currency forward and option contracts to offset the foreign exchange gains and losses generated by the re-measurement of certain assets and liabilities recorded in non-functional currencies. Changes in the fair value of these derivatives are recognized in current earnings in other income and expense as offsets to the changes in the fair value of the related assets or liabilities. Due to currency market movements, changes in option time value can lead to increased volatility in other income and expense.

Interest Rate Risk Management

From time to time, the Company historically entered into interest rate derivative transactions with financial institutions in order to better match the Company's floating-rate interest income on its cash equivalents and short-term investments with its fixed-rate interest expense on any outstanding long-term debt, and/or to diversify a portion of the Company's exposure away from fluctuations in short-term U.S. interest rates.

During 2001 and 2002, the Company entered into and then subsequently terminated various interest rate debt swap agreements generating a realized gain of $23 million. These gains were deferred and amortized over the remaining life of the underlying debt, which matured and was repaid in February 2004.

As of September 24, 2005 and September 25, 2004, the Company had no interest rate derivatives outstanding.

Note 2—Financial Instruments (Continued)

Non-Current Debt and Equity Investments and Related Gains and Losses

The Company previously held significant investments in ARM Holdings plc (ARM), Akamai Technologies, Inc. (Akamai), and EarthLink Network, Inc. (EarthLink). The Company sold all of the remaining holdings in these non-current investments in 2004 and 2003. Pretax gains recorded upon the sale of these non-current investments were $4 million and $10 million in 2004 and 2003, respectively.

Note 3—Consolidated Financial Statement Details (in millions)

Other Current Assets

	2005	2004
Vendor non-trade receivables	$ 417	$ 276
Other current assets	231	209
Total other current assets	$ 648	$ 485

Property, Plant, and Equipment

	2005	2004
Land and buildings	$ 361	$ 351
Machinery, equipment, and internal-use software	494	422
Office furniture and equipment	81	79
Leasehold improvements	545	446
	1,481	1,298
Accumulated depreciation and amortization	(664)	(591)
Net property, plant, and equipment	$ 817	$ 707

Other Assets

	2005	2004
Non-current deferred tax assets	$ 183	$ 86
Capitalized software development costs, net	38	25
Other assets	117	80
Total other assets	$ 338	$ 191

Accrued Expenses

	2005	2004
Deferred revenue—current	$ 501	$ 342
Accrued marketing and distribution	221	147
Accrued compensation and employee benefits	167	134
Accrued warranty and related costs	188	105
Other current liabilities	628	472
Total accrued expenses	$ 1,705	$ 1,200

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3—Consolidated Financial Statement Details (in millions) (Continued)

Non-current Liabilities

	2005	2004
Deferred revenue—non-current	$ 281	$ 202
Deferred tax liabilities	308	113
Other non-current liabilities	12	8
Total non-current liabilities	$ 601	$ 323

Interest and Other Income, net

	2005	2004	2003
Interest income	$ 183	$ 64	$ 69
Interest expense	—	(3)	(8)
Gains on sales of short term investments	—	1	21
Other income (expense), net	(18)	(9)	1
Total interest and other income, net	$ 165	$ 53	$ 83

Note 4—Goodwill and Other intangible Assets

The Company is currently amortizing its acquired intangible assets with definite lives over periods ranging from 3 to 10 years.

The following table summarizes the components of gross and net intangible asset balances (in millions):

	September 24, 2005			September 25, 2004		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Goodwill	$ 69	$ —	$ 69	$ 80	$ —	$ 80
Other acquired intangible assets	5	(5)	—	5	(5)	—
Acquired technology	61	(34)	27	42	(25)	17
Total acquired intangible assets	$ 135	$ (39)	$ 96	$ 127	$ (30)	$ 97

During the fourth quarter of 2005, the Company recorded an adjustment of approximately $11 million to goodwill relating to a reduction of valuation allowances that were recorded at the time certain net operating loss carryforwards (NOLs) were acquired in previous business combinations. During the fourth quarter of 2005, these NOLs were deemed to be more likely than not to be realized and accordingly the valuation allowances were reversed against the related goodwill that was recognized at the time of the acquisitions.

During the third quarter of 2004, the Company recorded an adjustment of approximately $5 million to goodwill related to the acquisition of PowerSchool, Inc. (PowerSchool) in 2001. This reduction of goodwill included the cancellation of 158,334 shares of the Company's common stock, valued at approximately $2 million, that were previously held in escrow and were refunded upon resolution of certain matters arising out of the acquisition of PowerSchool. This adjustment also included approximately $3 million to adjust the original estimates of the pre-acquisition PowerSchool restructuring liability to actual costs incurred.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4—Goodwill and Other intangible Assets (Continued)

Expected annual amortization expense related to acquired technology is as follows (in millions):

Fiscal Years:	
2006	$ 10
2007	8
2008	5
2009	1
2010	1
Thereafter	2
Total expected annual amortization expense	$ 27

Amortization expense related to acquired intangible assets was $9 million, $7 million, and $10 million in 2005, 2004, and 2003, respectively.

Note 5—Restructuring Charges

Fiscal 2004 Restructuring Actions

The Company recorded total restructuring charges of approximately $23 million during the year ended September 25, 2004, including approximately $14 million in severance costs, $5.5 million in asset impairments, and a $3.5 million charge for lease cancellations in conjunction with the vacating of a leased sales facility related to a European workforce reduction during the fourth quarter of 2004. Of the $23 million charge, $19.7 million had been utilized by the end of 2005, with the remaining $3.3 million consisting of $0.7 million for employee severance benefits and $2.6 million for lease cancellations. These actions will result in the termination of 461 employees, 448 of which had been terminated prior to the end of 2005.

The following table summarizes activity associated with restructuring actions initiated during 2004 (in millions):

	Employee Severance Benefits	Asset Impairments	Lease Cancellations	Totals
Total charge	$ 14.0	$ 5.5	$ 3.5	$ 23.0
Total spending through September 24, 2005	(12.4)	—	(0.9)	(13.3)
Total non-cash items	—	(5.2)	—	(5.2)
Adjustments	(0.9)	(0.3)	—	(1.2)
Accrual at September 24, 2005	$ 0.7	$ —	$ 2.6	$ 3.3

Fiscal 2003 Restructuring Actions

The Company recorded total restructuring charges of approximately $26.8 million during the year ended September 27, 2003, including approximately $7.4 million in severance costs, a $5.0 million charge to write-off deferred compensation, $7.1 million in asset impairments, and a $7.3 million charge for lease cancellations primarily related to the closure of the Company's Singapore manufacturing operations during the first quarter of 2003. Of the $26.8 million charge, all had been utilized by the end of 2005, except for approximately $1.7 million related to operating lease costs on abandoned facilities. During the third quarter of 2003, approximately $500,000 of the amount originally accrued for lease cancellations was determined to be in excess due to the sublease of a property sooner than originally expected and a shortfall

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 5—Restructuring Charges (Continued)

of approximately $500,000 was identified in the severance accrual due to higher than expected severance costs related to the closure of the Company's Singapore manufacturing operations. These adjustments had no net effect on reported operating expense. These actions resulted in the termination of 353 employees.

The following table summarizes activity associated with restructuring actions initiated during 2003 (in millions):

	Employee Severance Benefits	Deferred Compensation Write-off	Asset Impairments	Lease Cancellations	Totals
Total charge	$ 7.4	$ 5.0	$ 7.1	$ 7.3	$ 26.8
Total spending through September 24, 2005	(7.9)	—	—	(5.1)	(13.0)
Total non-cash items	—	(5.0)	(7.1)	—	(12.1)
Adjustments	0.5	—	—	(0.5)	—
Accrual at September 24, 2005	$ —	$ —	$ —	$ 1.7	$ 1.7

Note 6—Income Taxes

The provision for income taxes consisted of the following (in millions):

	2005	2004	2003
Federal:			
Current	$ 303	$ 34	$ 18
Deferred	146	56	(7)
	449	90	11
State:			
Current	66	5	4
Deferred	(91)	(18)	(11)
	(25)	(13)	(7)
Foreign:			
Current	59	46	21
Deferred	(3)	(16)	(1)
	56	30	20
Provision for income taxes	$ 480	$ 107	$ 24

The foreign provision for income taxes is based on foreign pretax earnings of approximately $922 million, $384 million, and $250 million in 2005, 2004, and 2003, respectively. As of September 24, 2005, approximately $4.3 billion of the Company's cash, cash equivalents, and short-term investments were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S. The Company's consolidated financial statements fully provide for any related tax liability on amounts that may be repatriated, aside from undistributed earnings of certain of the Company's foreign subsidiaries that are intended to be indefinitely reinvested in operations outside the U.S. U.S. income taxes have not been provided on a cumulative total of $1.2 billion of such earnings. It is not practicable to determine the income tax liability that might be incurred if these earnings were to be distributed.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 6—Income Taxes (Continued)

On October 22, 2004, the American Jobs Creation Act (AJCA) was signed into law. The AJCA includes a provision for the deduction of 85% of certain foreign earnings that are repatriated, as defined in the AJCA. The legislation provided the Company with the option to apply this provision to repatriations of qualifying earnings in either 2005 or 2006. The Company is continuing to evaluate the effects of the repatriation provision and expects to complete the evaluation in 2006. A maximum of $755 million may be eligible for repatriation under the reduced tax rate provided by AJCA. However, given the uncertainties and complexities of the repatriation provision and the Company's continuing evaluation, the Company has not yet determined the amount that may be repatriated or the related potential income tax effects of such repatriation.

Deferred tax assets and liabilities reflect the effects of tax losses, credits, and the future income tax effects of temporary differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases and are measured using enacted tax rates that apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

As of September 24, 2005 and September 25, 2004, the significant components of the Company's deferred tax assets and liabilities were (in millions):

	2005	2004
Deferred tax assets:		
Accrued liabilities and other reserves	$ 321	$ 195
Tax losses and credits	305	329
Basis of capital assets and investments	96	65
Accounts receivable and inventory reserves	36	32
Other	9	26
Total deferred tax assets	767	647
Less valuation allowance	5	30
Net deferred tax assets	762	617
Deferred tax liabilities:		
Unremitted earnings of subsidiaries	557	413
Total deferred tax liabilities	557	413
Net deferred tax asset	$ 205	$ 204

As of September 24, 2005, the Company had operating loss carryforwards for federal tax purposes of approximately $62 million, which expire from 2011 through 2024. A portion of these carryforwards was acquired from the Company's previous acquisitions, the utilization of which is subject to certain limitations imposed by the Internal Revenue Code. The Company also has Federal credit carryforwards and various state and foreign tax loss and credit carryforwards, the tax effect of which is approximately $206 million and which expire between 2010 and 2025. The remaining benefits from tax losses and credits do not expire. As of September 24, 2005 and September 25, 2004, a valuation allowance of $5 million and $30 million, respectively, was recorded against the deferred tax asset for the benefits of tax losses that may not be realized. The remaining valuation allowance relates principally to the state operating losses. Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets.

Note 6—Income Taxes (Continued)

A reconciliation of the provision for income taxes, with the amount computed by applying the statutory federal income tax rate (35% in 2005, 2004, and 2003) to income before provision for income taxes, is as follows (in millions):

	2005	2004	2003
Computed expected tax	$ 636	$ 134	$ 32
State taxes, net of federal effect	(19)	(5)	(4)
Indefinitely invested earnings of foreign subsidiaries	(98)	(31)	(13)
Nondeductible executive compensation	11	10	5
Research and development credit, net	(26)	(5)	(7)
Other items	(24)	4	11
Provision for income taxes	$ 480	$ 107	$ 24
Effective tax rate	26%	28%	26%

During 2005, the Company reversed certain tax contingency reserves and recorded a corresponding benefit to income tax expense primarily as a result of a change in the estimated outcome of certain tax disputes. Additionally, during the fourth quarter of 2005, the Company recorded a benefit to tax expense to adjust its net deferred tax assets as a result of the Company's year-end review of its deferred tax accounts, the impact of which was not material to the current or prior periods' results of operations. The total benefit to income tax expense from the reversal of these tax contingency reserves and adjustments to net deferred tax assets was $67 million. The Company also recorded a $14 million credit to income tax expense resulting from a reduction of the valuation allowance.

The Internal Revenue Service (IRS) has completed its field audit of the Company's federal income tax returns for all years prior to 2002 and proposed certain adjustments. Certain of these adjustments are being contested through the IRS Appeals Office. Substantially all IRS audit issues for these years have been resolved. In addition, the Company is also subject to audits by state, local, and foreign tax authorities. Management believes that adequate provisions have been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. Should any issues addressed in the Company's tax audits be resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs.

Note 7—Shareholders' Equity

Preferred Stock

The Company has 5 million shares of authorized preferred stock, none of which is outstanding. Under the terms of the Company's Restated Articles of Incorporation, the Board of Directors is authorized to determine or alter the rights, preferences, privileges and restrictions of the Company's authorized but unissued shares of preferred stock.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 7—Shareholders' Equity (Continued)

Restricted Stock Units

During 2005 and 2004, the Company's Board of Directors approved the grant of 230,000 and 5.03 million restricted stock units, respectively, to members of the Company's senior management team, excluding its CEO. These restricted stock units generally vest over four years either in two equal installments on the second and fourth anniversaries of the date of grant or in equal installments on each of the first through fourth anniversaries of the grant date. Upon vesting, the restricted stock units will convert into an equivalent number of shares of common stock. The Company has recorded $10.3 million and $64.4 million in 2005 and 2004, respectively, in value for these restricted stock units as a component of shareholders' equity and is amortizing the amounts on a straight-line basis over the four-year requisite service period. The value of the restricted stock units was based on the closing market price of the Company's common stock on the date of grant. The restricted stock units have been included in the calculation of diluted earnings per share utilizing the treasury stock method.

CEO Restricted Stock Award

On March 19, 2003, the Company entered into an Option Cancellation and Restricted Stock Award Agreement (the Agreement) with Mr. Steven P. Jobs, its CEO. The Agreement cancelled stock option awards for the purchase of 55 million shares of the Company's common stock previously granted to Mr. Jobs in 2000 and 2001. Mr. Jobs retained options to purchase 120,000 shares of the Company's common stock granted in August of 1997 in his capacity as a member of the Company's Board of Directors, prior to becoming the Company's CEO. The Agreement replaced the cancelled options with a restricted stock award of 10 million shares of the Company's common stock. The restricted stock award generally vests three years from the date of grant. Vesting of some or all of the restricted shares will be accelerated in the event Mr. Jobs is terminated without cause, dies, or has his management role reduced following a change in control of the Company.

The Company determined the value of the restricted stock award in accordance with APB Opinion No. 25 and has recorded the value as deferred stock compensation as a component of shareholders' equity and is amortizing that amount on a straight-line basis over the 3 year service period. The value of the restricted stock award was based on the closing market price of the Company's common stock on the date of the award. The 10 million restricted shares have been included in the calculation of diluted earnings per share utilizing the treasury stock method.

Stock Repurchase Plan

In July 1999, the Company's Board of Directors authorized a plan for the Company to repurchase up to $500 million of its common stock. This repurchase plan does not obligate the Company to acquire any specific number of shares or acquire shares over any specified period of time.

During the fourth quarter of 2001, the Company entered into a forward purchase agreement to acquire 3.1 million shares of its common stock in September of 2003 at an average price of $8.32 per share for a total cost of $25.5 million. In August 2003, the Company settled this agreement prior to its maturity, at which time the Company's common stock had a fair value of $11.41. Other than this forward purchase transaction, the Company has not engaged in any transactions to repurchase its common stock since 2000. Since inception of the stock repurchase plan, the Company had repurchased a total of 13.1 million shares at a cost of $217 million. The Company was authorized to repurchase up to an additional $283 million of its common stock as of September 24, 2005.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 7—Shareholders' Equity (Continued)

Comprehensive Income

Comprehensive income consists of two components, net income and other comprehensive income. Other comprehensive income refers to revenue, expenses, gains and losses that under U.S. generally accepted accounting principles are recorded as an element of shareholders' equity but are excluded from net income. The Company's other comprehensive income consists of foreign currency translation adjustments from those subsidiaries not using the U.S. dollar as their functional currency, unrealized gains and losses on marketable securities categorized as available-for-sale, and net deferred gains and losses on certain derivative instruments accounted for as cash flow hedges.

The following table summarizes the components of accumulated other comprehensive income (loss), net of taxes (in millions):

	2005	2004	2003
Unrealized gains/(losses) on available-for-sale securities	$ (4)	$ (4)	$ 1
Unrealized gains/(losses) on derivative investments	4	(4)	(16)
Cumulative foreign currency translation	—	(7)	(20)
Accumulated other comprehensive income/(loss)	$—	$ (15)	$ (35)

The following table summarizes activity in other comprehensive income related to available-for-sale securities, net of taxes (in millions):

	2005	2004	2003
Change in fair value of available-for-sale securities	$—	$ (1)	$ 11
Adjustment for net gains realized and included in net income	—	(4)	(23)
Change in unrealized gain/loss on available-for-sale securities	$—	$ (5)	$ (12)

The tax effect related to the change in unrealized gain on available-for-sale securities was $4 million and $6 million for 2004 and 2003, respectively. The tax effect on the reclassification adjustment for net gains/losses included in net income was $1 million and $(8) million for 2004 and 2003, respectively.

The following table summarizes activity in other comprehensive income related to derivatives, net of taxes, held by the Company (in millions):

	2005	2004	2003
Changes in fair value of derivatives	$ 7	$ (21)	$ (24)
Adjustment for net gains realized and included in net income	1	33	19
Change in unrealized gain/loss on derivative instruments	$ 8	$ 12	$ (5)

The tax effect related to the changes in fair value of derivatives was $(3) million, $10 million, and $11 million for 2005, 2004, and 2003, respectively. The tax effect related to derivative gains/losses reclassified from other comprehensive income to net income was $(2) million, $(13) million, and $(7) million for 2005, 2004, and 2003, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 8—Employee Benefit Plans

2003 Employee Stock Plan

The 2003 Employee Stock Plan (the 2003 Plan) is a shareholder approved plan that provides for broad-based grants to employees, including executive officers. Based on the terms of individual option grants, options granted under the 2003 Plan generally expire 7 to 10 years after the grant date and generally become exercisable over a period of 4 years, based on continued employment, with either annual or quarterly vesting. The 2003 Plan permits the granting of incentive stock options, nonstatutory stock options, restricted stock units, stock appreciation rights, and stock purchase rights.

1997 Employee Stock Option Plan

In August 1997, the Company's Board of Directors approved the 1997 Employee Stock Option Plan (the 1997 Plan), a non-shareholder approved plan for grants of stock options to employees who are not officers of the Company. Based on the terms of individual option grants, options granted under the 1997 Plan generally expire 7 to 10 years after the grant date and generally become exercisable over a period of 4 years, based on continued employment, with either annual or quarterly vesting. In October 2003, the Company terminated the 1997 Employee Stock Option Plan and cancelled all remaining unissued shares totaling 28,590,702. No new options can be granted from the 1997 Plan.

Employee Stock Option Exchange Program

On March 20, 2003, the Company announced a voluntary employee stock option exchange program (the Exchange Program) whereby eligible employees, other than executive officers and members of the Board of Directors, had an opportunity to exchange outstanding options with exercise prices at or above $12.50 per share for a predetermined smaller number of new stock options issued with exercise prices equal to the fair market value of one share of the Company's common stock on the day the new awards were issued, which was to be at least six months plus one day after the exchange options were cancelled. On April 17, 2003, in accordance with the Exchange Program, the Company cancelled options to purchase 33,138,386 shares of its common stock. On October 22, 2003, new stock options totaling 13,394,736 shares were issued to employees at an exercise price of $11.38 per share, which is equivalent to the closing price of the Company's stock on that date. No financial or accounting impact to the Company's financial position, results of operations or cash flow was associated with this transaction.

1997 Director Stock Option Plan

In August 1997, the Company's Board of Directors adopted a shareholder approved Director Stock Option Plan (DSOP) for non-employee directors of the Company. Initial grants of 30,000 options under the DSOP vest in three equal installments on each of the first through third anniversaries of the date of grant, and subsequent annual grants of 10,000 options are fully vested at grant.

Rule 10b5-1 Trading Plans

Certain of the Company's executive officers, including Mr. Timothy D. Cook, Mr. Peter Oppenheimer, Mr. Jonathan Rubinstein, Mr. Philip W. Schiller, Dr. Bertrand Serlet, and Dr. Avadis Tevanian, Jr., have entered into trading plans pursuant to Rule 10b5-1(c)(1) of the Securities Exchange Act of 1934, as amended. A trading plan is a written document that pre-establishes the amounts, prices and dates (or formula for determining the amounts, prices and dates) of future purchases or sales of the Company's stock including the exercise and sale of employee stock options and shares acquired pursuant to the Company's employee stock purchase plan and upon vesting of restricted stock units.

Note 8—Employee Benefit Plans (Continued)

Employee Stock Purchase Plan

The Company has a shareholder approved employee stock purchase plan (the Purchase Plan), under which substantially all employees may purchase common stock through payroll deductions at a price equal to 85% of the lower of the fair market values as of the beginning and end of six month offering periods. Stock purchases under the Purchase Plan are limited to 10% of an employee's compensation, up to a maximum of $25,000 in any calendar year. Beginning with the six-month offering period that started on June 30, 2003, the number of shares authorized for issuance is limited to a total of 1 million shares per offering period. During 2005, 2004, and 2003, adjusted for the February 2005 stock split 2.3 million, 3.9 million, and 4.3 million shares, respectively, were issued under the Purchase Plan. As of September 24, 2005, approximately 3.8 million shares were reserved for future issuance under the Purchase Plan.

Employee Savings Plan

The Company has an employee savings plan (the Savings Plan) qualifying as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code. Under the Savings Plan, participating U.S. employees may defer a portion of their pre-tax earnings, up to the Internal Revenue Service annual contribution limit ($14,000 for calendar year 2005). The Company matches 50% to 100% of each employee's contributions, depending on length of service, up to a maximum 6% of the employee's earnings. The Company's matching contributions to the Savings Plan were approximately $28 million, $24 million, and $21 million in 2005, 2004, and 2003, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 8—Employee Benefit Plans (Continued)

Stock Option Activity

A summary of the Company's stock option activity and related information for the last three fiscal years follows (share amounts are presented in thousands):

	Shares Available for Grant	Outstanding Options Number of Shares	Outstanding Options Weighted Average Exercise Price
Balance at September 28, 2002	13,142	218,860	$ 14.09
Restricted Stock Granted	(10,000)	—	—
Options Granted	(8,358)	8,358	$ 8.19
Options Cancelled	96,886	(96,886)	$ 19.80
Options Exercised	—	(4,308)	$ 7.02
Plan Shares Expired	(10)	—	—
Balance at September 27, 2003	91,660	126,024	$ 9.54
Restricted Stock Units Granted	(5,030)	—	—
Options Granted	(36,394)	36,394	$ 11.48
Options Cancelled	6,010	(6,010)	$ 10.35
Options Exercised	—	(45,686)	$ 8.60
Plan Shares Expired	(32,196)	—	—
Balance at September 25, 2004	24,050	110,722	$ 10.52
Additional Options Authorized	49,000	—	—
Restricted Stock Units Granted	(460)	—	—
Options Granted	(16,214)	16,214	$ 42.52
Options Cancelled	3,844	(3,844)	$ 13.28
Restricted Stock Units Cancelled	230	—	—
Options Exercised	—	(49,871)	$ 10.05
Plan Shares Expired	(1,493)	—	—
Balance at September 24, 2005	58,957	73,221	$ 17.79

In conjunction with the amendments to the 2003 Plan that were approved at the Annual Meeting of Shareholders held on April 21, 2005, the number of shares available for grant under the 2003 Plan will be reduced by two times the number of restricted shares and restricted stock units granted. This amendment is effective for all grants made after April 21, 2005.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 8—Employee Benefit Plans (Continued)

The options outstanding as of September 24, 2005 have been segregated into eight ranges for additional disclosure as follows (option amounts are presented in thousands):

	Options Outstanding			Options Exercisable	
	Options Outstanding as of September 24, 2005	Weighted-Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Options Exercisable as of September 24, 2005	Weighted Average Exercise Price
$0.62-$9.13	10,092	4.29	$ 7.33	8,310	$ 7.26
$9.14-$10.20	14,954	5.65	$ 9.76	13,516	$ 9.73
$10.21-$10.80	2,284	5.19	$ 10.31	996	$ 10.37
$10.81-$10.90	11,726	5.36	$ 10.89	2,858	$ 10.89
$10.91-$11.38	9,151	5.10	$ 11.37	2,920	$ 11.37
$11.39-$23.72	9,622	5.39	$ 16.52	5,797	$ 17.50
$23.73-$46.10	4,791	6.38	$ 36.04	406	$ 31.62
$46.11-$49.87	10,601	6.94	$ 46.75	—	$ —
$0.62-$49.87	73,221	5.53	$ 17.79	34,803	$ 10.94

As of September 25, 2004, the Company had exercisable options outstanding to purchase 60.0 million shares with a weighted average exercise price of $10.30 per share. As of September 27, 2003, the Company had exercisable options outstanding to purchase 77.5 million shares with a weighted average exercise price of $9.38 per share.

The Company had 5.03 million restricted stock units outstanding as of September 24, 2005, which were excluded from the options outstanding balances in the preceding tables. None of these restricted stock units was vested as of September 24, 2005. These restricted stock units have been deducted from the shares available for grant under the Company's stock option plans.

Note 9—Stock-Based Compensation

The Company has provided pro forma disclosures in Note 1 of these Notes to Consolidated Financial Statements of the effect on net income and earnings per share as if the fair value method of accounting for stock compensation had been used for its employee stock option grants and employee stock purchase plan purchases. These pro forma effects have been estimated at the date of grant and beginning of the period, respectively, using the Black-Scholes option pricing model.

For purposes of the pro forma disclosures provided pursuant to SFAS No. 123, the option awards issued in October 2003 and the awards cancelled as part of the Employee Stock Option Exchange Program have been accounted for using modification accounting. In accordance with SFAS No. 123, the grant date of the awards issued is the date of acceptance of the exchange offer by participating employees. The cancellation of certain of the Company's CEO's options and replacement with restricted shares in March 2003 is also being accounted for using modification accounting for purposes of the pro forma disclosures provided pursuant to SFAS No. 123.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 9—Stock-Based Compensation (Continued)

The assumptions used for each of the last three fiscal years and the resulting estimate of weighted-average fair value per share of options granted during those years are as follows:

	2005	2004	2003
Expected life of stock options	3.5 - 3.6 years	3.5 years	3.5 - 4 years
Expected life of stock purchases	6 months	6 months	6 months
Interest rate—stock options	3.13% - 3.88%	2.33% - 3.15%	2.14% - 2.45%
Interest rate—stock purchases	1.67% - 3.30%	0.96% - 1.67%	1.10% - 1.77%
Volatility—stock options	39% - 40%	40%	40% - 63%
Volatility—stock purchases	32% - 48%	32% - 44%	35% - 44%
Dividend yields	—	—	—
Weighted-average fair value of options granted during the year	$ 14.41	$ 3.69	$ 3.32
Weighted-average fair value of stock purchases during the year	$ 7.55	$ 2.78	$ 2.12

For purposes of the pro forma disclosures provided pursuant to SFAS No. 123, the expected volatility assumptions used by the Company are based on the historical volatility of the Company's common stock over the most recent period commensurate with the estimated expected life of the Company's stock options and other relevant factors including implied volatility in market traded options on the Company's common stock and the impact of unusual fluctuations not reasonably expected to recur on the historical volatility of the Company's common stock. The Company bases its expected life assumption on its historical experience and on the terms and conditions of the stock options it grants to employees.

Note 10—Commitments and Contingencies

Lease Commitments

The Company leases various equipment and facilities, including retail space, under noncancelable operating lease arrangements. The Company does not currently utilize any other off-balance-sheet financing arrangements. The major facility leases are for terms of 5 to 15 years and generally provide renewal options for terms of 3 to 5 additional years. Leases for retail space are for terms of 5 to 20 years, the majority of which are for 10 years, and often contain multi-year renewal options. As of September 24, 2005, the Company's total future minimum lease payments under noncancelable operating leases were $865 million, of which $606 million related to leases for retail space.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 10—Commitments and Contingencies (Continued)

Rent expense under all operating leases, including both cancelable and noncancelable leases, was $140 million, $103 million, and $97 million in 2005, 2004, and 2003, respectively. Future minimum lease payments under noncancelable operating leases having remaining terms in excess of one year as of September 24, 2005, are as follows (in millions):

Fiscal Years	
2006	$ 108
2007	110
2008	101
2009	97
2010	95
Later years	354
Total minimum lease payments	$ 865

Accrued Warranty and Indemnifications

The Company offers a basic limited parts and labor warranty on its hardware products. The basic warranty period for hardware products is typically one year from the date of purchase by the end-user. The Company also offers a 90-day basic warranty for its service parts used to repair the Company's hardware products. The Company provides currently for the estimated cost that may be incurred under its basic limited product warranties at the time related revenue is recognized. Factors considered in determining appropriate accruals for product warranty obligations include the size of the installed base of products subject to warranty protection, historical and projected warranty claim rates, historical and projected cost-per-claim, and knowledge of specific product failures that are outside of the Company's typical experience. The Company assesses the adequacy of its preexisting warranty liabilities and adjusts the amounts as necessary based on actual experience and changes in future estimates.

The following table reconciles changes in the Company's accrued warranties and related costs (in millions):

	2005	2004	2003
Beginning accrued warranty and related costs	$ 105	$ 67	$ 69
Cost of warranty claims	(188)	(105)	(71)
Accruals for product warranties	271	143	69
Ending accrued warranty and related costs	$ 188	$ 105	$ 67

The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against itself or an indemnified third-party and, in the opinion of management, does not have a potential liability related to unresolved infringement claims subject to indemnification that would have a material adverse effect on its financial condition, liquidity or results of operations. Therefore, the Company did not record a liability for infringement costs as of either September 24, 2005 or September 25, 2004.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 10—Commitments and Contingencies (Continued)

Concentrations in the Available Sources of Supply of Materials and Product

Although most components essential to the Company's business are generally available from multiple sources, other key components (including microprocessors and application-specific integrated circuits ("ASICs")) are currently obtained by the Company from single or limited sources. Some other key components, while currently available to the Company from multiple sources, are at times subject to industry-wide availability and pricing pressures. In addition, the Company uses some components that are not common to the rest of the personal computer industry, and new products introduced by the Company often initially utilize custom components obtained from only one source until the Company has evaluated whether there is a need for and subsequently qualifies additional suppliers. If the supply of a key single-sourced component to the Company were to be delayed or curtailed, or in the event a key manufacturing vendor delays shipments of completed products to the Company, the Company's ability to ship related products in desired quantities and in a timely manner could be adversely affected. The Company's business and financial performance could also be adversely affected depending on the time required to obtain sufficient quantities from the original source, or to identify and obtain sufficient quantities from an alternative source. Continued availability of these components may be affected if producers were to decide to concentrate on the production of common components instead of components customized to meet the Company's requirements. Finally, significant portions of the Company's CPUs, logic boards, and assembled products are now manufactured by outsourcing partners, primarily in various parts of Asia. Although the Company works closely with its outsourcing partners on manufacturing schedules, the Company's operating results could be adversely affected if its outsourcing partners were unable to meet their production obligations.

Long-Term Supply Agreements

Subsequent to September 24, 2005, the Company entered into long-term supply agreements with Hynix Semiconductor, Inc., Intel Corporation, Micron Technology, Inc., Samsung Electronics Co., Ltd., and Toshiba Corporation to secure supply of NAND flash memory through calendar year 2010. As part of these agreements, the Company intends to prepay a total of $1.25 billion for flash memory components by the end of the second quarter of 2006.

Contingencies

The Company is subject to certain other legal proceedings and claims that have arisen in the ordinary course of business and have not been fully adjudicated. In the opinion of management, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate have a material adverse effect on its financial condition, liquidity, or results of operations. However, the results of legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations including, in some instances, the requirement to provide customers the ability to return product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have recently been passed in several jurisdictions in which the Company operates including various European Union member countries, Japan and certain states within the U.S. Although the Company does not anticipate any material adverse effects in the future based on the nature of its operations and the thrust of such laws, there is no assurance that

Note 10—Commitments and Contingencies (Continued)

such existing laws or future laws will not have a material adverse effect on the Company's financial condition, liquidity, or results of operations.

Note 11—Segment Information and Geographic Data

In accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, the Company reports segment information based on the "management" approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of the Company's reportable segments.

The Company manages its business primarily on a geographic basis. The Company's reportable operating segments are comprised of the Americas, Europe, Japan, and Retail. The Americas, Europe, and Japan reportable segments do not include activities related to the Retail segment. The Americas segment includes both North and South America. The Europe segment includes European countries as well as the Middle East and Africa. The Retail segment operates Apple-owned retail stores in the U.S., Canada, Japan, and the U.K. Other operating segments include Asia-Pacific, which includes Australia and Asia except for Japan, and the Company's subsidiary, FileMaker, Inc. Each reportable geographic operating segment provides similar hardware and software products and similar services, and the accounting policies of the various segments are the same as those described in Note 1, "Summary of Significant Accounting Policies," except as described below for the Retail segment.

The Company evaluates the performance of its operating segments based on net sales. The Retail segment's performance is also evaluated based on operating income. Net sales for geographic segments are generally based on the location of the customers. Operating income for each segment includes net sales to third parties, related cost of sales, and operating expenses directly attributable to the segment. Operating income for each segment excludes other income and expense and certain expenses that are managed outside the operating segments. Costs excluded from segment operating income include various corporate expenses, manufacturing costs and variances not included in standard costs, income taxes, and various nonrecurring charges. Corporate expenses include research and development, corporate marketing expenses, manufacturing costs and variances not included in standard costs, and other separately managed general and administrative expenses including certain corporate expenses associated with support of the Retail segment. The Company does not include intercompany transfers between segments for management reporting purposes. Segment assets exclude corporate assets. Corporate assets include cash, short-term and long-term investments, manufacturing facilities, miscellaneous corporate infrastructure, goodwill and other acquired intangible assets, and retail store construction-in-progress that is not subject to depreciation. Except for the Retail segment, capital expenditures for long-lived assets are not reported to management by segment. Capital expenditures by the Retail segment were $132 million, $104 million, and $92 million for 2005, 2004, and 2003 respectively.

Operating income for all segments, except Retail, includes cost of sales at manufacturing standard cost, other cost of sales, related sales and marketing costs, and certain general and administrative costs. This measure of operating income, which includes manufacturing profit, provides a comparable basis for comparison between the Company's various geographic segments. Certain manufacturing expenses and related adjustments not included in segment cost of sales, including variances between standard and actual manufacturing costs and the mark-up above standard cost for product supplied to the Retail segment, are included in corporate expenses.

Note 11—Segment Information and Geographic Data (Continued)

Management assesses the operating performance of the Retail segment differently than it assesses the operating performance of the Company's geographic segments. The Retail segment revenue and operating income is intended to depict a measure comparable to that of the Company's major channel partners in the U.S. operating retail stores so the Company can evaluate the Retail segment performance as if it were a channel partner. Therefore, the Company makes three significant adjustments to the Retail segment for management reporting purposes that are not included in the results of the Company's other segments.

First, the Retail segment's operating income includes cost of sales for Apple products at an amount normally charged to major channel partners in the U.S. operating retail stores, less the cost of sales programs and incentives provided to those channel partners and the Company's cost to support those partners. For the years ended September 24, 2005, September 25, 2004, and September 27, 2003, this resulted in the recognition of additional cost of sales above standard cost by the Retail segment and an offsetting benefit to corporate expenses of approximately $435 million, $213 million, and $106 million, respectively.

Second, the Company's service and support contracts are transferred to the Retail segment at the same cost as that charged to the Company's major retail channel partners in the U.S., resulting in a measure of revenue and gross margin for those items that is comparable between the Company's Retail stores and those retail channel partners. The Retail segment recognizes the full amount of revenue and cost of sales of the Company's service and support contracts at the time of sale. Because the Company has not yet earned the revenue or incurred the costs associated with the sale of these contracts, an offset to these amounts is recognized in other operating segments' net sales and cost of sales. For the year ended September 24, 2005, this resulted in the recognition of net sales and cost of sales by the Retail segment, with corresponding offsets in other operating segments, of $92 million and $64 million, respectively. For the year ended September 25, 2004, the net sales and cost of sales recognized by the Retail segment for sales of service and support contracts were $54 million and $37 million, respectively. For the year ended September 27, 2003, this resulted in the recognition of net sales and cost of sales by the Retail segment of $30 million and $20 million, respectively.

Third, the Company has opened seven high profile stores in New York, Los Angeles, Chicago, San Francisco, Tokyo, Japan, Osaka, Japan, and London, England as of September 24, 2005. These high profile stores are larger than the Company's typical retail stores and were designed to further promote brand awareness and provide a venue for certain corporate sales and marketing activities, including corporate briefings. As such, the Company allocates certain operating expenses associated with these stores to corporate marketing expense to reflect the estimated benefit realized Company-wide. The allocation of these operating costs is based on the amount incurred for a high profile store in excess of that incurred by a more typical Company retail location. Expenses allocated to corporate marketing resulting from the operations of these stores were $31 million, $16 million, and $6 million for the years ended September 24, 2005, September 25, 2004, and September 27, 2003, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 11—Segment Information and Geographic Data (Continued)

Summary information by operating segment follows (in millions):

	2005	2004	2003
Americas:			
Net sales	$ 6,590	$ 4,019	$ 3,181
Operating income	$ 798	$ 465	$ 323
Depreciation, amortization, and accretion	$ 6	$ 6	$ 5
Segment assets (a)	$ 705	$ 563	$ 494
Europe:			
Net sales	$ 3,073	$ 1,799	$ 1,309
Operating income	$ 454	$ 280	$ 130
Depreciation, amortization, and accretion	$ 4	$ 4	$ 4
Segment assets	$ 289	$ 259	$ 252
Japan:			
Net sales	$ 920	$ 677	$ 698
Operating income	$ 140	$ 115	$ 121
Depreciation, amortization, and accretion	$ 3	$ 2	$ 3
Segment assets	$ 199	$ 114	$ 130
Retail:			
Net sales	$ 2,350	$ 1,185	$ 621
Operating income (loss)	$ 151	$ 39	$ (5)
Depreciation, amortization, and accretion (b)	$ 43	$ 35	$ 25
Segment assets (b)	$ 555	$ 351	$ 243
Other Segments (c):			
Net sales	$ 998	$ 599	$ 398
Operating income	$ 118	$ 90	$ 51
Depreciation, amortization, and accretion	$ 2	$ 2	$ 2
Segment assets	$ 133	$ 124	$ 78

(a) The Americas asset figures do not include fixed assets held in the U.S. Such fixed assets are not allocated specifically to the Americas segment and are included in the corporate assets figures below.

(b) Retail segment depreciation and asset figures reflect the cost and related depreciation of its retail stores and related infrastructure. Retail store construction-in-progress, which is not subject to depreciation, is reflected in corporate assets.

(c) Other Segments include Asia-Pacific and FileMaker.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 11—Segment Information and Geographic Data (Continued)

A reconciliation of the Company's segment operating income and assets to the consolidated financial statements follows (in millions):

	2005	2004	2003
Segment operating income	$ 1,661	$ 989	$ 620
Retail manufacturing margin (a)	435	213	106
Corporate expenses, net (b)	(446)	(853)	(701)
Restructuring costs	—	(23)	(26)
Consolidated operating income (loss)	$ 1,650	$ 326	$ (1)
Segment assets	$ 1,881	$ 1,411	$ 1,197
Corporate assets	9,670	6,639	$ 5,618
Consolidated assets	$ 11,551	$ 8,050	$ 6,815
Segment depreciation, amortization, and accretion	$ 58	$ 49	$ 39
Corporate depreciation, amortization, and accretion	121	101	74
Consolidated depreciation, amortization, and accretion	$ 179	$ 150	$ 113

(a) Represents the excess of the Retail segment's cost of sales over the Company's standard cost of sales for products sold through the Retail segment.

(b) Corporate expenses include research and development, corporate marketing expenses, manufacturing costs and variances not included in standard costs, and other separately managed general and administrative expenses including certain corporate expenses associated with support of the Retail segment.

No single customer accounted for more than 10% of net sales in 2005, 2004, or 2003. Net sales and long-lived assets related to operations in the U.S., Japan, and other foreign countries are as follows (in millions):

	2005	2004	2003
Net Sales:			
U.S.	$ 8,194	$ 4,893	$ 3,627
Japan	1,021	738	698
Other Countries	4,716	2,648	1,882
Total Net Sales	$ 13,931	$ 8,279	$ 6,207
Long-Lived Assets:			
U.S.	$ 738	$ 637	$ 635
Japan	63	52	19
Other Countries	112	72	60
Total Long-Lived Assets	$ 913	$ 761	$ 714

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 11—Segment Information and Geographic Data (Continued)

Information regarding net sales by product is as follows (in millions):

	2005	2004	2003
Net Sales:			
Desktops (a)	$ 3,436	$ 2,373	$ 2,475
Portables (b)	2,839	2,550	2,016
Total Macintosh net sales	6,275	4,923	4,491
iPod	4,540	1,306	345
Other music related products and services (c)	899	278	36
Peripherals and other hardware (d)	1,126	951	691
Software, service, and other net sales (e)	1,091	821	644
Total Net Sales	$ 13,931	$ 8,279	$ 6,207

(a) Includes iMac, eMac, Mac mini, Power Mac and Xserve product lines.

(b) Includes iBook and PowerBook product lines.

(c) Consists of iTunes Music Store sales and iPod services, and Apple-branded and third-party iPod accessories.

(d) Includes sales of Apple-branded and third-party displays, wireless connectivity and networking solutions, and other hardware accessories.

(e) Includes sales of Apple-branded operating system, application software, third-party software, AppleCare, and Internet services.

Note 12—Related Party Transactions and Certain Other Transactions

In March 2002, the Company entered into a Reimbursement Agreement with its CEO, Mr. Steven P. Jobs, for the reimbursement of expenses incurred by Mr. Jobs in the operation of his private plane when used for Apple business. The Reimbursement Agreement became effective for expenses incurred by Mr. Jobs for Apple business purposes since he took delivery of the plane in May 2001. The Company recognized a total of $1.1 million, $483,000, and $404,000 in expenses pursuant to the Reimbursement Agreement during 2005, 2004, and 2003, respectively. All expenses recognized pursuant to the Reimbursement Agreement have been included in selling, general, and administrative expenses in the consolidated statements of operations.

Subsequent to September 24, 2005, the Company entered into an agreement with Pixar to sell certain of Pixar's short films on the iTunes Music Store. Mr. Steven P. Jobs, the Company's CEO is also the CEO, Chairman, and a large shareholder of Pixar.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 13—Selected Quarterly Financial Information (Unaudited)

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
	(Tabular amounts in millions, except per share amounts)			
2005				
Net sales	$ 3,678	$ 3,520	$ 3,243	$ 3,490
Gross margin	$ 1,035	$ 1,044	$ 968	$ 996
Net income	$ 430	$ 320	$ 290	$ 295
Earnings per common share:				
Basic	$ 0.52	$ 0.39	$ 0.36	$ 0.37
Diluted	$ 0.50	$ 0.37	$ 0.34	$ 0.35
2004				
Net sales	$ 2,350	$ 2,014	$ 1,909	$ 2,006
Gross margin	$ 634	$ 559	$ 530	$ 536
Net income	$ 106	$ 61	$ 46	$ 63
Earnings per common share:				
Basic	$ 0.14	$ 0.08	$ 0.06	$ 0.09
Diluted	$ 0.13	$ 0.08	$ 0.06	$ 0.08

Basic and diluted earnings per share are computed independently for each of the quarters presented. Therefore, the sum of quarterly basic and diluted per share information may not equal annual basic and diluted earnings per share.

Net income during the fourth quarter of 2005 benefited by $81 million from the reversal of certain tax contingency reserves and adjustments to net deferred tax assets, including reductions to valuation allowances.

Net income during the fourth, third, and second quarters of 2004 included restructuring charges, net of tax, of $4 million, $6 million, and $7 million, respectively. Net income during the fourth quarter of 2004 included after-tax gains related to non-current investments of $3 million.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Apple Computer, Inc.:

We have audited the accompanying consolidated balance sheets of Apple Computer, Inc. and subsidiaries (the Company) as of September 24, 2005 and September 25, 2004, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the years in the three-year period ended September 24, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of September 24, 2005 and September 25, 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended September 24, 2005, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of September 24, 2005, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated November 29, 2005 expressed an unqualified opinion on management's assessment of, and the effective operation of internal control over financial reporting.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for asset retirement obligations and for financial instruments with characteristics of both liabilities and equity in 2003.

/s/ KPMG LLP

Mountain View, California
November 29, 2005

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Apple Computer, Inc.:

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting, that Apple Computer, Inc. and subsidiaries maintained effective internal control over financial reporting as of September 24, 2005, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Apple Computer, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of Apple Computer, Inc.'s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Apple Computer, Inc. maintained effective internal control over financial reporting as of September 24, 2005, is fairly stated, in all material respects, based on criteria established in *Internal Control-Integrated Framework* issued by COSO. Also, in our opinion, Apple Computer, Inc. maintained, in all material respects, effective internal control over financial reporting as of September 24, 2005, based on criteria established in *Internal Control-Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Apple Computer, Inc. as of September 24, 2005 and September 25, 2004, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended September 24, 2005, and our report dated November 29, 2005 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Mountain View, California
November 29, 2005

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures
Based on an evaluation under the supervision and with the participation of the Company's management, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures as defined in rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (Exchange Act) were effective as of September 24, 2005 to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Inherent Limitations Over Internal Controls
The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the Company's assets;

(ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that the Company's receipts and expenditures are being made only in accordance with authorizations of the Company's management and directors; and

(iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Management, including the Company's Chief Executive Officer and Chief Financial Officer, does not expect that the Company's internal controls will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of internal controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Also, any evaluation of the effectiveness of controls in future periods are subject to the risk that those internal controls may become inadequate because of changes in business conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management's Annual Report on Internal Control Over Financial Reporting
The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). Management conducted an evaluation of the effectiveness of the Company's internal control over financial reporting based on the criteria set forth in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, management has concluded that the Company's internal control over financial reporting was

effective as of September 24, 2005. The Company's independent registered public accounting firm, KPMG LLP, has issued an attestation report on the Company's assessment of its internal control over financial reporting. The report on the audit of internal control over financial reporting appears on page 99 of this Form 10-K.

Changes in Internal Control Over Financial Reporting

There were no significant changes in the Company's internal control over financial reporting identified in management's evaluation during the fourth quarter of fiscal 2005 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information

None.

PART III

Item 10. Directors and Executive Officers of the Registrant

Directors

Listed below are the Company's seven directors whose terms expire at the next annual meeting of shareholders.

Name	Position With the Company	Age	Director Since
Fred D. Anderson	Director	61	2004
William V. Campbell	Co-lead Director	65	1997
Millard S. Drexler	Director	61	1999
Albert A. Gore, Jr.	Director	57	2003
Steven P. Jobs	Director and Chief Executive Officer	50	1997
Arthur D. Levinson	Co-lead Director	55	2000
Jerome B. York	Director	67	1997

Fred D. Anderson has been a founding partner of Elevation Partners, a private equity firm focused on the media and entertainment industry, since July 2004. Previously, Mr. Anderson served as the Company's Executive Vice President and Chief Financial Officer from April 1996 to June 2004. Mr. Anderson also serves on the Board of Directors of eBay Inc.

William V. Campbell has been Chairman of the Board of Directors of Intuit, Inc. *("Intuit")* since August 1998. From September 1999 to January 2000, Mr. Campbell acted as Chief Executive Officer of Intuit. From April 1994 to August 1998, Mr. Campbell was President and Chief Executive Officer and a director of Intuit. From January 1991 to December 1993, Mr. Campbell was President and Chief Executive Officer of GO Corporation. Mr. Campbell also serves on the Board of Directors of Opsware, Inc.

Millard S. Drexler has been Chairman and Chief Executive Officer of J. Crew Group, Inc. since January 2003. Previously, Mr. Drexler was Chief Executive Officer of Gap Inc. from 1995 and President from 1987 until September 2002. Mr. Drexler was also a member of the Board of Directors of Gap Inc. from November 1983 until October 2002.

Albert A. Gore, Jr. has served as a Senior Advisor to Google, Inc. since 2001. He has also served as Executive Chairman of Current TV since 2002 and as Chairman of Generation Investment Management since 2004. He is a visiting professor at Middle Tennessee State University. Mr. Gore was inaugurated as the 45th Vice President of the U.S. in 1993. He was re-elected in 1996 and served for a total of eight years as President of the Senate, a member of the Cabinet and the National Security Council. Prior to 1993, he served eight years in the U.S. Senate and eight years in the U.S. House of Representatives.

Steven P. Jobs is one of the Company's co-founders and currently serves as its Chief Executive Officer. Mr. Jobs is also the Chairman and Chief Executive Officer of Pixar Animation Studios.

Arthur D. Levinson, Ph.D. has been Chief Executive Officer and a Director of Genentech Inc. ("*Genentech*") since July 1995. Dr. Levinson has been Chairman of the Board of Directors of Genentech since September 1999. He joined Genentech in 1980 and served in a number of executive positions, including Senior Vice President of R&D from 1993 to 1995. Dr. Levinson also serves on the Board of Directors of Google, Inc.

Jerome B. York has been Chief Executive Officer of Harwinton Capital Corporation, a private investment company that he controls, since September 2003. From January 2000 until September 2003, Mr. York was Chairman and Chief Executive Officer of MicroWarehouse, Inc., a reseller of computer hardware, software and peripheral products. From September 1995 to October 1999, he was Vice Chairman of Tracinda Corporation. From May 1993 to September 1995 he was Senior Vice President and Chief

Financial Officer of IBM Corporation, and served as a member of IBM's Board of Directors from January 1995 to August 1995. Mr. York is also a director of Tyco International Ltd. and Exide Technologies.

Role of the Board; Corporate Governance Matters

It is the paramount duty of the Board of Directors to oversee the Chief Executive Officer and other senior management in the competent and ethical operation of the Company on a day-to-day basis and to assure that the long-term interests of the shareholders are being served. To satisfy this duty, the directors take a proactive, focused approach to their position, and set standards to ensure that the Company is committed to business success through maintenance of the highest standards of responsibility and ethics.

Members of the Board bring to the Company a wide range of experience, knowledge and judgment. These varied skills mean that governance is far more than a "check the box" approach to standards or procedures. The governance structure in the Company is designed to be a working structure for principled actions, effective decision-making and appropriate monitoring of both compliance and performance. The key practices and procedures of the Board are outlined in the Corporate Governance Guidelines available on the Company's website at www.apple.com/investor.

Board Committees

The Board has a standing Compensation Committee, a Nominating and Corporate Governance Committee ("*Nominating Committee*") and an Audit and Finance Committee ("*Audit Committee*"). All committee members are independent under the listing standards of the NASDAQ Stock Market.

The Audit Committee is primarily responsible for overseeing the services performed by the Company's independent auditors and internal audit department, evaluating the Company's accounting policies and its system of internal controls and reviewing significant financial transactions. Members of the Audit Committee are Messrs. Campbell and York and Dr. Levinson.

The Compensation Committee is primarily responsible for reviewing the compensation arrangements for the Company's executive officers, including the Chief Executive Officer, and for administering the Company's equity compensation plans. Members of the Compensation Committee are Messrs. Campbell, Drexler, and Gore.

The Nominating Committee assists the Board in identifying qualified individuals to become directors, determines the composition of the Board and its committees, monitors the process to assess Board effectiveness and helps develop and implement the Company's corporate governance guidelines. The Nominating Committee also considers nominees proposed by shareholders. Members of the Nominating Committee are Messrs. Drexler and Gore and Dr. Levinson.

The Audit, Compensation and Nominating Committees operate under written charters adopted by the Board. These charters are available on Apple's website at www.apple.com/investor.

Audit Committee Financial Expert

All members of the Company's Audit Committee, Messrs. Campbell and York and Dr. Levinson, qualify as "audit committee financial experts" under Item 401 (h) of Regulation S-K and are considered "independent" as the term is used in Item 7(d)(3)(iv) of Schedule 14A under the Exchange Act.

Code of Ethics

The Company has a code of ethics that applies to all of the Company's employees, including its principal executive officer, principal financial officer, principal accounting officer and its Board of Directors. A copy of this code, "Ethics: The Way We Do Business Worldwide" is available on the Company's website at www.apple.com/investor. The Company intends to disclose any changes in or waivers from its code of ethics by posting such information on its website or by filing a Form 8-K.

Executive Officers

The following sets forth certain information regarding executive officers of the Company. Information pertaining to Mr. Jobs, who is both a director and an executive officer of the Company, may be found in the section entitled "**Directors.**"

Timothy D. Cook, Chief Operating Officer (age 45), joined the Company in February 1998. Mr. Cook also served with the Company as Executive Vice President, Worldwide Sales and Operations from 2002 to 2005. In 2004, his responsibilities were expanded to include the Company's Macintosh hardware engineering. From 1998 to 2002, Mr. Cook served in the position of Senior Vice President, Worldwide Operations, Sales, Service and Support. Prior to joining the Company, Mr. Cook held the position of Vice President, Corporate Materials for Compaq Computer Corporation ("*Compaq*"). Previous to his work at Compaq, Mr. Cook was the Chief Operating Officer of the Reseller Division at Intelligent Electronics. Mr. Cook also spent 12 years with IBM, most recently as Director of North American Fulfillment. Mr. Cook also serves as a member of the Board of Directors of Nike, Inc.

Nancy R. Heinen, Senior Vice President, General Counsel and Secretary (age 49), joined the Company in September 1997. Prior to joining the Company, Ms. Heinen held the position of Vice President, General Counsel and Secretary of the Board of Directors at NeXT Software, Inc. ("*NeXT*") from February 1994 until the acquisition of NeXT by the Company in February 1997.

Ronald B. Johnson, Senior Vice President, Retail (age 47), joined the Company in January 2000. Prior to joining the Company, Mr. Johnson spent 16 years with Target Stores, most recently as Senior Merchandising Executive.

Peter Oppenheimer, Senior Vice President and Chief Financial Officer (age 42), joined the Company in July 1996. Mr. Oppenheimer also served with the Company in the position of Vice President and Corporate Controller and as Senior Director of Finance for the Americas. Prior to joining the Company, Mr. Oppenheimer was CFO of one of the four business units for Automatic Data Processing, Inc. ("*ADP*"). Prior to joining ADP, Mr. Oppenheimer spent six years in the Information Technology Consulting Practice with Coopers and Lybrand.

Jonathan Rubinstein, Senior Vice President, iPod Division (age 49), joined the Company in February 1997. Mr. Rubinstein also served with the Company in the position of Senior Vice President, Hardware Engineering. Before joining the Company, Mr. Rubinstein was Executive Vice President and Chief Operating Officer of FirePower Systems Incorporated, from May 1993 to August 1996. Mr. Rubinstein also serves as a member of the Board of Directors of Immersion Corporation.

Philip W. Schiller, Senior Vice President, Worldwide Product Marketing (age 45), rejoined the Company in 1997. Prior to rejoining the Company, Mr. Schiller was Vice President of Product Marketing at Macromedia, Inc. from December 1995 to March 1997 and was Director of Product Marketing at FirePower Systems, Inc. from 1993 to December 1995. Prior to that, Mr. Schiller spent six years at the Company in various marketing positions.

Bertrand Serlet, Ph.D., Senior Vice President, Software Engineering (age 44), joined the Company in February 1997 upon the Company's acquisition of NeXT. At NeXT, Dr. Serlet held several engineering and managerial positions, including Director of Web Engineering. Prior to NeXT, from 1985 to 1989, Dr. Serlet worked as a research engineer at Xerox PARC.

Sina Tamaddon, Senior Vice President, Applications (age 48), joined the Company in September 1997. Mr. Tamaddon has also served with the Company in the position of Senior Vice President, Worldwide Service and Support, and Vice President and General Manager, Newton Group. Before joining the

Company, Mr. Tamaddon held the position of Vice President, Europe with NeXT from September 1996 through March 1997. From August 1994 to August 1996, Mr. Tamaddon held the position of Vice President, Professional Services with NeXT.

Avadis Tevanian, Jr., Ph.D., Senior Vice President, Chief Software Technology Officer (age 44), joined the Company in February 1997 upon the Company's acquisition of NeXT. Dr. Tevanian served with the Company in the position of Senior Vice President, Software Engineering from 1997 to July 2003. With NeXT, Dr. Tevanian held several positions, including Vice President, Engineering, from April 1995 to February 1997. Prior to April 1995, Dr. Tevanian worked as an engineer with NeXT and held several management positions.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires the Company's officers and directors, and persons who own more than ten percent of a registered class of the Company's equity securities, to file reports of securities ownership and changes in such ownership with the Securities and Exchange Commission ("*SEC*"). Officers, directors and greater than ten percent shareholders also are required by rules promulgated by the SEC to furnish the Company with copies of all Section 16(a) forms they file.

Based solely upon a review of the copies of such forms furnished to the Company or written representations that no Forms 5 were required, the Company believes that all Section 16(a) filing requirements were met during fiscal year 2005.

Item 11. Executive Compensation

Information Regarding Executive Compensation

The following table summarizes compensation information for the last three fiscal years for (i) Mr. Jobs, Chief Executive Officer and (ii) the four most highly compensated executive officers other than the Chief Executive Officer who were serving as executive officers of the Company at the end of the fiscal year (collectively, the "*Named Executive Officers*").

SUMMARY COMPENSATION TABLE

		Annual Compensation		Long-Term Compensation		
Name and Principal Position	Fiscal Year	Salary ($)	Bonus ($)	Restricted Stock Award ($)	Securities Underlying Options* (#)	All Other Compensation ($)
Steven P. Jobs	2005	1	—	—	—	—
Chief Executive Officer	2004	1	—	—	—	—
	2003	1	—	74,750,000(1)	—	—
Timothy D. Cook	2005	602,434	600,239	—	—	12,600(3)
Chief Operating Officer	2004	602,632	—	7,650,000(2)	—	12,588(3)
	2003	617,673	—	—	—	9,929(3)
Ronald B. Johnson	2005	552,795	550,202	—	—	—
Senior Vice President, Retail	2004	484,836	1,500,000	6,375,000(2)	—	—
	2003	452,404	1,500,000	—	—	—
Peter Oppenheimer	2005	552,189	550,202	—	—	21,092(3)
Senior Vice President and	2004	450,739	—	6,375,000(2)	—	3,808(3)
Chief Financial Officer	2003	402,237	—	—	—	—
Jonathan Rubinstein	2005	552,795	551,239	—	—	12,600(3)
Senior Vice President,	2004	485,216	—	6,375,000(2)	—	12,300(3)
iPod Division	2003	452,939	—	—	—	11,986(3)

(1) In March 2003, Mr. Jobs voluntarily cancelled all of his outstanding options, excluding those granted to him in his capacity as a Director. In March 2003, the Board awarded Mr. Jobs 10 million (split-adjusted) restricted shares of the Company's Common Stock that generally vest in full on the third anniversary of the grant date.

(2) Market value of restricted stock units granted on March 24, 2004 (based on $12.75 per share, the closing price of the Company's common stock on the NASDAQ National Market on the day of grant). Restricted stock units generally vest over four years with 50% of the total number of shares vesting on each of the second and fourth anniversaries of the grant date.

(3) Consists of matching contributions made by the Company in accordance with the terms of the 401(k) plan.

Option Grants in Last Fiscal Year

There were no options, restricted stock, or restricted stock units granted to the Named Executive Officers during fiscal year 2005.

Options Exercised and Year-End Option Holdings

The following table provides information about stock option exercises by the Named Executive Officers during fiscal year 2005 and stock options held by each of them at fiscal year-end. The table has been adjusted to reflect the Company's two-for-one stock split in February 2005.

AGGREGATED OPTION EXERCISES IN THE LAST FISCAL YEAR AND FISCAL YEAR-END OPTION VALUES

Name	Shares Acquired on Exercise (#)	Value Realized ($)	Number of Securities Underlying Unexercised Options at Fiscal Year-End (#)		Value of Unexercised In-the-Money Options at Fiscal Year-End ($)(1)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
Steven P. Jobs	—	—	120,000(2)	—(3)	$ 5,694,000(2)	—
Timothy D. Cook	500,000	$ 13,329,677	—	—(3)	—	—
Ronald B. Johnson	1,350,000	$ 32,257,127	2,100,000	150,000(3)	$ 61,910,625	$ 6,220,500
Peter Oppenheimer	—	—	1,107,500	37,500(3)	$ 45,994,859	$ 1,560,062
Jonathan Rubinstein	1,800,000	$ 31,012,815	—	—(3)	—	—

(1) Market value of securities underlying in-the-money options at the end of fiscal year 2005 (based on $53.20 per share, the closing price of Common Stock on the NASDAQ National Market on September 23, 2005), minus the exercise price.

(2) Consists of 120,000 options granted to Mr. Jobs in his capacity as a director pursuant to the 1997 Director Stock Option Plan. Since accepting the position of CEO, Mr. Jobs is no longer eligible to receive option grants under the Director Plan. In March 2003, Mr. Jobs voluntarily cancelled all of his outstanding options, excluding those granted to him in his capacity as a director.

(3) This does not include 10 million restricted shares granted to Mr. Jobs, 600,000 restricted stock units granted to Mr. Cook, and 500,000 restricted stock units granted to each of Messrs. Johnson, Oppenheimer, and Rubinstein.

Director Compensation

The form and amount of director compensation is determined by the Board after a review of recommendations made by the Nominating Committee. The current practice of the Board is to base a substantial portion of a director's annual retainer on equity. In 1998, shareholders approved the 1997 Director Stock Option Plan (the "*Director Plan*") and 1,600,000 shares were reserved for issuance thereunder. Pursuant to the Director Plan, the Company's non-employee directors are granted an option to acquire 30,000 shares of Common Stock upon their initial election to the Board ("*Initial Options*"). The Initial Options vest and become exercisable in three equal annual installments on each of the first through third anniversaries of the grant date. On the fourth anniversary of a non-employee director's initial election to the Board and on each subsequent anniversary thereafter, the director will be entitled to receive an option to acquire 10,000 shares of Common Stock ("*Annual Options*"). Annual Options are fully vested and immediately exercisable on their date of grant. As of the end of the fiscal year, there were options for 740,000 shares outstanding under the Director Plan. Since accepting the position of CEO, Mr. Jobs is no longer eligible for grants under the Director Plan. Non-employee directors also receive a $50,000 annual retainer paid in quarterly increments. In addition, directors receive up to two free computer systems per year and are eligible to purchase additional equipment at a discount. Directors do not receive any additional consideration for serving on committees or as committee chairperson.

Compensation Committee Interlocks and Insider Participation

The current members of the Compensation Committee are Messrs. Campbell, Drexler and Gore, none of whom are employees of the Company and all of whom are considered "independent" directors under the applicable NASDAQ rules. There were no interlocks or insider participation between any member of the Board or Compensation Committee and any member of the board of the directors or compensation committee of another company.

Arrangements with Named Executive Officers

Change In Control Arrangements—Stock Options, Restricted Stock, and Restricted Stock Units
In the event of a "change in control" of the Company, all outstanding options under the Company's stock option plans, except the Director Plan, will, unless otherwise determined by the plan administrator, become fully exercisable, and will be cashed out at an amount equal to the difference between the applicable "change in control price" and the exercise price. The Director Plan provides that upon a "change in control" of the Company, all outstanding options held by non-employee directors will automatically become fully exercisable and will be cashed out at an amount equal to the difference between the applicable "change in control price" and the exercise price of the options. A "change in control" under these plans is generally defined as (i) the acquisition by any person of 50% or more of the combined voting power of the Company's outstanding securities or (ii) the occurrence of a transaction requiring shareholder approval and involving the sale of all or substantially all of the assets of the Company or the merger of the Company with or into another corporation.

In addition, options, restricted stock grants, and restricted stock units granted to the Named Executive Officers generally provide that in the event there is a "change in control," as defined in the Company's stock option plans, and if in connection with or following such "change in control," their employment is terminated without "Cause" or if they should resign for "Good Reason," those options, restricted stock, and restricted stock units outstanding that are not yet vested as of the date of such "change in control" shall become fully vested. Further, restricted stock and restricted stock units granted to the Named Executive Officers also provide that, in the event the Company terminates the Officer without cause at any time, the restricted stock units and restricted stock will vest in full. Generally, "Cause" is defined to include a felony conviction, willful disclosure of confidential information or willful and continued failure to perform his or her employment duties. "Good Reason" includes resignation of employment as a result of a substantial diminution in position or duties, or an adverse change in title or reduction in annual base salary.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth certain information as of October 31, 2005 (the "*Table Date*") with respect to the beneficial ownership of the Company's Common Stock by (i) each person the Company believes beneficially holds more than 5% of the outstanding shares of Common Stock; (ii) each director; (iii) each Named Executive Officer listed in the Summary Compensation Table under the heading "**Executive Compensation;**" and (iv) all directors and executive officers as a group. On the Table Date, 839,776,934 shares of Common Stock were issued and outstanding. Unless otherwise indicated, all persons named as beneficial owners of Common Stock have sole voting power and sole investment power with respect to the shares indicated as beneficially owned. In addition, unless otherwise indicated, all persons named below can be reached at Apple Computer, Inc., 1 Infinite Loop, Cupertino, CA 95014.

Security Ownership of 5% Holders, Directors, Nominees and Executive Officers

Name of Beneficial Owner	Shares of Common Stock Beneficially Owned(1)	Percent of Common Stock Outstanding
Fidelity Investments	58,552,916(2)	6.97%
Barclays Global Investors	55,223,982(3)	6.58%
AXA	47,861,070(4)	5.70%
Steven P. Jobs	10,120,004(5)	1.21%
Fred D. Anderson	5,344	*
William V. Campbell	211,004(6)	*
Timothy D. Cook	12,597(7)	*
Millard S. Drexler	210,000(8)	*
Albert A. Gore, Jr.	40,000(9)	*
Ronald B. Johnson	2,112,597(10)	*
Arthur D. Levinson	352,400(11)	*
Peter Oppenheimer	396,643(12)	*
Jonathan J. Rubinstein	22,174(13)	*
Jerome B. York	70,000(14)	*
All executive officers and directors as a group (16 persons)	16,307,625(15)	1.94%

(1) Represents shares of Common Stock held and/or options held by such individuals that were exercisable at the Table Date or within 60 days thereafter. This does not include options or restricted stock units that vest after 60 days. The share numbers have been adjusted to reflect the Company's two-for-one stock split in February 2005.

(2) Based on a Form 13F filed November 14, 2005 by FMR Corp. FMR Corp. lists its address as 82 Devonshire Street, Boston, MA, 02109, in such filing.

(3) Based on a Form 13F filed November 14, 2005, by Barclays Global Investors. Barclays Global Investors lists its address as 45 Fremont Street, San Francisco, CA 94105.

(4) Based on a Form 13F filed November 14, 2005, by AXA. AXA lists its address as 25, Avenue Matigon, Paris, France 10.

(5) Includes 120,000 shares of Common Stock that Mr. Jobs has the right to acquire by exercise of stock options.

(6) Includes 210,000 shares of Common Stock that Mr. Campbell has the right to acquire by exercise of stock options.

(7) Excludes 600,000 restricted stock units.

(8) Includes 170,000 shares of Common Stock that Mr. Drexler has the right to acquire by exercise of stock options.

(9) Consists of 40,000 shares of Common Stock that Mr. Gore has the right to acquire by exercise of stock options.

(10) Includes 2,100,000 shares of Common Stock that Mr. Johnson has the right to acquire by exercise of stock options and excludes 500,000 restricted stock units.

(11) Includes 2,000 shares of Common Stock that Dr. Levinson holds indirectly and 90,000 shares of Common Stock that Dr. Levinson has the right to acquire by exercise of stock options.

(12) Includes 382,500 shares of Common Stock that Mr. Oppenheimer has the right to acquire by exercise of stock options and excludes 500,000 restricted stock units.

(13) Excludes 500,000 restricted stock units.

(14) Includes 30,000 shares of Common Stock that Mr. York has the right to acquire by exercise of stock options.

(15) Includes 5,870,796 shares of Common Stock that executive officers or directors have the right to acquire by exercise of stock options. Does not include 4.4 million of restricted stock units.

* Represents less than 1% of the issued and outstanding shares of Common Stock on the Table Date.

Equity Compensation Plan Information

The following table sets forth certain information, as of September 24, 2005, concerning shares of common stock authorized for issuance under all of the Company's equity compensation plans. The table has been adjusted to reflect the Company's two-for-one stock split in February 2005.

	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by shareholders	42,365,700	$ 23.27	62,791,724(1)
Equity compensation plans not approved by shareholders	30,827,565	$ 10.27	—
Total equity compensation plans(2)	73,193,265	$ 17.79	62,791,724

(1) This number includes 3,834,300 shares of common stock reserved for issuance under the Employee Stock Purchase Plan, 440,000 shares available for issuance under the 1997 Director Stock Option Plan, and 58,517,424 shares available for issuance under the 2003 Employee Stock Plan. The grant of 5,260,000 shares of restricted stock units has been deducted from the number of shares available for future issuance. Shares of restricted stock and restricted stock units granted after April 2005 count against the shares available for grant as two shares for every share granted. This amount does not include shares under the 1990 Stock Option Plan that was terminated in 1997. No new options can be granted under the 1990 Stock Option Plan.

(2) This table does not include 28,082 outstanding options assumed in connection with a prior acquisition of a company that originally granted those options. These assumed options have a weighted average exercise price of $3.39 per share. No additional options may be granted under the assumed plan.

Item 13. Certain Relationships and Related Transactions

In March 2002, the Company entered into a Reimbursement Agreement with its Chief Executive Officer, Mr. Steven P. Jobs, for the reimbursement of expenses incurred by Mr. Jobs in the operation of his private plane when used for Apple business. The Reimbursement Agreement is effective for expenses incurred by Mr. Jobs for Apple business purposes since he took delivery of the plane in May 2001. During 2005, the Company recognized a total of $1,075,545 in expenses pursuant to this reimbursement agreement related to expenses incurred by Mr. Jobs during 2005.

In October 2005, the Company entered into an agreement with Pixar to sell certain of Pixar's short films on the iTunes Music Store. Mr. Jobs, the Company's Chief Executive Officer is also the Chief Executive Officer, Chairman, and a large shareholder of Pixar.

Item 14. Principal Accountant Fees and Services

The following table sets forth the fees paid to the Company's independent registered public accounting firm, KPMG LLP, during fiscal years 2005 and 2004.

Audit and Non-Audit Fees

	2005	2004
Audit Fees	$ 6,948,800(1)	$ 3,402,300
Audit-Related Fees	46,700(2)	57,000
Tax Fees	923,000(3)	784,500
All Other Fees	—	—
Total	$ 7,918,500	$ 4,243,800

(1) Audit fees relate to professional services rendered in connection with the audit of the Company's annual financial statements and internal control over financial reporting, quarterly review of financial statements included in the Company's Forms 10-Q, and audit services provided in connection with other statutory and regulatory filings.

(2) Audit-related fees primarily relate to professional services for the audits of employee benefit plans.

(3) Tax fees include $690,000 for professional services rendered in connection with tax compliance and preparation relating to the Company's expatriate program, tax audits and international tax compliance; and $233,000 for international tax consulting and planning services. The Company does not engage KPMG to perform personal tax services for its executive officers.

Policy on Audit Committee Pre-Approval of Audit and Non-Audit Services Performed by the Independent Auditors
Prior to the enactment of the Sarbanes-Oxley Act of 2002 (the "*Act*"), the Company adopted an auditor independence policy that banned its auditors from performing non-financial consulting services, such as information technology consulting and internal audit services. This auditor policy also mandates that the audit and non-audit services and related budget be approved by the Audit Committee in advance, and that the Audit Committee be provided with quarterly reporting on actual spending. In accordance with this policy, all services to be performed by KPMG were pre-approved by the Audit Committee.

Subsequent to the enactment of the Act, the Audit Committee met with KPMG to further understand the provisions of that Act as it relates to auditor independence. KPMG rotated the lead audit partner for fiscal year 2005 and will rotate other partners as appropriate in compliance with the Act. The Audit Committee will continue to monitor the activities undertaken by KPMG to comply with the Act.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a) Index to Exhibits

Exhibit Number	Exhibit Description	Incorporated by Reference Form	Incorporated by Reference Filing Date/ Period End Date	Filed herewith
3.1	Restated Articles of Incorporation, filed with the Secretary of State of the State of California on January 27, 1988.	S-3	7/27/88	
3.2	Amendment to Restated Articles of Incorporation, filed with the Secretary of State of the State of California on May 4, 2000.	10-Q	5/11/00	
3.3	By-Laws of the Company, as amended through June 7, 2004.	10-Q	6/26/04	
3.4	Certificate of Amendment to Restated Articles of Incorporation, as amended, filed with the Secretary of State of the State of California on February 25, 2005.	10-Q	3/26/05	
4.2	Indenture dated as of February 1, 1994, between the Company and Morgan Guaranty Trust Company of New York.	10-Q	4/01/94	
4.3	Supplemental Indenture dated as of February 1, 1994, among the Company, Morgan Guaranty Trust Company of New York, as resigning trustee, and Citibank, N.A., as successor trustee.	10-Q	4/01/94	
4.5	Form of the Company's 6 1/2% Notes due 2004.	10-Q	4/01/94	
4.8	Registration Rights Agreement, dated June 7, 1996 among the Company and Goldman, Sachs & Co. and Morgan Stanley & Co. Incorporated.	S-3	8/28/96	
4.9	Certificate of Determination of Preferences of Series A Non-Voting Convertible Preferred Stock of Apple Computer, Inc.	10-K	9/26/97	
10.A.3	Apple Computer, Inc. Savings and Investment Plan, as amended and restated effective as of October 1, 1990.	10-K	9/27/91	
10.A.3-1	Amendment of Apple Computer, Inc. Savings and Investment Plan dated March 1, 1992.	10-K	9/25/92	
10.A.3-2	Amendment No. 2 to the Apple Computer, Inc. Savings and Investment Plan.	10-Q	3/28/97	
10.A.5	1990 Stock Option Plan, as amended through November 5, 1997.	10-Q	12/26/97	
10.A.6	Apple Computer, Inc. Employee Stock Purchase Plan, as amended through April 21, 2005.	10-Q	3/26/05	
10.A.8	Form of Indemnification Agreement between the Registrant and each officer of the Registrant.	10-K	9/26/97	
10.A.43	NeXT Computer, Inc. 1990 Stock Option Plan, as amended.	S-8	3/21/97	

10.A.49	1997 Employee Stock Option Plan, as amended through October 19, 2001.	10-K	9/28/02	
10.A.50	1997 Director Stock Option Plan.	10-Q	3/27/98	
10.A.51	2003 Employee Stock Plan, as amended through November 9, 2005.			✓
10.A.52	Reimbursement Agreement dated as of May 25, 2001 by and between the Registrant and Steven P. Jobs.	10-Q	6/29/02	
10.A.53	Option Cancellation and Restricted Stock Award Agreement dated as of March 19, 2003 by and between The Registrant and Steven P. Jobs.	10-Q	6/28/03	
10.A.54	Form of Restricted Stock Unit Award Agreement.	10-Q	3/27/04	
10.A.54-1	Alternative Form of Restricted Stock Unit Award Agreement.			✓
10.A.55	Apple Computer, Inc. Performance Bonus Plan dated April 21, 2005.	10-Q	3/26/05	
10.A.56	Form of Election to Satisfy Tax Withholding with Stock.	8-K	8/15/05	
10.A.57	Form of Option Agreements.			✓
10.B.18*	Custom Sales Agreement effective October 21, 2002 between the Registrant and International Business Machines Corporation.	10-K	9/27/03	
10.B.19*	Purchase Agreement effective August 10, 2005 between the Registrant and Freescale Semiconductor, Inc.			✓
14.1	Code of Ethics of the Company.	10-K	9/27/03	
21	Subsidiaries of Apple Computer, Inc.			✓
23.1	Consent of Independent Registered Public Accounting Firm.			✓
31.1	Rule13a-14(a)/15d-14(a) Certification of Chief Executive Officer.			✓
31.2	Rule13a-14(a)/15d-14(a) Certification of Chief Financial Officer.			✓
32.1	Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer.			✓

* Confidential Treatment requested as to certain portions of this exhibit.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, this 29th day of November 2005.

APPLE COMPUTER, INC.
By: /s/ PETER OPPENHEIMER
Peter Oppenheimer
Senior Vice President and Chief Financial Officer

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Steven P. Jobs and Peter Oppenheimer, jointly and severally, his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this Annual Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Name	Title	Date
/s/ STEVEN P. JOBS STEVEN P. JOBS	Chief Executive Officer and Director (Principal Executive Officer)	November 29, 2005
/s/ PETER OPPENHEIMER PETER OPPENHEIMER	Senior Vice President and Chief Financial Officer (Principal Financial and Principal Accounting Officer)	November 29, 2005
/s/ FRED ANDERSON FRED ANDERSON	Director	November 29, 2005
/s/ WILLIAM V. CAMPBELL WILLIAM V. CAMPBELL	Director	November 29, 2005
/s/ MILLARD S. DREXLER MILLARD S. DREXLER	Director	November 29, 2005
/s/ ALBERT GORE, JR. ALBERT GORE, JR.	Director	November 29, 2005
/s/ ARTHUR D. LEVINSON ARTHUR D. LEVINSON	Director	November 29, 2005
/s/ JEROME B. YORK JEROME B. YORK	Director	November 29, 2005

EXHIBIT 5

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended September 30, 2006

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ____________ to ____________

Commission file number 000-10030

APPLE COMPUTER, INC.
(Exact name of registrant as specified in its charter)

CALIFORNIA	**942404110**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1 Infinite Loop Cupertino, California	**95014**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **(408) 996-1010**

Securities registered pursuant to Section 12(b) of the Act:
Common Stock, no par value
(Title of class)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

The aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant, as of April 1, 2006, was approximately $45,716,583,100 based upon the closing price reported for such date on the NASDAQ Global Select Market. For purposes of this disclosure, shares of Common Stock held by persons who hold more than 5% of the outstanding shares of Common Stock and shares held by executive officers and directors of the registrant have been excluded because such persons may be deemed to be affiliates. This determination of executive officer or affiliate status is not necessarily a conclusive determination for other purposes.

859,273,757 shares of Common Stock Issued and Outstanding as of December 13, 2006

The Business section and other parts of this Annual Report on Form 10-K ("Form 10-K") contain forward-looking statements that involve risks and uncertainties. Many of the forward-looking statements are located in "Management's Discussion and Analysis of Financial Condition and Results of Operations." Forward-looking statements provide current expectations of future events based on certain assumptions and include any statement that does not directly relate to any historical or current fact. Forward-looking statements can also be identified by words such as "anticipates," "believes," "estimates," "expects," "intends," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and the Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Risk Factors" under Part I, Item 1A of this Form 10-K. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Explanatory Note

In this Form 10-K, Apple Computer, Inc. ("Apple" or "the Company") is restating its consolidated balance sheet as of September 24, 2005, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the fiscal years ended September 24, 2005 and September 25, 2004, and each of the quarters in fiscal year 2005.

This Form 10-K also reflects the restatement of "Selected Consolidated Financial Data" in Item 6 for the fiscal years ended September 2005, 2004, 2003, and 2002, and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 for the fiscal years ended September 24, 2005 and September 25, 2004.

Previously filed annual reports on Form 10-K and quarterly reports on Form 10-Q affected by the restatements have not been amended and should not be relied on.

On June 29, 2006, the Company announced that an internal review had discovered irregularities related to the issuance of certain stock option grants made between 1997 and 2001, including a grant to its Chief Executive Officer ("CEO") Steve Jobs. The Company also announced that a Special Committee of outside directors ("Special Committee") had been formed and had hired independent counsel to conduct a full investigation of the Company's past stock option granting practices. On October 4, 2006, the Company announced the key results of the Special Committee's investigation, which are set forth in the Company's Form 8-K filed on that date.

As a result of the internal review and the independent investigation, management has concluded, and the Audit and Finance Committee of the Board of Directors agrees, that incorrect measurement dates were used for financial accounting purposes for certain stock option grants made in prior periods. Therefore, the Company has recorded additional non-cash stock-based compensation expense and related tax effects with regard to past stock option grants, and the Company is restating previously filed financial statements in this Form 10-K. These adjustments, after tax, amounted to $4 million, $7 million, and $10 million in fiscal years 2006, 2005 and 2004, respectively. The adjustment to 2006 was recorded in the fourth quarter of fiscal year 2006 due to its insignificance.

The independent counsel and its forensic accountants ("Investigative Team") reviewed the facts and circumstances surrounding stock option grants made on 259 dates. The Investigative Team spent over 26,500 person-hours searching more than one million physical and electronic documents and interviewing more than 40 current and former directors, officers, employees, and advisors. Based on a review of the totality of evidence and the applicable law, the Special Committee found no misconduct by current management. The Special Committee's investigation identified a number of grants for which grant dates were intentionally selected in order to obtain favorable exercise prices. The terms of these and certain other grants, as discussed below, were finalized after the originally assigned grant dates. The Special Committee concluded that the procedures for granting, accounting for, and reporting stock option grants did not include sufficient safeguards to prevent manipulation. Although the investigation found that CEO Steve Jobs was aware or recommended the selection of some favorable grant dates, he did not receive or financially benefit from these grants or appreciate the accounting implications. The Special Committee also found that the investigation had raised serious concerns regarding the actions of two former officers in connection with the accounting, recording and reporting of stock option grants.

Based on the evidence and findings from the Company's internal review and the Special Committee's independent investigation, an analysis was performed of the measurement dates for the 42,077 stock option grants made on 259 dates between October 1996 and January 2003 (the "relevant period"). The Company believes that the analysis was properly limited to the relevant period. In addition to analyzing all grants made during the relevant period, the Company sampled certain grants between 1994 and 1997 and found none that required accounting adjustments. The first grants for which stock-based compensation expense is required are dated December 29, 1997. The Company also examined grants made after the relevant period and found none that required accounting adjustments. Moreover, in the years after 2002, Apple made significant changes in its stock option granting practices in response to evolving legal, regulatory and accounting requirements.

Consistent with the accounting literature and recent guidance from the Securities and Exchange Commission ("SEC"), the grants during the relevant period were organized into categories based on grant type and process by which the grant was finalized. The Company analyzed the evidence related to each category of grants including, but not limited to, electronic and physical documents, document metadata, and witness interviews. Based on the relevant facts and circumstances, the Company applied the controlling accounting standards to determine, for every grant within each category, the proper measurement date. If the measurement date is not the originally assigned grant date, accounting adjustments were made as required, resulting in stock-based compensation expense and related tax effects.

The 42,077 grants were classified as follows: (1) 17 grants to persons elected or appointed to the Board of Directors ("director grants"); (2) 3,892 grants to employees under the Monday/Tuesday Plan described below ("Monday/Tuesday grants"); (3) 27,096 grants made in broad-based awards to large numbers of employees, usually on an annual basis ("focal grants"); (4) 9,988 other grants ratified at meetings of the Board or Compensation Committee ("meeting grants"); (5) 1,082 other grants ratified by unanimous written consent ("UWC") of the Board or Compensation Committee ("other UWC grants"); and (6) two grants to the CEO ("CEO grants"). All references to the number of option shares, option exercise prices, and share prices in this Explanatory Note have not been adjusted for any subsequent stock splits.

With the exception of director grants, all stock option grants were subject to ratification by the Board or Compensation Committee at a meeting or by UWC. Following approval of the grants at a meeting or by UWC, the Company's legal staff would prepare a Secretary's Certificate certifying the ratification of the grants. Based on the facts and circumstances described below, the Company has concluded that the recipients and terms of certain grants were fixed for accounting purposes before ratification pursuant to parameters previously approved by the Board or Compensation Committee through the Monday/Tuesday Plan and the focal process. As further discussed below, within these parameters, management had the authority to determine the recipients and terms for each grant. Thus, the Company has concluded that the measurement dates for these grants occurred when management's process for allocating these grants was completed and the grants were ready for ratification, which was considered perfunctory. With regard to all other grants, the Company has concluded that the grants were finalized and the measurement dates occurred when the grants were ratified. For many grants, however, the dates of ratification cannot be established because the dates the UWCs were executed by the Board or Compensation Committee members or received by the Company are not available. For such grants, the Company has concluded that the date of the preparation of the Secretary's Certificate is the best alternative for determining the actual date of ratification.

As discussed below, the Company's analysis determined that the originally assigned grant dates for 6,428 grants on 42 dates are not the proper measurement dates. Accordingly, after accounting for forfeitures, the Company has recognized stock-based compensation expense of $105 million on a pre-tax basis over the respective awards' vesting terms. No adjustments were required for the remaining 35,649 grants. The adjustments were determined by category as follows:

Director Grants—Seventeen director grants were made during the relevant period. Two director grants were made pursuant to a 1997 plan that dated the grants on the enactment of the plan. The remaining fifteen grants were automatically made under the Director Stock Option Plan for non-employee directors, which was approved by shareholders in 1998, on the date of a director's election or appointment to the Board and on subsequent anniversaries, beginning on the fourth anniversary. Accordingly, the analysis determined that the originally assigned grant date for each director grant is the measurement date, and no accounting adjustments are required.

Monday/Tuesday Grants—Beginning in December 1998, 3,892 new hire grants and grants for promotion and retention purposes ("promotion/retention grants") were made during the relevant period under the "Monday/Tuesday Plan." Under the Monday/Tuesday Plan, new hire grants made within pre-established guidelines approved by the Board or Compensation Committee were dated on the Monday that the recipient started work (or the following Monday, if the recipient started on another day). The Company's analysis showed this process to be reliable with very low error rates. Promotion/retention grants, also based on pre-established guidelines, were made generally on the first Tuesday of each month. The Company has concluded that the new hire and promotion/retention grants made pursuant to the Monday/Tuesday Plan within pre-established guidelines do not require adjustment, with the exception of six grants that were erroneously dated before the employees' start dates. For 120 new hire and promotion/retention grants made outside the guidelines, however, the Company has concluded that the measurement dates are the dates of ratification by the Board or Compensation Committee rather than the dates used for grants within guidelines. Accordingly, based on the methodology described above, the Company has recognized stock-based compensation expense of $6 million from 126 grants. If other dates in the period between the preparation of the UWC and the preparation of the Secretary's Certificate had been used as measurement dates for grants whose actual ratification dates are unknown, the total stock-based compensation expense would have ranged from approximately $3 million to $7 million.

Focal Grants—During the relevant period, 27,096 focal grants were made to employees typically on an annual basis as part of an extensive process that required several months to complete. Pursuant to limits, guidelines and practices previously approved by the Board or Compensation Committee, managers throughout the Company would make recommendations for grants to employees in their areas of responsibility. After senior management had determined that the grants were made in accordance with these established limits, guidelines and practices, management treated the grants as final when they were submitted to the Board or Compensation Committee for ratification. The Company has concluded that for 5,595 grants on five dates, the originally assigned grant dates are not the proper measurement dates. For these grants, management's process for finalizing the grants was completed after the originally assigned grant dates. As a result, the Company has recognized $29 million of stock-based compensation expense. For two of the five grant dates comprising 3,744 grants, the evidence shows that the grants were finalized and the measurement date occurred one day after the originally assigned grant dates. The grants on these two dates represent more than $16 million of the total $29 million of stock-based compensation expense resulting from focal grants.

Other Meeting Grants—During the relevant period, meetings of the Board or Compensation Committee were held to ratify 9,988 grants that are not Monday/Tuesday, focal or CEO grants. The grant dates and measurement dates for these grants are the meeting dates when the grants were ratified, with the exception of 46 grants. Forty-two of these 46 grants are dated concurrent with a meeting that considered and approved certain grants, but the evidence indicates that all of the grants may not have been finalized until a later date. One of the 46 grants was approved and dated at another meeting, but the recipient, who was becoming employed by the Company as part of a corporate acquisition, did not start until a later date. Two other grants were approved before the employees' start dates. Another grant was mistakenly cancelled and subsequently reinstated, requiring an accounting adjustment. Thus, for these 46 grants the Company has concluded that the originally assigned grant dates are not the proper measurement dates. As a result, the Company has recognized $2 million of stock-based compensation expense.

Other UWC Grants—During the relevant period, 1,082 grants were approved by UWCs for a variety of purposes, including executive recruitment, retention, promotion and new hires outside the Monday/Tuesday process. These grants were not made pursuant to pre-established guidelines adopted by the Board or Compensation Committee. Therefore, the Company has concluded that these grants were not finalized for accounting purposes until ratification by the Board or Compensation Committee. Accordingly, for 660 grants, the Company has concluded that the originally assigned grant dates are not the proper measurement dates. As a result, the Company has recognized $48 million of stock-based compensation expense. If other dates in the period from the preparation of the UWC to the preparation of the Secretary's Certificate had been used as measurement dates for grants whose actual ratification dates are unknown, the total stock-based compensation would have ranged from approximately $35 million to $56 million.

CEO Grants—During the relevant period, the Company made two grants to CEO Steve Jobs. The first grant, dated January 12, 2000, was for 10 million option shares. The second grant, dated October 19, 2001, was for 7.5 million option shares. Both grants were cancelled in March 2003 prior to being exercised, when Mr. Jobs received 5 million shares of restricted stock.

With respect to the grant dated January 12, 2000, the Board on December 2, 1999, authorized a special "CEO Compensation Committee" to grant Mr. Jobs up to 15 million shares. The evidence indicates that the CEO Compensation Committee finalized the terms of the grant on January 12, 2000, although the Committee's action was memorialized in a UWC transmitted on January 18, 2000. Because the measurement date is the originally assigned grant date, the Company has not recognized any stock-based compensation expense from this grant. If the Company had determined that the measurement date was the date when the UWC was executed or received, then additional stock-based compensation would have been recognized.

The grant dated October 19, 2001 was originally approved at a Board meeting on August 29, 2001, with an exercise price of $17.83. The terms of the grant, however, were not finalized until December 18, 2001. The grant was dated October 19, 2001, with an exercise price of $18.30. The approval for the grant was improperly recorded as occurring at a special Board meeting on October 19, 2001. Such a special Board meeting did not occur. There was no evidence, however, that any current member of management was aware of this irregularity. The Company has recognized $20 million in stock-based compensation expense for this grant, reflecting the difference between the exercise price of $18.30 and the share price on December 18, 2001 of $21.01.

The incremental impact from recognizing stock-based compensation expense resulting from the investigation of past stock option grants is as follows (dollars in millions):

Fiscal Year	Pre-Tax Expense (Income)	After Tax Expense
1998	$ (1)	$—
1999	8	6
2000	13	9
2001	19	13
2002	29	23
2003	16	12
Total 1998 – 2003 impact	84	63
2004	13	10
2005	7	7
2006	1	4
Total	$ 105	$ 84

Additionally, the Company has restated the pro forma expense under Statement of Financial Accounting Standards ("SFAS") No. 123 in Note 1 of the Notes to Consolidated Financial Statements of this Form 10-K to reflect the impact of these adjustments for the years ended September 24, 2005 and September 25, 2004.

PART I

Item 1. Business

Company Background

Apple Computer, Inc. ("Apple" or the "Company") was incorporated under the laws of the State of California on January 3, 1977. The Company designs, manufactures, and markets personal computers and related software, services, peripherals, and networking solutions. The Company also designs, develops, and markets a line of portable digital music players along with related accessories and services, including the online sale of third-party audio and video products. The Company's products and services include the Macintosh® line of desktop and portable computers, the Mac OS® X operating system, the iPod® line of portable digital music players, the iTunes Store®, a portfolio of peripherals that support and enhance the Macintosh and iPod product lines, a portfolio of consumer and professional software applications, a variety of other service and support offerings, and the Xserve® and Xserve RAID server and storage products. The Company sells its products worldwide through its online stores, its retail stores, its direct sales force, and third-party wholesalers, resellers, and value-added resellers. In addition, the Company sells a variety of third-party Macintosh and iPod compatible products including application software, printers, storage devices, speakers, headphones, and various other accessories and supplies through its online and retail stores. The Company sells to education, consumer, creative professional, business, and government customers. The Company's fiscal year ends on the last Saturday of September. Unless otherwise stated, all information presented in this Form 10-K is based on the Company's fiscal calendar.

Business Strategy

The Company is committed to bringing the best personal computing and portable digital music experience to students, educators, creative professionals, businesses, government agencies, and consumers through its innovative hardware, software, peripherals, services, and Internet offerings. The Company's business strategy leverages its unique ability to design and develop its own operating system, hardware, application software, and services to provide its customers new products and solutions with superior ease-of-use, seamless integration, and innovative industrial design. The Company believes continual investment in research and development is critical to facilitate innovation of new and improved products and technologies. Besides updates to its existing line of personal computers and related software, services, peripherals, and networking solutions, the Company continues to capitalize on the convergence of digital consumer electronics and the personal computer by creating and refining innovations like the iPod and iTunes Store. The Company's strategy also includes expanding its distribution network to effectively reach more of its targeted customers and provide them with a high-quality sales and after-sales support experience.

Digital Lifestyle

The Company believes that for both professionals and consumers the personal computer has become the center of an evolving digital lifestyle by integrating and enhancing the utility of advanced digital devices such as the Company's iPods, digital video and still cameras, televisions, CD and DVD players, cellular phones, personal digital assistants, and other consumer electronic devices. The attributes of the personal computer that enable this functionality include a high-quality user interface, easy access to relatively inexpensive data storage, the ability to run complex applications, and the ability to connect easily to a wide variety of other digital devices and to the Internet. The Company is the only participant in the personal computer industry that controls the design and development of the entire personal computer—from the hardware and operating system to sophisticated applications. This, along with its products' original industrial designs, intuitive ease-of-use, built-in graphics, multimedia and networking capabilities, uniquely positions the Company to offer innovative integrated digital lifestyle solutions.

Expanded Distribution

The Company believes a high-quality buying experience with knowledgeable salespersons that can convey the value of the Company's products and services greatly enhances its ability to attract and retain customers. The Company sells many of its products and resells certain third-party products in most of its major markets directly to consumers, education customers, and businesses through its retail and online stores. The Company has also invested in programs to enhance reseller sales, including the Apple Sales Consultant Program, which places Apple employees and contractors at selected third-party reseller locations. The Company believes providing direct contact with its targeted customers is an efficient way to demonstrate the advantages of its Macintosh computer and other products over those of its competitors. The Company has significantly increased the points of distribution for the iPod product family in order to make its products available at locations where its customers shop.

By the end of fiscal 2006, the Company had opened a total of 165 retail stores, including 147 stores in the U.S. and a total of 18 stores in Canada, Japan, and the U.K. The Company opened 5 additional stores in October and November 2006. The Company has typically located its stores at high-traffic locations in quality shopping malls and urban shopping districts.

One of the goals of the retail initiative is to bring new customers to the Company and expand its installed base through sales to computer users who currently do not own a Macintosh computer and first time personal computer buyers. By operating its own stores and building them in desirable high-traffic locations, the Company is able to better control the customer retail experience and attract new customers. The stores are designed to simplify and enhance the presentation and marketing of personal computers and related products. To that end, retail store configurations have evolved into various sizes in order to accommodate market demands. The stores employ experienced and knowledgeable personnel who provide product advice and certain hardware support services. The stores offer a wide selection of third-party hardware, software, and various other computing products and supplies selected to complement the Company's own products. Additionally, the stores provide a forum in which the Company is able to offer specialized service and personalized training.

Education

Throughout its history, the Company has focused on the use of technology in education and has been committed to delivering tools to help educators teach and students learn. The Company believes effective integration of technology into classroom instruction can result in higher levels of student achievement, especially when used to support collaboration, information access, and the expression and representation of student thought and ideas. The Company creates solutions that enable new modes of curriculum delivery, better ways of conducting research, and opportunities for professional development of faculty, students, and staff. The Company has designed a range of products and services to meet the needs of education customers. These products and services include the iMac™ and the MacBook®, video creation and editing solutions, wireless networking, professional development solutions, and one-to-one (1:1) learning solutions. A 1:1 learning solution typically consist of a portable computer for every student and teacher along with the installation of a wireless network.

Creative Professionals

Creative professionals constitute one of the Company's most important markets for both hardware and software products. This market is also important to many third-party developers who provide Macintosh-compatible hardware and software solutions. Creative customers utilize the Company's products for a variety of activities including digital video and film production and editing; digital video and film special effects, compositing and titling; digital still photography and workflow management; graphic design, publishing, and print production; music creation and production; audio production and sound design; and web design, development, and administration.

The Company designs its high-end hardware solutions, including servers, desktops, and portable Macintosh systems, to incorporate the power, expandability, and features desired by creative professionals. The Company's operating system, Mac OS X, incorporates powerful graphics and audio technologies and features developer tools to optimize system and application performance when running creative solutions provided by the Company or third-party developers.

Business Organization

The Company manages its business primarily on a geographic basis. The Company's reportable operating segments are comprised of the Americas, Europe, Japan, and Retail. The Americas, Europe, and Japan reportable segments do not include activities related to the Retail segment. The Americas segment includes both North and South America. The Europe segment includes European countries as well as the Middle East and Africa. The Retail segment currently operates Apple-owned retail stores in the U.S., Canada, Japan, and the U.K. Other operating segments include Asia-Pacific, which includes Australia and Asia except for Japan, and the Company's subsidiary, FileMaker, Inc. Each reportable geographic operating segment provides similar hardware and software products and similar services. Further information regarding the Company's operating segments may be found in Part II, Item 7 of this Form 10-K under the heading "Segment Operating Performance," and in Part II, Item 8 of this Form 10-K in the Notes to Consolidated Financial Statements at Note 11, "Segment Information and Geographic Data."

Hardware Products

The Company offers a range of personal computing products including desktop and notebook computers, server and storage products, related devices and peripherals, and various third-party hardware products. The Company's Macintosh® systems, excluding servers and storage systems, features the Company's Mac OS® X Version 10.4 Tiger™ and iLife® suite of software for digital photography, music, movies, and music and website creation.

Macintosh® Computers

In June 2005, the Company announced its plan to begin using Intel microprocessors in its computers. During 2006, the Company introduced new Intel-based models of the MacBook™ Pro, MacBook, Mac® Pro, iMac®, and Mac mini computers. All Intel-based Macintosh systems feature a fully native version of Mac OS X Version 10.4 Tiger, including the Rosetta™ translation technology, which allows most PowerPC-based Macintosh applications to run on Intel-based Macintosh computers. The Company's transition to Intel microprocessors for Macintosh systems was completed in August 2006, and its transition for Xserve® was completed in November 2006. There are potential risks and uncertainties associated with the transition to Intel microprocessors, which are further discussed in Item 1A of this 10-K under the heading "Risk Factors."

MacBook™ Pro

The MacBook Pro family of notebook computers is designed for professionals and advanced consumer users. Introduced in January 2006, the MacBook Pro includes either a 15-inch or 17-inch widescreen display, a built-in iSight video camera, Front Row with the Apple Remote, and the MagSafe™ power adapter. Current MacBook Pro models include Intel Core 2 Duo processors at 2.16GHz or 2.33GHz, ATI Mobility Radeon X1600 graphics, 667MHz DDR2 main memory, a Serial ATA hard drive, and a slot-loading double-layer SuperDrive™. Every MacBook Pro features a 1-inch thin aluminum enclosure and includes AirPort Extreme wireless networking, Bluetooth 2.0+EDR, Gigabit Ethernet, two or three USB 2.0 ports, FireWire 400 and 800 ports, combination analog and optical digital audio input and output ports, a full-sized DVI video-out port, an ExpressCard/34 slot, scrolling trackpad, and backlit keyboard.

MacBook™

The MacBook is designed for consumer and education users. Introduced in May 2006, the MacBook includes a 13-inch widescreen display, a built-in iSight video camera, Front Row with the Apple Remote, and the MagSafe magnetic power adapter. Current MacBook models include Intel Core 2 Duo processors at 1.83GHz and 2.0GHz, Intel integrated GMA 950 graphics, 667MHz DDR2 main memory, a Serial ATA hard drive, and a slot-loading Combo optical drive or double-layer SuperDrive. Available in either black or white, every MacBook includes built-in AirPort Extreme wireless networking, Bluetooth 2.0+EDR, Gigabit Ethernet, two USB 2.0 ports, one FireWire 400 port, combination analog and optical digital audio input and output ports, a mini-DVI video output port, and scrolling trackpad.

Mac® Pro

The Mac Pro desktop computer is targeted at business and professional users and is designed to meet the performance, expansion, and networking needs of the most demanding Macintosh user. Introduced in August 2006, the Mac Pro features two Intel Xeon dual-core processors running up to 3.0GHz, each with 4MB of shared Level 2 cache and independent 1.33GHz front-side buses, 667MHz fully buffered memory, and a 256-bit wide memory architecture. The Mac Pro also features a direct attach storage solution for snap-in installation of up to four 750GB Serial ATA hard drives for a total of 3TB of internal storage and support for two optical drives to simultaneously read and/or write to CDs and DVDs. Every Mac Pro includes three full-length PCI Express expansion slots and one double-wide PCI Express graphics slot to support double-wide graphics cards. The Mac Pro also includes dual Gigabit Ethernet ports, optical digital input and output ports, analog audio input and output ports, and multiple FireWire 400, FireWire 800 and USB 2.0 ports.

iMac®

The iMac desktop computer is targeted at consumer and education markets. Introduced in January 2006 and updated in September 2006, the Intel-based iMac is currently available with an integrated 17-inch widescreen LCD display, 512MB or 1GB of 667MHz DDR2 memory expandable to 2GB or 3GB, a 1.83GHz or 2.0GHz Intel Core 2 Duo processor, Intel integrated GMA 950 or ATI Radeon X1600 graphics, and a 160GB Serial ATA hard drive. The iMac is also available with a 20-inch or 24-inch widescreen LCD display, 1GB of 667MHz memory expandable to 3GB, a 2.16GHz processor, ATI Radeon X1600 or NVIDIA GeForce 7300 GT graphics, and 250GB Serial ATA hard drive. All models include a built-in iSight video camera, mini-DVI video-out port, multiple USB 2.0 and FireWire ports, built-in Gigabit Ethernet, and AirPort Extreme 802.11g wireless networking. Most models also include built-in Bluetooth 2.0+EDR, the Apple Remote, and a slot-loading double-layer SuperDrive.

Mac® mini

In February 2006, the Company introduced the Intel-based Mac mini that includes Front Row with the Apple Remote. The new Mac mini offers 512MB of 667MHz memory expandable to 2GB and either a 1.66GHz or 1.83GHz Intel Core Duo processor. Every Mac mini now includes built-in Gigabit Ethernet, AirPort Extreme 802.11g wireless networking, Bluetooth 2.0+EDR, and a total of four USB 2.0 ports. Mac mini includes a full-size DVI interface and a VGA-out adapter to connect to a variety of displays, including televisions, and features both analog and digital audio outputs.

Xserve® and Xserve RAID Storage System

Xserve is a rack-mount server product designed for simple setup and remote management of intensive input/output (I/O) applications such as digital video, high-resolution digital imagery, and large databases. In November 2006, the Company began shipping Xserve, a 64-bit server featuring Mac OS® X Server 10.4 on two Intel Xeon dual-core processors running at 2.0GHz, 2.66GHz, or 3.0GHz, with support for up to 32GB of memory. Xserve includes PCI Express and independent 1.33GHz front side buses with 4MB of shared Level 2 memory cache. Two eight-lane PCI Express expansion slots provide up to 2GB of throughput each to support fibre channel, networking, and graphics cards. Xserve supports up to 2.25TB of hot-plug storage. The Company's Xserve RAID storage system delivers up to 7TB of storage capacity and also expanded support for heterogeneous environments. The dual independent RAID controllers with 512MB cache per controller offer sustained throughput of over 385 Mbps.

Music Products and Services

The Company offers its iPod® line of portable digital music players and related accessories to Macintosh and Windows users. The Company also provides an online service to distribute third-party music, audio books, music videos, short films, television shows, movies, and iPod games through its iTunes Store. In addition to the Company's own iPod accessories, thousands of third-party iPod compatible products are available, including portable and desktop speaker systems, headphones, car radio solutions, voice recorders, cables and docks, power supplies and chargers, and carrying cases and armbands.

iPod®

The iPod is the Company's hard-drive based portable digital music player and was updated in September 2006. The iPod is available in a 30GB model capable of holding up to 7,500 songs, 25,000 photos, or 75 hours of video, and an 80GB model capable of holding up to 20,000 songs, 25,000 photos, or 100 hours of video. The iPod features up to 20 hours of battery life and includes a 2.5-inch color screen that can display album artwork, photos, and video content including music videos, video and audio podcasts, short films, television shows, movies, and games. Other key features of the iPod include a calendar, contact utility, and data storage capability. The iPod features the Company's patent-pending Click Wheel, a touch-sensitive wheel with five push buttons for one-handed navigation. The iPod also includes the Company's patent-pending Auto-Sync technology that automatically synchronizes and updates the iPod's digital music and other content whenever it is connected to a Macintosh or Windows computer via USB. All iPods work with the Company's iTunes digital music management software ("iTunes software") available for both Macintosh and Windows-based computers.

iPod® nano

In September 2006, the Company introduced the second-generation version of its flash-memory-based iPod nano featuring an aluminum body and up to 24 hours of battery life. The second-generation iPod nano includes the Click Wheel, a smaller and lighter design, a brighter color screen than its predecessor, and new Search and Quick Scroll features that make it easier to find content. The iPod nano is available in 2GB, 4GB and 8GB configurations and in a variety of colors.

iPod® shuffle

In September 2006, the Company introduced a new version of its flash-memory-based iPod shuffle. The new iPod shuffle weighs half an ounce and features an all-new aluminum design and a built-in clip. The new iPod shuffle contains one gigabyte of flash memory capable of holding up to 240 songs and provides up to 12 hours of battery life. The iPod shuffle is based on the Company's shuffle feature that allows users to listen to their music in random order. iPod shuffle works with iTunes and its patent-pending AutoFill option that automatically selects songs to fill the iPod shuffle from a user's iTunes library.

iTunes® Store

The Company's iTunes Store, available for both Macintosh and Windows-based computers, is a service that allows customers to find, purchase, and download third-party digital music, audio books, music videos, short films, television shows and movies, and iPod games. The iTunes Store also features the Podcast Directory that allows customers to search for and download audio programs to their computers and automatically receive new episodes over the Internet. Customers can search the contents of the store catalog to locate works by title, artist, or album, or browse the entire contents of the store by genre and artist. Originally introduced in the U.S. in April 2003, the iTunes Store now serves customers in 22 countries.

The iTunes Store is fully integrated with iTunes software allowing customers to preview, purchase, download, organize, share, and transfer digital content to an iPod using a single software application. Further discussion of the iTunes software may be found below under the heading "Software Products and Computer Technologies." The iTunes Store offers customers a broad range of personal rights to the third-party content they have purchased. Content purchased through the store may also be used in certain applications such as iPhoto®, iMovie®, and iDVD®. Additional features of the iTunes Store include gift certificates that can be sent via e-mail; prepaid music cards; an "allowance" feature that enables users to automatically deposit funds into an iTunes Store account every month; online gift options that let customers give specific content to anyone with an email address; parental controls; and album reviews.

Peripheral Products

The Company sells a variety of Apple-branded and third-party computer hardware peripheral products directly to end-users through its retail and online stores, including printers, storage devices, computer memory, digital video and still cameras, and various other computing products and supplies.

Displays

The Company manufactures a family of widescreen flat panel displays including the 30-inch Apple Cinema HD Display™, a widescreen active-matrix LCD with 2560-by-1600 pixel resolution, the 23-inch Apple Cinema HD Display with 1920-by-1200 pixel resolution and the 20-inch Apple Cinema Display® with 1680-by-1050 pixel resolution. These displays feature built-in dual FireWire and dual USB 2.0 ports and use the industry standard DVI interface for a pure digital connection with the Company's latest Mac Pro, MacBook Pro, and MacBook systems. The Cinema Displays feature an aluminum design with a thin bezel, suspended by an aluminum stand that allows viewing angle adjustment.

Software Products and Computer Technologies

The Company offers a range of software products for education, creative, consumer, and business customers, including Mac OS X, the Company's proprietary operating system software for the Macintosh; server software and related solutions; professional application software; and consumer, education, and business oriented application software.

Operating System Software

Mac OS X is built on an open-source UNIX-based foundation. The most recent version, Mac OS X Tiger, is the fifth major release of Mac OS X. Tiger incorporates innovations including Spotlight™, a desktop search technology that lets users find items stored on their Macintosh computers, including documents, emails, contacts, and images; and Dashboard, a way to instantly access information such as weather forecasts and stock quotes, using a new class of mini-applications called widgets. Mac OS X Server version 10.4 is the server version of the Mac OS operating system.

Server Software and Server Solutions

In April 2006, the Company introduced Apple Remote Desktop 3, the Company's third generation desktop management application. Apple Remote Desktop 3 is a Universal application, meaning that it runs natively on both Intel and PowerPC-based Macintosh computers (Universal) for asset management and remote assistance that enables Spotlight searches across multiple Tiger systems and includes over 30 Automator actions for automating repetitive system administration tasks, a Dashboard Widget that provides observation of remote systems, and AutoInstall for installing software automatically on mobile systems when they return online.

Xsan®, the Company's enterprise-class Storage Area Network ("SAN") file system, is a 64-bit cluster file system for Mac OS X that enables organizations to consolidate storage resources and provide multiple computers with concurrent file-level read/write access to shared volumes over Fibre Channel. Advanced features such as metadata controller failover and Fibre Channel multipathing ensure high availability; file-level locking allows multiple systems to read and write concurrently to the same volume which is ideal for complex workflows; bandwidth reservation provides for effective ingestion of bandwidth-intensive data streams, such as high resolution video; and flexible volume management results in more efficient use of storage resources. Xsan can be used in heterogeneous environments that include Windows, UNIX, and Linux server operating system platforms.

Professional Application Software

In March 2006, the Company introduced Final Cut Studio® 5.1, the Company's High Definition ("HD") video production suite. Final Cut Studio features Final Cut Pro® 5, Soundtrack® Pro, Motion 2, and DVD Studio Pro® 4. All of these applications are Universal.

Final Cut Pro® 5.1, the latest version of the Company's video editing software, includes editing tools that work natively with most formats, from Digital Video ("DV") and High Definition Video ("HDV") to fully uncompressed HD. With a real-time multi-stream effects architecture, multicam editing tools, and advanced color correction, Final Cut Pro 5.1 enables users to view and cut from multiple sources in real time, group up to 128 sources together into multi-clips, then add or subtract cameras at any time.

DVD Studio Pro® 4 is the latest version of the Company's professional DVD authoring application. With DVD Studio Pro 4 users can author Standard Definition ("SD") or HD DVDs in a graphic interactive environment. DVD Studio Pro 4 includes Compressor 2, a full-featured video and audio compression application. Compressor gives users control over encoding, including the ability to encode several clips in one batch operation to a wide variety of formats including H.264.

Motion 2 is a real-time motion graphics software application that enables Final Cut Pro editors to add motion graphics to their projects. Motion 2 features interactive animation of text and graphics for DVD motion menus, video or film in real time, and quick output rendering by built-in GPU acceleration at 8-bit, 16-bit, or 32-bit float film quality. With Motion 2's design tool, Replicator, users can automatically generate and animate multiple copies of a graphic, shape, or movie.

Soundtrack® Pro is an audio editing and sound design application that gives audio and video professionals a way to edit, mix, and repair audio. Soundtrack Pro features a waveform editor with flexible Action Layers that allow users to re-order, bypass, or change any edit, effect, or process. Find-and-Fix features identify and repair common audio problems such as background noise, pops, clicks, and hum. An integrated multitrack mixer allows editors to apply common effects to multiple tracks and group common tracks. Soundtrack Pro also features over 50 professional plug-ins for enhancing sounds, and over 5,000 music and sound effect loops.

In February 2006, the Company introduced Logic® Pro 7.2, a Universal version of the Company's music creation and audio production software. Logic Pro 7.2 is used by musicians around the world and by professionals in music production and film scoring. It combines digital music composition, notation, and audio production facilities in one comprehensive product and includes software instruments such as Sculpture®, a component-modeling based synthesizer; UltraBeat®, a drum synthesizer with built-in step sequencer; and digital signal processing (DSP) plug-ins including Guitar Amp Pro, a full-featured guitar amplifier simulator. Along with workflow enhancements, mastering plug-ins, and support for Apple Loops, Logic Pro 7 adds distributed audio processing, a technology that allows professionals to utilize multiple Macintosh systems to expand available DSP power via an Ethernet network.

Consumer, Education, and Business Oriented Application Software

iLife® '06

In January 2006, the Company introduced iLife '06, an upgrade to its consumer-oriented digital lifestyle application suite, which features iWeb™, iPhoto® 6, iMovie® HD 6, iDVD® 6, GarageBand™ 3, and iTunes®. All of these applications are Universal.

iWeb™ is a new application in the iLife '06 suite. iWeb allows users to create online photo albums, blogs, and podcasts and customize websites using editing tools.

iPhoto® is the Company's consumer-oriented digital photo software application. iPhoto 6 adds new photo management and editing features, supports up to 250,000 photos, and introduces Photocasting™. Photocasting allows .Mac users to share and automatically update photo albums over the Internet with anyone who uses a Macintosh or Windows-based computer.

iMovie® HD is the Company's consumer-oriented digital video editing software application. iMovie HD 6 includes new real-time effects that take advantage of Core Video technology, which uses the computer's video card's graphics processing unit to deliver hardware acceleration to quickly preview video effects. iMovie HD 6 also provides a solution to make video podcasts, which can be published with iWeb, and includes audio enhancement tools and sound effects.

iDVD® is the Company's consumer-oriented software application that enables users to turn iMovie files, QuickTime® files, and digital pictures into DVDs that can be played on most consumer DVD players. iDVD® 6 allows users to take content shot with HDV and widescreen DV cameras and author custom DVDs with widescreen menus, movies, and high resolution slideshows. iDVD 6 features 10 new Apple-designed menu themes in both widescreen (16:9) and standard (4:3) formats.

GarageBand™ is the Company's consumer-oriented music creation software application that allows users to play, record and create music using a simple interface. With GarageBand, recorded performances, digital audio and looping tracks can be arranged and edited to create songs. GarageBand 3 allows users to record, produce, and publish through iWeb their own podcasts, including artwork, sound effects, and music jingles.

iLife '06 also includes iTunes, the Company's digital music jukebox software application that allows users to purchase a variety of digital content available through the Company's iTunes Store. iTunes organizes content using searching, browsing, and playlists, and also includes features such as iMix playlist sharing and provides integration with the complete family of iPods. In September 2006, the Company introduced iTunes 7, the latest version of its iTunes software. iTunes 7 delivers new features such as album and Cover Flow views of music, television shows, and movies, enabling users to quickly find titles in their library as well as casually browse through titles they already own.

iWork™ '06

In January 2006, the Company introduced iWork '06, a new Universal version of the Company's suite of productivity software designed to help users create, present, and publish documents and presentations. iWork '06 includes Pages® 2 and Keynote® 3.

Pages® gives users the tools to create letters, newsletters, reports, brochures and resumes with advanced typography, multiple columns, footnotes, tables of content and styles. Pages 2 features mail merge with Mac OS X Address Book, which allows users to personalize documents by dragging and dropping individual contacts into documents using templates with predefined fields. Pages 2 also features new templates for newsletters, flyers, posters, school reports, scrapbooks, brochures, business proposals, and invoices. Pages 2 allows users to insert tables that have basic calculation functionality within any document and users can export their Pages 2 document to other formats.

Keynote® is the Company's presentation software that gives users the ability to create presentations, portfolios, interactive slideshows, and storyboards. Keynote 3 offers additional ways to create presentations and interactive slideshows. It features new cinematic transitions including vertical and horizontal blinds, revolving door, and swoosh. A new view mode, Light Table, allows users to view an entire presentation and reorganize slides using drag and drop.

Final Cut® Express HD enables users to capture, edit, and output DV and HDV over a single FireWire cable, and supports Digital Cinema Desktop with multiple displays. In May 2006, the Company introduced a Universal version of Final Cut Express HD 3.5. Features introduced in this version include Dynamic RT for real-time playback of multi-stream effects, Soundtrack 1.5 with a suite of audio production tools, and LiveType 2.1 with animated text and titles.

In March 2006, the Company introduced Logic® Express 7.2, a Universal version of the Company's streamlined version of Logic Pro 7.2 that provides a basic set of professional tools to compose and produce music for students, educators, and advanced hobbyists. Its high-resolution audio of up to 24-bit/96kHz, the adaptive self-configuring track mixer, and 32-bit floating-point math provides professional sound quality. Logic Express 7 comes with support for projects from GarageBand, offering users a smooth migration path to high-end audio production.

FileMaker, Inc., a wholly owned subsidiary of the Company, develops, publishes, and distributes desktop-based database management application software for both Macintosh and Windows-based computers. The FileMaker® Pro database software and related products offer relational databases and desktop-to-web publishing capabilities. In July 2006, the Company introduced FileMaker Pro 8.5, a Universal version of its database management application. New features of FileMaker Pro 8.5 include FileMaker Web Viewer, which allows for a live web browser to be put into a database.

Internet Software and Services

The Company is focused on delivering seamless integration with and access to the Internet throughout the Company's products and services. The Company's Internet solutions adhere to many industry standards to provide an optimized user experience through interoperability.

Safari™

Safari, the Company's Mac OS X compatible web browser, uses the advanced interface technologies underlying Mac OS X and includes built-in Google search; SnapBack™ to instantly return to search results; a way to name, organize and present bookmarks; tabbed browsing; and automatic "pop-up" ad blocking.

QuickTime®

QuickTime, the Company's multimedia software for Macintosh or Windows-based computers, features streaming of live and stored video and audio over the Internet and playback of high-quality audio and video on computers. QuickTime 7 features H.264 encoding and can automatically determine a user's connection speed to ensure they are getting the highest-quality content stream possible. QuickTime 7 also delivers multi-channel audio and supports audio formats, including AIFF, WAV, MOV, MP4 (AAC only), CAF, and AAC/ADTS.

The Company offers several other QuickTime products. QuickTime 7 Pro, a suite of software tools, allows creation and editing of Internet-ready audio and video files. QuickTime 7 Pro allows users to create H.264 video, capture audio and video, create multi-channel audio, and export multiple files while playing back or editing video.

.Mac™

The Company's .Mac offering is a suite of Internet services that for an annual fee provides Macintosh users with a powerful set of Internet tools. .Mac services include: HomePage, for personal web sites; iDisk, a virtual hard drive accessible anywhere with Internet access; .Mac Sync, which keeps Safari bookmarks, iCal® calendars, Address Book information, Keychain® (passwords), and Mac OS X Mail preferences up-to-date across multiple Macintosh computers and available via web browser when users are away from their Mac; .Mac Mail, an ad-free email service; and Learning Center, featuring tutorials for certain software applications. The current version of .Mac includes .Mac Groups, a service that helps members communicate, coordinate schedules, and stay in sync with private groups of friends or colleagues; an updated version of .Mac Backup software that allows members to archive the content of their iLife Home folder; and combined iDisk and email storage of up to 1GB for individuals and 2GB for families.

Wireless Connectivity and Networking
AirPort Extreme®
AirPort Extreme is the Company's Wi-Fi wireless networking technology. AirPort Extreme is based on the 802.11g standard, which supports speeds up to 54 Mbps, and is fully compatible with most Wi-Fi devices that use the 802.11b standard. AirPort Extreme Base Stations can serve up to 50 Macintosh and Windows users simultaneously, provide wireless bridging to extend the range beyond just one base station, and support USB printer sharing to allow multiple users to wirelessly share USB printers connected directly to the base station. AirPort Extreme client technology is built into most Macintosh models, and is an available option for all.

AirPort® Express™
AirPort Express is the first 802.11g mobile base station that can be plugged directly into the wall for wireless Internet connections and USB printing. Airport Express also features analog and digital audio outputs that can be connected to a stereo and AirTunes™ music networking software that works with iTunes, giving users a way to wirelessly stream iTunes music from their Macintosh or Windows-based computer to any room in the house. AirPort Express features a single piece design weighing 6.7 ounces.

Other Connectivity and Networking Solutions
Mac OS X includes capabilities for Bluetooth technology. Bluetooth is an industry standard for wirelessly connecting computers and peripherals that supports transmission of data at up to 3 Mbps within a range of approximately 30 feet. Bluetooth technology for Mac OS X lets customers wirelessly share files between Macintosh systems, synchronize and share contact information with Palm-OS based PDAs, and access the Internet through Bluetooth-enabled cell phones. Bluetooth is built into most Macintosh models.

Bonjour®, the Company's zero configuration networking technology, is based on open Internet Engineering Task Force ("IETF") Standard Protocols such as IP, ARP, and DNS and is built into Mac OS X. This technology uses industry standard networking protocols and zero configuration technology including Ethernet or 802.11-based wireless networks like the Company's AirPort products. The source code for this technology also includes software to support UNIX, Linux, and Windows-based systems and devices.

The Company developed FireWire, a high-speed serial I/O technology for connecting digital devices such as digital camcorders and cameras to desktop and portable computers. FireWire has high data-transfer speed and "hot plug-and-play" capability and is currently integrated in all Macintosh systems.

Product Support and Services
AppleCare® offers a range of support options for the Company's customers. These options include assistance that is built into software products, printed and electronic product manuals, online support including comprehensive product information as well as technical assistance, and the AppleCare Protection Plan. The AppleCare Protection Plan is a fee-based service that typically includes three years of phone support and hardware repairs, dedicated web-based support resources, and user diagnostic tools.

Markets and Distribution
The Company's customers are primarily in the education, creative, consumer, and business markets. The Company distributes its products through wholesalers, resellers, national and regional retailers and cataloguers. No individual customer accounted for more than 10% of net sales in 2006, 2005, or 2004. The Company also sells many of its products and resells certain third-party products in most of its major markets directly to consumers, education customers, and businesses through its own sales force and retail and online stores. Ten percent of the Company's net sales in 2006 were through its U.S. education channel, including sales to elementary and secondary schools, higher education institutions, and individual customers.

Competition
The Company is confronted by aggressive competition in all areas of its business. The markets for consumer electronics, personal computers and related software and peripheral products are highly competitive. These markets are characterized by rapid technological advances in both hardware and software that have substantially increased the capabilities and use of personal computers and other digital electronic devices and have resulted in the frequent introduction of new products with competitive price, feature, and performance characteristics. Over the past several years, price competition in these markets have been particularly intense. The Company's competitors who sell personal computers based on other operating systems have aggressively cut prices and lowered their product margins to gain or maintain market share. The Company's results of operations and financial condition can be adversely affected by these and other industry-wide downward pressures on gross margins. The principal competitive factors include price, relative price/performance, product quality and reliability, design innovation, availability of software, product features, marketing and distribution capability, service and support, availability of hardware peripherals, and corporate reputation. Further, as the personal computer industry and its customers place more reliance on the Internet, an increasing number of Internet devices that are smaller, simpler, and less expensive than traditional personal computers may compete for market share with the Company's existing products.

The Company's music products and services have faced significant competition from other companies promoting their own digital music and content products and services, including those offering free peer-to-peer music and video services. The Company believes it currently retains a competitive advantage from innovation and by more effectively integrating the entire solution including the hardware (personal computer and iPod), software (iTunes), and distribution of content (iTunes Store). However, the Company expects competition in this space to intensify as competitors attempt to imitate the Company's approach to tightly integrate these components within their individual offerings or, alternatively, collaborate with each other to offer solutions that are more integrated than those they currently offer. Some of these current and potential competitors have substantial resources and may be able to provide such products and services at little or no profit or even at a loss to compete with the Company's offerings.

The Company's future operating results and financial condition are substantially dependent on the Company's ability to continue to develop improvements to the Macintosh platform and to the Company's hardware, software and services related to digital content to maintain perceived functional and design advantages over competing platforms.

Raw Materials
Although most components essential to the Company's business are generally available from multiple sources, certain key components including microprocessors and application-specific integrated circuits ("ASICs") are currently obtained by the Company from single or limited sources. Some key components, while currently available to the Company from multiple sources, are at times subject to industry-wide availability constraints and pricing pressures. In addition, the Company uses some components uncommon to the rest of the personal computer and consumer electronics industries, and new products introduced by

the Company often initially utilize custom components obtained from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. If the supply of a key or single-sourced component to the Company were to be delayed or curtailed or in the event a key manufacturing vendor delays shipments of completed products to the Company, the Company's ability to ship related products in desired quantities and in a timely manner could be adversely affected. The Company's business and financial performance could also be adversely affected depending on the time required to obtain sufficient quantities from the original source, or to identify and obtain sufficient quantities from an alternative source. Continued availability of these components may be affected if producers were to decide to concentrate on the production of common components instead of components customized to meet the Company's requirements. The Company attempts to mitigate these potential risks by working closely with these and other key suppliers on product introduction plans, strategic inventories, coordinated product introductions, and internal and external manufacturing schedules and levels. Consistent with industry practice, the Company acquires components through a combination of formal purchase orders, supplier contracts, and open orders based on projected demand information. The Company's purchase commitments typically cover its requirements for periods ranging from 30 to 150 days.

The Company believes there are several component suppliers and manufacturing vendors whose loss to the Company could have a material adverse effect upon the Company's business and financial position. At this time, such vendors include Agere Systems, Inc., Ambit Microsystems Corporation, Amperex Technology Limited, ASUSTeK Corporation, ATI Technologies, Inc., Atheros Communications Inc., AU Optronics Corporation, Broadcom Corporation, Chi Mei Optoelectronics Corporation, Cypress Semiconductor Corporation, Hitachi Global Storage Technologies, Hon Hai Precision Industry Co., Ltd., Intel Corporation, Inventec Appliances Corporation, LG. Phillips Co., Ltd., Matsushita, NVIDIA Corp., PortalPlayer, Inc., Quanta Computer, Inc., Renesas Semiconductor Co. Ltd., Samsung Electronics, Sony Corporation, Synaptics, Inc., Texas Instruments, and Toshiba Corporation.

Research and Development

Because the personal computer and consumer electronics industries are characterized by rapid technological advances, the Company's ability to compete successfully is heavily dependent upon its ability to ensure a continuing and timely flow of competitive products, services, and technologies to the marketplace. The Company continues to develop new products and technologies and to enhance existing products in the areas of hardware and peripherals, consumer electronic products, system software, applications software, networking and communications software and solutions, and the Internet. The Company may expand the range of its product offerings and intellectual property through licensing and/or acquisition of third-party business and technology. The Company's research and development expenditures totaled $712 million, $535 million (as restated[(1)]), and $491 million (as restated[(1)]) in 2006, 2005, and 2004, respectively.

Patents, Trademarks, Copyrights and Licenses

The Company currently holds rights to patents and copyrights relating to certain aspects of its computer systems, iPods, peripherals, software, and services. In addition, the Company has registered, and/or has applied to register, trademarks and service marks in the U.S. and a number of foreign countries for "Apple," the Apple logo, "Macintosh," "iPod," "iTunes," "iTunes Store," and numerous other trademarks and service marks. Although the Company believes the ownership of such patents, copyrights, trademarks and service marks is an important factor in its business and that its success does depend in part on the ownership thereof, the Company relies primarily on the innovative skills, technical competence, and marketing abilities of its personnel.

(1) See the "Explanatory Note" immediately preceding Part I, Item 1 and Note 2, "Restatement of Consolidated Financial Statements" in Notes to Consolidated Financial Statements of this Form 10-K.

Many of the Company's products are designed to include intellectual property obtained from third-parties. While it may be necessary in the future to seek or renew licenses relating to various aspects of its products and business methods, the Company believes, based upon past experience and industry practice, such licenses generally could be obtained on commercially reasonable terms; however, there is no guarantee that such licenses could be obtained at all. Because of technological changes in the computer industry, current extensive patent coverage, and the rapid rate of issuance of new patents, it is possible certain components of the Company's products and business methods may unknowingly infringe existing patents of others. From time to time, the Company has been notified that it may be infringing certain patents or other intellectual property rights of third-parties.

Foreign and Domestic Operations and Geographic Data

The U.S. represents the Company's largest geographic marketplace. Approximately 60% of the Company's net sales in 2006 came from sales to customers inside the U.S. Final assembly of products sold by the Company is currently performed in the Company's manufacturing facility in Cork, Ireland, and by external vendors in Fremont, California; Fullerton, California; Taiwan; the Republic of Korea; the People's Republic of China; and the Czech Republic. Currently, manufacturing of many of the components used in the Company's products is performed by third-party vendors in Taiwan, China, Japan, Korea, and Singapore. Final assembly of substantially all of the Company's portable products, including MacBook Pros, MacBooks, and iPods, is performed by third-party vendors in China. Margins on sales of the Company's products in foreign countries, and on sales of products that include components obtained from foreign suppliers, can be adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including tariffs and antidumping penalties.

Information regarding financial data by geographic segment is set forth in Part II, Item 8 of this Form 10-K and in the Notes to Consolidated Financial Statements at Note 11, "Segment Information and Geographic Data."

Seasonal Business

The Company has historically experienced increased net sales in its first and fourth fiscal quarters compared to other quarters in its fiscal year due to seasonal demand related to the holiday season and the beginning of the school year. This historical pattern should not be considered a reliable indicator of the Company's future net sales or financial performance.

Warranty

The Company offers a basic limited parts and labor warranty on its hardware products. The basic warranty period for hardware products is typically one year from the date of purchase by the end-user. The Company also offers a 90-day basic warranty for its service parts used to repair the Company's hardware products. In addition, consumers may purchase extended service coverage on most of the Company's hardware products in all of its major markets.

Backlog

In the Company's experience, the actual amount of product backlog at any particular time is not a meaningful indication of its future business prospects. In particular, backlog often increases in anticipation of or immediately following new product introductions as dealers anticipate shortages. Backlog is often reduced once dealers and customers believe they can obtain sufficient supply. Because of the foregoing, backlog should not be considered a reliable indicator of the Company's ability to achieve any particular level of revenue or financial performance.

Environmental Laws
Compliance with federal, state, local, and foreign laws enacted for the protection of the environment has to date had no material effect on the Company's capital expenditures, earnings, or competitive position. In the future, these laws could have a material adverse effect on the Company.

Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations including, in some instances, the requirement to provide customers the ability to return product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have recently been passed in several jurisdictions in which the Company operates including various European Union member countries, Japan and certain states within the U.S. Although the Company does not anticipate any material adverse effects in the future based on the nature of its operations and the thrust of such laws, there is no assurance that such existing laws or future laws will not have a material adverse effect on the Company's financial condition, liquidity, or results of operations.

Employees
As of September 30, 2006, the Company had 17,787 full-time equivalent employees and an additional 2,399 temporary equivalent employees and contractors.

Available Information
The Company's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are filed with the U.S. Securities and Exchange Commission (SEC). Such reports and other information filed by the Company with the SEC are available on the Company's website at http://www.apple.com/investor when such reports are available on the SEC website. The public may read and copy any materials filed by the Company with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy, and information statements and other information regarding issuers that file electronically with the SEC at http://www.sec.gov. The contents of these websites are not incorporated into this filing. Further, the Company's references to the URLs for these websites are intended to be inactive textual references only.

Item 1A. Risk Factors

Because of the following factors, as well as other factors affecting the Company's operating results and financial condition, past financial performance should not be considered to be a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

The matters relating to the investigation by the Special Committee of the Board of Directors and the restatement of the Company's consolidated financial statements may result in additional litigation and governmental enforcement actions.
On June 29, 2006, the Company announced that an internal review had discovered irregularities related to the issuance of certain stock option grants made between 1997 and 2001, including a grant to its Chief Executive Officer ("CEO"), Steve Jobs. The Company also announced a Special Committee of outside directors ("Special Committee") had been formed and had hired independent counsel to conduct a full investigation of the Company's past stock option granting practices. As described in the Explanatory Note immediately preceding Part I, Item 1, and in Note 2 "Restatement of Consolidated Financial Statements" in Notes to Consolidated Financial Statements in this Form 10-K, as a result of the internal review and independent investigation, management has concluded, and the Audit and Finance Committee agrees, that incorrect measurement dates were used for financial accounting purposes for stock option grants made in

certain prior periods. As a result, the Company has recorded additional non-cash stock-based compensation expense, and related tax effects, with regard to certain past stock option grants, and the Company has restated certain previously filed financial statements included in this Form 10-K.

The internal review, the independent investigation, and related activities have required the Company to incur substantial expenses for legal, accounting, tax and other professional services, have diverted management's attention from the Company's business, and could in the future harm its business, financial condition, results of operations and cash flows.

While the Company believes it has made appropriate judgments in determining the correct measurement dates for its stock option grants, the SEC may disagree with the manner in which the Company has accounted for and reported, or not reported, the financial impact. Accordingly, there is a risk the Company may have to further restate its prior financial statements, amend prior filings with the SEC, or take other actions not currently contemplated.

The Company's past stock option granting practices and the restatement of prior financial statements have exposed the Company to greater risks associated with litigation, regulatory proceedings and government enforcement actions. As described in Part I, Item 3, "Legal Proceedings", several derivative complaints and a class action complaint have been filed in state and federal courts against the Company's directors and certain of its executive officers pertaining to allegations relating to stock option grants. The Company has provided the results of its internal review and independent investigation to the SEC and the United States Attorney's Office for the Northern District of California, and in that regard the Company has responded to informal requests for documents and additional information. The Company intends to continue full cooperation. No assurance can be given regarding the outcomes from litigation, regulatory proceedings or government enforcement actions relating to the Company's past stock option practices. The resolution of these matters will be time consuming, expensive, and will distract management from the conduct of the Company's business. Furthermore, if the Company is subject to adverse findings in litigation, regulatory proceedings or government enforcement actions, the Company could be required to pay damages or penalties or have other remedies imposed, which could harm its business, financial condition, results of operations and cash flows.

In August 2006, the Company received a NASDAQ Staff Determination letter stating that, as a result of the delayed filing of the Company's Form 10-Q for the quarter ended July 1, 2006 (the "Third Quarter Form 10-Q"), the Company was not in compliance with the filing requirements for continued listing as set forth in Marketplace Rule 4310(c)(14) and was therefore subject to delisting from the NASDAQ Stock Market. On October 24, 2006, the NASDAQ Listing Qualifications Panel granted the Company's request for continued listing, subject to the Company filing the Third Quarter Form 10-Q, and any required restatements, with the SEC by December 29, 2006. On December 29, 2006, the Company filed the Third Quarter Form 10-Q with the SEC. With the filing of this Form 10-K, the Company believes that it has remedied its non-compliance with Marketplace Rule 4310(c)(14), subject to NASDAQ's affirmative completion of its compliance protocols and its notification of the Company accordingly. However, if the SEC disagrees with the manner in which the Company has accounted for and reported, or not reported, the financial impact of past stock option grants, there could be further delays in filing subsequent SEC reports that might result in delisting of the Company's common stock from the NASDAQ Global Select Market.

Unfavorable results of legal proceedings could adversely affect the Company's results of operations.
The Company is subject to various legal proceedings and claims that are discussed in Part I, Item 3 of this Form 10-K. The Company is also subject to certain other legal proceedings and claims that have arisen in the ordinary course of business and which have not been fully adjudicated. Results of legal proceedings cannot be predicted with certainty. In addition, litigation may be disruptive to the Company's normal

business operations. Should the Company fail to prevail in certain legal matters, the Company's financial condition, liquidity, or results of operations could be adversely affected.

Economic conditions and political events could adversely affect the demand for the Company's products and the financial health of its suppliers, distributors, and resellers.
The Company's operating performance depends significantly on economic conditions in the U.S. and abroad. At times in the past, demand for the Company's products has been negatively impacted by difficult global economic conditions. Uncertainty about future economic conditions makes it difficult to forecast future demand for the Company's products and related operating results. Should global and/or regional economic conditions deteriorate, demand for the Company's products could be adversely affected, as could the financial health of its suppliers, distributors, and resellers.

War, terrorism, public health issues, and other circumstances could disrupt supply, delivery, or demand of products, which could negatively affect the Company's operations and performance.
War, terrorism, public health issues, and other business interruptions, whether in the U.S. or abroad, have caused and could cause damage or disruption to international commerce and global economy, and thus may have a strong negative impact on the global economy, the Company, and the Company's suppliers or customers. The Company's major business operations are subject to interruption by earthquake, other natural disasters, fire, power shortages, terrorist attacks and other hostile acts, labor disputes, public health issues, and other events beyond its control. The majority of the Company's research and development activities, its corporate headquarters, information technology systems, and other critical business operations, including certain component suppliers and manufacturing vendors, are located near major seismic faults. Because the Company does not carry earthquake insurance for direct quake-related losses, the Company's operating results and financial condition could be materially adversely affected in the event of a major earthquake or other natural or man-made disaster.

Although it is impossible to predict the occurrences or consequences of any such events, such events could result in a decrease in demand for the Company's products, make it difficult or impossible for the Company to deliver products to its customers or to receive components from its suppliers, and create delays and inefficiencies in the Company's supply chain. In addition, should major public health issues including pandemics arise, the Company could be negatively affected by more stringent employee travel restrictions, additional limitations in the availability of freight services, governmental actions limiting the movement of products between various regions, delays in production ramps of new products, and disruptions in the operations of the Company's manufacturing vendors and component suppliers. The Company's operating results and financial condition have been, and in the future may be, adversely affected by such events.

The market for personal computers and related peripherals and services, as well as digital music devices and related services, is highly competitive. If the Company is unable to effectively compete in these markets, its results of operations could be adversely affected.
The personal computer industry is highly competitive and is characterized by aggressive pricing practices, downward pressure on gross margins, frequent introduction of new products, short product life cycles, evolving industry standards, continual improvement in product price/performance characteristics, rapid adoption of technological and product advancements by competitors, price sensitivity on the part of consumers, and a large number of competitors. Price competition in the market for personal computers and related peripherals has been particularly intense as competitors who sell Windows and Linux based personal computers have aggressively cut prices and lowered their product margins for personal computing products. The Company's results of operations and financial condition have been, and in the future may continue to be, adversely affected by these and other industry-wide pricing pressures and downward pressures on gross margins.

The personal computer industry has also been characterized by rapid technological advances in software functionality, hardware performance, and features based on existing or emerging industry standards. Further, as the personal computer industry and its customers place more reliance on the Internet, an increasing number of Internet devices that are smaller and simpler than traditional personal computers may compete for market share with the Company's existing products. Several competitors of the Company have targeted certain of the Company's key market segments, including consumer, education, professional and consumer digital video editing, and design and publishing. Several of the Company's competitors have introduced digital music products and/or online stores offering digital music distribution that mimic many of the unique design, technical features, and solutions of the Company's products. The Company has a significant number of competitors, many of whom have broader product lines and larger installed customer bases than those of the Company. Additionally, there has been a trend towards consolidation in the personal computer industry that has resulted in larger and potentially stronger competitors in the Company's markets.

The Company is currently the only maker of hardware using the Mac OS. The Mac OS has a minority market share in the personal computer market, which is dominated by makers of computers utilizing competing operating systems, including Windows and Linux. The Company's future operating results and financial condition are substantially dependent on its ability to continue to develop improvements to the Macintosh platform to maintain perceived design and functional advantages over competing platforms. Additionally, if unauthorized copies of the Mac OS are used on other companies' hardware products and result in decreased demand for the Company's hardware products, the Company's results of operations may be adversely affected.

The Company is currently focused on market opportunities related to digital music distribution and related consumer electronic devices, including iPods. The Company faces significant competition from other companies promoting their own digital music products including MP3 players, music enabled cell phones, free peer-to-peer music and video services, and free streaming of digital content via the Internet. These competitors include both new entrants with different market approaches, such as subscription services models, and also larger companies that may have significant technical, marketing, distribution, and other resources, as well as established hardware, software, and digital content supplier relationships. Failure to effectively compete could negatively affect the Company's operating results and financial position. The Company expects competition in this space to intensify as competitors attempt to imitate the Company's approach to tightly integrating these components within their individual offerings or work more collaboratively with each other to offer solutions that are more integrated than those they offer currently. Some of these current and potential competitors have substantial resources and may be able to provide such products and services at little or no profit or even at a loss to compete with the Company's offerings. There can be no assurance the Company will be able to continue to provide products and services that effectively compete in these markets. The Company may also have to respond to price competition by lowering prices and/or increasing features which could adversely affect the Company's music product gross margins as well as overall Company gross margins.

The Company also faces significant competition in the U.S. education market. U.S. elementary and secondary schools, as well as college and university customers, remain a core market for the Company. In an effort to gain market share and remain competitive, the Company will continue to pursue one-to-one (1:1) learning solutions in education. 1:1 learning solutions typically consist of a portable computer for every student and teacher along with the installation of a wireless network. These 1:1 learning solutions and other strategic sales are generally priced more aggressively and could result in significantly less profitability or financial losses, particularly for larger deals. Although the Company believes it has taken certain steps to strengthen its position in the education market, there can be no assurance that the Company will be able to increase or maintain its share of the education market or execute profitably on large strategic arrangements. Failure to do so may have an adverse impact on the Company's operating results and financial condition.

Future operating results are dependent upon the Company's ability to obtain a sufficient supply of components, including microprocessors, some of which are in short supply or available only from limited sources.
Although most components essential to the Company's business are generally available from multiple sources, certain key components including microprocessors and ASICs are currently obtained by the Company from single or limited sources. Some key components (including without limitation DRAM, NAND flash-memory, and TFT-LCD flat-panel displays), while currently available to the Company from multiple sources, are at times subject to industry-wide availability and pricing pressures. In addition, new products introduced by the Company often initially utilize custom components obtained from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. In situations where a component or product utilizes new technologies, initial capacity constraints may exist until such time as the suppliers' yields have matured. The Company and other producers in the personal computer and consumer electronics industries also compete for various components with other industries that have experienced increased demand for their products. The Company uses some components that are not common to the rest of the personal computer or consumer electronics industries. Continued availability of these components may be affected if producers decided to concentrate on the production of components other than those customized to meet the Company's requirements. If the supply of a key component were delayed or constrained on a new or existing product, the Company's results of operations and financial condition could be adversely affected.

The Company must successfully manage frequent product introductions and transitions to remain competitive and effectively stimulate customer demand.
Due to the highly volatile and competitive nature of the personal computer and consumer electronics industries, which are characterized by dynamic customer demand patterns and rapid technological advances, the Company must continually introduce new products and technologies, enhance existing products to remain competitive, and effectively stimulate customer demand for new products and upgraded versions of the Company's existing products. The success of new product introductions is dependent on a number of factors, including market acceptance; the Company's ability to manage the risks associated with product transitions, including the transition to Intel-based Macintosh computers, and production ramp issues; the availability of application software for new products; the effective management of purchase commitments and inventory levels in line with anticipated product demand; the availability of products in appropriate quantities and costs to meet anticipated demand; and the risk that new products may have quality or other defects in the early stages of introduction. Accordingly, the Company cannot determine in advance the ultimate effect new products will have on its sales or results of operations.

In June 2005, the Company announced its plan to begin using Intel microprocessors in its computers. During 2006, the Company introduced new Intel-based models of the MacBook Pro, MacBook, Mac Pro, iMac, and Mac mini computers. The Company's transition to Intel microprocessors for Macintosh systems was completed in August 2006, and its transition for Xserve was completed in November 2006. This transition has been and will continue to be subject to numerous risks and uncertainties including the timely innovation and delivery of related hardware and software products to support Intel microprocessors, market acceptance of Intel-based Macintosh computers, and the development and availability on acceptable terms of components and services essential to enable the Company to timely deliver Intel-based Macintosh computers. In addition, the Company is dependent on third-party software developers such as Microsoft and Adobe to timely develop current and future applications that run on Intel-based Macintosh computers. Universal versions of Microsoft Office and Adobe's Creative Suite applications are not currently available. Additionally, there can be no assurance that the Company will be able to maintain its historical gross margin percentages on its products, including Intel-based Macintosh computers, which may adversely impact the Company's results of operations.

The Company's products from time to time experience quality problems that can result in decreased net sales and operating profits.
The Company sells highly complex hardware and software products that can contain defects in design and manufacture. Sophisticated operating system software and applications, such as those sold by the Company, often contain "bugs" that can unexpectedly interfere with the operation of the software. Defects may also occur in components and products the Company purchases from third-parties. There can be no assurance that the Company will be able to detect and fix all defects in the hardware and software it sells. Failure to do so could result in lost revenue, loss of reputation, and significant warranty and other expense to remedy.

Because orders for components, and in some cases commitments to purchase components, must be placed in advance of customer orders, the Company faces substantial inventory risk.
The Company records a write-down for inventories of components and products that have become obsolete or are in excess of anticipated demand or net realizable value and accrues necessary reserves for cancellation fees for orders of products and components that have been cancelled. Although the Company believes its inventory and related provisions are currently adequate, given the rapid and unpredictable pace of product obsolescence in the computer and consumer electronics industries and the transition to Intel-based Macintosh computers, no assurance can be given that the Company will not incur additional inventory and related charges. In addition, such charges have had, and may have, a material effect on the Company's financial position and results of operations.

The Company must order components for its products and build inventory in advance of product shipments. Because the Company's markets are volatile and subject to rapid technology and price changes, and because of the transition to Intel-based Macintosh computers, there is a risk the Company will forecast incorrectly and produce or order from third parties excess or insufficient inventories of particular products. Consistent with industry practice, components are normally acquired through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. Such purchase commitments typically cover the Company's forecasted component and manufacturing requirements for periods ranging from 30 to 150 days. The Company's operating results and financial condition have been in the past and may in the future be materially adversely affected by the Company's ability to manage its inventory levels and respond to short-term shifts in customer demand patterns.

The Company is dependent on manufacturing and logistics services provided by third parties, many of whom are located outside of the U.S.
Most of the Company's products are manufactured in whole or in part by third-party manufacturers. In addition, the Company has outsourced much of its transportation and logistics management. While outsourcing arrangements may lower the cost of operations, they also reduce the Company's direct control over production and distribution. It is uncertain what effect such diminished control will have on the quality or quantity of the products manufactured or services rendered, or the flexibility of the Company to respond to changing market conditions. In addition, the Company is reliant on third-party manufacturers to adhere to the Company's supplier code of conduct. Moreover, although arrangements with such manufacturers may contain provisions for warranty expense reimbursement, the Company may remain at least initially responsible to the consumer for warranty service in the event of product defects. Any unanticipated product defect or warranty liability, whether pursuant to arrangements with contract manufacturers or otherwise, could adversely affect the Company's future operating results and financial condition.

Final assembly of products sold by the Company is currently performed in the Company's manufacturing facility in Cork, Ireland, and by external vendors in Fremont, California; Fullerton, California; Taiwan; the Republic of Korea; the People's Republic of China; and the Czech Republic. Currently, manufacturing of many of the components used in the Company's products is performed by third-party vendors in Taiwan, China, Japan, Korea, and Singapore. Final assembly of substantially all of the Company's portable products, including MacBook Pros, MacBooks, and iPods, is performed by third-party vendors in China. If for any reason manufacturing or logistics in any of these locations is disrupted by regional economic, business, labor, environmental, public health, or political issues, or due to information technology system failures or military actions, the Company's results of operations and financial condition could be adversely affected.

The Company's future operating performance is dependent on the performance of distributors and other resellers of the Company's products.

The Company distributes its products through wholesalers, resellers, national and regional retailers, and cataloguers, many of whom distribute products from competing manufacturers. In addition, the Company sells many of its products and resells certain third-party products in most of its major markets directly to end-users, certain education customers, and certain resellers through its online stores around the world and its retail stores. Many of the Company's resellers operate on narrow product margins and have been negatively impacted in the past by weak economic conditions. Considerable trade receivables that are not covered by collateral or credit insurance are outstanding with the Company's distribution and retail channel partners. The Company's business and financial results could be adversely affected if the financial condition of these resellers weakens, if resellers within consumer channels were to cease distribution of the Company's products, or if uncertainty regarding demand for the Company's products caused resellers to reduce their ordering and marketing of the Company's products. The Company has invested and will continue to invest in various programs to enhance reseller sales, including staffing selected resellers' stores with Company employees and contractors. These programs could require a substantial investment from the Company, while providing no assurance of return or incremental revenue to offset this investment.

Over the past several years, an increasing proportion of the Company's net sales have been made by the Company directly to end-users through its online stores around the world and through its retail stores in the U.S., Canada, Japan, and the U.K. Some of the Company's resellers have perceived this expansion of the Company's direct sales as conflicting with their own businesses and economic interests as distributors and resellers of the Company's products. Perception of such a conflict could discourage the Company's resellers from investing additional resources in the distribution and sale of the Company's products or lead them to limit or cease distribution of the Company's products. The Company's business and financial results could be adversely affected if expansion of its direct sales to end-users causes some or all of its resellers to cease or limit distribution of the Company's products.

The Company relies on third-party digital content, which may not be available to the Company on commercially reasonable terms or at all.

The Company contracts with third parties to offer their digital content to customers through the Company's iTunes Store. The Company pays substantial fees to obtain the rights to offer to its customers this third-party digital content. The Company's licensing arrangements with these third-party content providers are short-term in nature and do not guarantee the future renewal of these arrangements at commercially reasonable terms, if at all. Certain parties in the music industry have consolidated and formed alliances, which could limit the availability and increase the fees required to offer digital content to customers through the iTunes Store. Some third-party content providers currently or may in the future offer music products and services that compete with the Company's music products and services, and could take action to make it more difficult or impossible for the Company to license their digital content in the future. Further, other distributors of third-party content or third-party content owners may seek to limit the Company's access to or increase the total cost of such content. If the Company is unable to continue to offer a wide variety of digital content at reasonable prices with acceptable usage rules, or continue to expand its geographic reach outside the U.S., then sales and gross margins of the Company's iTunes Store, as well as related hardware and peripherals, including iPods, may be adversely affected.

Third-party content providers and artists require that the Company provide certain digital rights management ("DRM") solutions and other security mechanisms. If the requirements from content providers or artists change, then the Company may be required to further develop or license technology to address such new rights and requirements. In addition, certain countries have passed legislation or may propose legislation that would force the Company to license its DRM solutions so that content would be interoperable with competitor devices, which could lessen the protection of content subjecting it to piracy and could affect arrangements with the Company's content suppliers. There is no assurance the Company will be able to develop or license such solutions at a reasonable cost and in a timely manner, if at all, which could have a materially adverse effect on the Company's operating results and financial position.

The Company's future performance is dependent upon support from third-party software developers. If third-party software applications cease to be developed or available for the Company's hardware products, then customers may choose not to buy the Company's products.

The Company believes decisions by customers to purchase the Company's personal computers, as opposed to Windows-based systems, are often based on the availability of third-party software applications such as Microsoft Office. The Company also believes the availability of third-party application software for the Company's hardware products depends in part on third-party developers' perception and analysis of the relative benefits of developing, maintaining, and upgrading such software for the Company's products versus software for the larger Windows market or growing Linux market. This analysis may be based on factors such as the perceived strength of the Company and its products, the anticipated potential revenue that may be generated, continued acceptance by customers of Mac OS X, and the costs of developing such software products. To the extent the minority market share held by the Company in the personal computer market has caused software developers to question the Company's prospects in the personal computer market, developers could be less inclined to develop new application software or upgrade existing software for the Company's products and more inclined to devote their resources to developing and upgrading software for the larger Windows market or growing Linux market. The Company's recent announcement that it plans to add a feature to the next version of Mac OS X that will enable Intel-based Macintosh systems to run Windows XP may deter developers from creating software applications for Mac OS X if such applications are available for the Windows platform. Moreover, there can be no assurance software developers will continue to develop software for Mac OS X on a timely basis or at all.

In June 2005, the Company announced its plan to begin using Intel microprocessors in its computers. During 2006, the Company introduced new Intel-based models of the MacBook Pro, MacBook, Mac Pro, iMac, and Mac mini computers. The Company's transition to Intel microprocessors for Macintosh systems was completed in August 2006, and its transition for Xserve was completed in November 2006. The Company depends on third-party software developers to timely develop current and future applications that run on Intel microprocessors. Universal versions of Microsoft Office and Adobe's Creative Suite applications are not currently available. The lack of applications that run on Intel-based Macintosh systems, including Microsoft Office and Adobe Creative Suite, could have a materially adverse effect on the Company's operating results and financial position.

In addition, past and future development by the Company of its own software applications and solutions may negatively impact the decision of software developers, such as Microsoft and Adobe, to develop, maintain, and upgrade similar or competitive software for the Company's products. The Company currently markets and sells a variety of software applications for use by professionals, consumers, and education customers that could influence the decisions of third-party software developers to develop or upgrade Macintosh-compatible software products. Software applications currently marketed by the Company include software for professional film and video editing, professional compositing and visual effects for large format film and video productions, professional music production and music post production, professional and consumer DVD encoding and authoring, professional digital photo editing and workflow management, consumer digital video and digital photo editing and management, digital music management, desktop-based database management, word processing, and high-quality presentations. Discontinuance of third-party software products for the Macintosh platform could have an adverse effect on the Company's net sales and results of operations.

The Company's business relies on access to patents and intellectual property obtained from third parties, and the Company's future results could be adversely affected if it is alleged or found to have infringed on the intellectual property rights of others.
Many of the Company's products are designed to include intellectual property obtained from third parties. While it may be necessary in the future to seek or renew licenses relating to various aspects of its products and business methods, the Company believes that based upon past experience and industry practice, such licenses generally could be obtained on commercially reasonable terms. However, there can be no assurance that the necessary licenses would be available or available on acceptable terms.

Because of technological changes in the computer and consumer electronics industries, current extensive patent coverage, and the rapid rate of issuance of new patents, it is possible certain components of the Company's products and business methods may unknowingly infringe existing patents of others. The Company has from time to time been notified that it may be infringing certain patents or other intellectual property rights of others. Responding to such claims, regardless of their merit, can be time-consuming, result in significant expenses, and cause the diversion of management and technical personnel. Several pending claims are in various stages of evaluation. The Company may consider the desirability of entering into licensing agreements in certain of these cases. However, no assurance can be given that such licenses can be obtained on acceptable terms or that litigation will not occur. In the event there is a temporary or permanent injunction entered prohibiting the Company from marketing or selling certain of its products or a successful claim of infringement against the Company requiring it to pay royalties to a third-party, the Company's future operating results and financial condition could be adversely affected. Information regarding certain claims and litigation involving the Company related to alleged patent infringement and other matters is set forth in Part I, Item 3 of this Form 10-K. In the opinion of management, the Company does not have a potential liability for damages or royalties from any current legal proceedings or claims related to the infringement of patent or other intellectual property rights of others that would individually or in the aggregate have a material adverse effect on its results of operations or financial condition. However, the results of such legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of the matters related to infringement of patent or other intellectual property rights of others described in Part I, Item 3 of this Form 10-K or should several of these matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

The Company's retail initiative has required and will continue to require a substantial investment and commitment of resources and is subject to numerous risks and uncertainties.
Through September 30, 2006, the Company had opened 165 retail stores. The Company's retail initiative has required substantial investment in equipment and leasehold improvements, information systems, inventory, and personnel. The Company has also entered into substantial operating lease commitments for retail space with lease terms ranging from 5 to 20 years, the majority of which are for 10 years. The Company could incur substantial costs should it choose to terminate these commitments or close individual stores. Such costs could adversely affect the Company's results of operations and financial condition. Additionally, a relatively high proportion of the Retail segment's costs are fixed because of personnel costs,

depreciation of store construction costs, and lease expense. As a result, significant losses would result should the Retail segment experience a significant decline in sales for any reason.

Certain of the Company's stores have been designed and built to serve as high-profile venues that function as vehicles for general corporate marketing, corporate events, and brand awareness. Because of their unique design elements, locations and size, these stores require substantially more investment in equipment and leasehold improvements than the Company's more typical retail stores. The Company has opened eight such stores through September 2006. Because of their location and size, these high-profile stores also require the Company to enter into substantially larger operating lease commitments compared to those required for its more typical stores. Current leases on such locations have terms ranging from 10 to 14 years with total remaining commitments per location ranging from \$4 million to \$33 million. Closure or poor performance of one of these high-profile stores could have a significant negative impact on the Company's results of operations and financial condition.

Many of the general risks and uncertainties the Company faces could also have an adverse impact on its Retail segment. Also, many factors unique to retail operations present risks and uncertainties, some of which are beyond the Company's control, that could adversely affect the Retail segment's future results, cause its actual results to differ from those currently expected, and/or have an adverse effect on the Company's consolidated results of operations. Potential risks and uncertainties unique to retail operations that could have an adverse impact on the Retail segment include, among other things, macro-economic factors that have a negative impact on general retail activity; inability to manage costs associated with store construction and operation; inability to sell third-party hardware and software products at adequate margins; failure to manage relationships with existing retail channel partners; lack of experience in managing retail operations outside the U.S.; costs associated with unanticipated fluctuations in the value of Apple-branded and third-party retail inventory; and inability to obtain and renew leases in quality retail locations at a reasonable cost.

Investment in new business strategies and initiatives could disrupt the Company's ongoing business and may present risks not originally contemplated.

The Company has and may in the future invest in new business strategies or engage in acquisitions that complement the Company's strategic direction and product roadmap. Such endeavors may involve significant risks and uncertainties, including distraction of management's attention away from current business operations; insufficient revenue generation to offset liabilities assumed and expenses associated with the strategy; and unidentified issues not discovered in the Company's due diligence process. Because these new ventures are inherently risky, no assurance can be given that such strategies and initiatives will be successful and will not materially adversely affect the Company's business, operating results or financial condition.

Declines in the sales of the Company's professional products, software, accessories, or service and support contracts, or increases in sales of consumer products, including iPods, may negatively impact the Company's gross margin and operating margin percentages.

The Company's professional products, including MacBook Pro and Mac Pro systems, software, accessories, and service and support contracts, generally have higher gross margins than the Company's consumer products, including the iMac, Mac mini, MacBook, iPod, and content from the iTunes Store. A shift in sales mix away from higher margin professional products towards lower margin consumer products could adversely affect the Company's future gross margin and operating margin percentages. The Company's traditional professional customers may choose to buy consumer products, specifically the iMac and MacBook, instead of professional products. Professional users may choose to buy the iMac due to its relative price performance and unique design featuring a flat panel screen. Professional users may also choose to purchase MacBooks instead of the Company's professional-oriented portable products due to their price performance and screen size. Additionally, significant future growth in iPod sales without corresponding growth in higher margin product sales could also reduce gross margin and operating margin percentages.

The Company expects its quarterly revenue and operating results to fluctuate for a variety of reasons.
The Company's profit margins vary among its products and its distribution channels. The Company's direct sales, primarily through its retail and online stores, generally have higher associated profitability than its indirect sales. As a result, the Company's gross margin and operating margin percentages, as well as overall profitability may be adversely impacted as a result of a shift in product, geographic or channel mix, or new product announcements, including the transition to Intel-based Macintosh computers. In addition, the Company generally sells more product during the third month of each quarter than it does during either of the first two months, a pattern typical in the personal computer and consumer electronics industries. This sales pattern can produce pressure on the Company's internal infrastructure during the third month of a quarter and may adversely impact the Company's ability to predict its financial results accurately. Furthermore, the Company has typically experienced greater net sales in the first and fourth fiscal quarters compared to other quarters in the fiscal year due to seasonal demand related to the holiday season and the beginning of the school year. Developments late in a quarter, such as lower-than-anticipated demand for the Company's products, an internal systems failure, or failure of one of the Company's key logistics, components suppliers, or manufacturing partners, could have significant adverse impacts on the Company and its results of operations and financial condition.

The Company has higher research and development and selling, general and administrative costs, as a percentage of revenue, than many of its competitors.
The Company's ability to compete successfully and maintain attractive gross margins and revenue growth is heavily dependent upon its ability to ensure a continuing and timely flow of innovative and competitive products and technologies to the marketplace. As a result, the Company generally incurs higher research and development costs as a percentage of revenue than its competitors who sell personal computers based on other operating systems. Many of these competitors seek to compete aggressively on price and maintain very low cost structures. Further, as a result of the expansion of the Company's Retail segment and costs associated with marketing the Company's brand including its unique operating system, the Company incurs higher selling costs as a percentage of revenue than many of its competitors. If the Company is unable to continue to develop and sell innovative new products with attractive gross margins, its results of operations may be materially adversely affected by its operating cost structure.

The Company is exposed to credit risk on its accounts receivable and prepayments related to long-term supply agreements. This risk is heightened during periods when economic conditions worsen.
The Company distributes its products through third-party computer resellers and retailers and directly to certain educational institutions and commercial customers. A substantial majority of the Company's outstanding trade receivables are not covered by collateral or credit insurance. The Company also has unsecured non-trade receivables from certain of its manufacturing vendors resulting from the sale by the Company of raw material components to these manufacturing vendors who manufacture sub-assemblies or assemble final products for the Company. In addition, the Company has entered into long-term supply agreements to secure supply of NAND flash-memory and has prepaid a total of $1.25 billion under these agreements. While the Company has procedures in place to monitor and limit exposure to credit risk on its trade and non-trade receivables as well as long-term prepayments, there can be no assurance such procedures will be effective in limiting its credit risk and avoiding losses. Additionally, if the global economy or regional economies deteriorate, the Company would be more likely to incur a material loss or losses as a result of the weakening financial condition of one or more of its customers or manufacturing vendors.

The Company's success depends largely on its ability to attract and retain key personnel.
Much of the future success of the Company depends on the continued service and availability of skilled personnel, including its Chief Executive Officer, members of its executive team, and those in technical, marketing and staff positions. Experienced personnel in the information technology industry are in high demand and competition for their talents is intense, especially in the Silicon Valley, where the majority of the Company's key employees are located. The Company has relied on its ability to grant stock options as one mechanism for recruiting and retaining this highly skilled talent. Recent accounting regulations requiring the expensing of stock options have resulted in increased stock-based compensation expense, which may cause the Company to reduce the amount of stock-based awards issued to employees. There can be no assurance that the Company will continue to successfully attract and retain key personnel.

The Company is subject to risks associated with the availability and coverage of insurance.
For certain risks, the Company does not maintain insurance coverage because of cost and/or availability. Because the Company retains some portion of its insurable risks, and in some cases self insures completely, unforeseen or catastrophic losses in excess of insured limits may have a material adverse effect on the Company's results of operations and financial position.

Failure of information technology systems and breaches in the security of data upon which the Company relies could adversely affect the Company's future operating results.
Information technology system failures and breaches of data security could disrupt the Company's ability to function in the normal course of business by potentially causing delays or cancellation of customer orders, impeding the manufacture or shipment of products, or resulting in the unintentional disclosure of customer or Company information. Management has taken steps to address these concerns for its own systems by implementing sophisticated network security and internal control measures. However, there can be no assurance that a system failure or data security breach of the Company or a third-party vendor will not have a material adverse effect on the Company's results of operations.

The Company's business is subject to the risks of international operations.
A large portion of the Company's revenue is derived from its international operations. As a result, the Company's operating results and financial condition could be significantly affected by risks associated with international activities, including economic and labor conditions, political instability, tax laws (including U.S. taxes on foreign subsidiaries), and changes in the value of the U.S. dollar versus the local currency in which the products are sold and goods and services are purchased. The Company's primary exposure to movements in foreign currency exchange rates relate to non-U.S. dollar denominated sales in Europe, Japan, Australia, Canada, and certain parts of Asia and non-dollar denominated operating expenses incurred throughout the world. Weaknesses in foreign currencies, particularly the Japanese Yen and the Euro, can adversely impact consumer demand for the Company's products and the U.S. dollar value of the Company's foreign currency denominated sales. Conversely, a strengthening in these and other foreign currencies can cause the Company to modify international pricing and affect the value of the Company's foreign denominated sales, and in some cases, may also increase the cost to the Company of some product components.

Margins on sales of the Company's products in foreign countries, and on sales of products that include components obtained from foreign suppliers, can be adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including tariffs and antidumping penalties.

Derivative instruments, such as foreign exchange forward and option positions have been utilized by the Company to hedge exposures to fluctuations in foreign currency exchange rates. The use of such hedging activities may not offset more than a portion of the adverse financial impact resulting from unfavorable movements in foreign exchange rates.

Further information related to the Company's global market risks may be found in Part II, Item 7A of this Form 10-K under the subheading "Foreign Currency Risk" and may be found in Part II, Item 8 of this Form 10-K at Notes 1 and 3 of Notes to Consolidated Financial Statements.

The Company is subject to risks associated with environmental regulations.
Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations including, in some instances, the requirement to provide customers the ability to return product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have recently been passed in several jurisdictions in which the Company operates, including various European Union member countries, Japan and certain states within the U.S. Although the Company does not anticipate any material adverse effects in the future based on the nature of its operations and the thrust of such laws, there is no assurance such existing laws or future laws will not have a material adverse effect on the Company's financial condition, liquidity, or results of operations.

Changes in accounting rules could affect the Company's future operating results.
Financial statements are prepared in accordance with U.S. generally accepted accounting principles. These principles are subject to interpretation by various governing bodies, including the Financial Accounting Standards Board ("FASB") and the SEC, who create and interpret appropriate accounting standards. A change from current accounting standards could have a significant effect on the Company's results of operations. In December 2004, the FASB issued new guidance that addresses the accounting for share-based payments, Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004) ("SFAS No. 123R"), *Share-Based Payment*, which the Company adopted in 2006. In 2006, stock-based compensation expense reduced diluted earnings per common share by approximately $0.14. Although the adoption of SFAS No. 123R is expected to continue to have a significant impact on the Company's results of operations, future changes to various assumptions used to determine the fair-value of awards issued or the amount and type of equity awards granted create uncertainty as to the amount of future stock-based compensation expense.

Changes in the Company's tax rates could affect its future results.
The Company's future effective tax rates could be favorably or unfavorably affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of the Company's deferred tax assets and liabilities, or by changes in tax laws or their interpretation. In addition, the Company is subject to the continuous examination of its income tax returns by the Internal Revenue Service and other tax authorities. The Company regularly assesses the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of its provision for income taxes. There can be no assurance the outcomes from these continuous examinations will not have an adverse effect on the Company's results of operations and financial condition.

The Company's stock price may be volatile.
The Company's stock has at times experienced substantial price volatility as a result of variations between its actual and anticipated financial results and as a result of announcements by the Company and its competitors. The stock market has experienced extreme price and volume fluctuations that have affected the market price of many technology companies in ways that may have been unrelated to the operating performance of these companies. Furthermore, the Company believes its stock price reflects high future growth and profitability expectations. If the Company fails to meet these expectations its stock price may significantly decline. In addition, increases in the Company's stock price may result in greater dilution of earnings per share.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Company's headquarters are located in Cupertino, California. The Company has a manufacturing facility in Cork, Ireland. As of September 30, 2006, the Company leased approximately 3.6 million square feet of space, primarily in the U.S., and to a lesser extent, in Europe, Japan, Canada, and the Asia Pacific region. The major facility leases are for terms of 5 to 15 years and generally provide renewal options for terms of 3 to 5 additional years. Leased space includes approximately 1.2 million square feet of retail space, a majority of which is in the U.S. Lease terms for retail space range from 5 to 20 years, the majority of which are for 10 years, and often contain multi-year renewal options.

The Company owns a 352,000 square-foot manufacturing facility in Cork, Ireland that also houses a customer support call center. The Company also owns 805,000 square feet of facilities in Sacramento, California that include warehousing and distribution operations as well as a customer support call center. In addition, the Company owns approximately 1.9 million square feet of facilities for research and development and corporate functions in Cupertino, California, including approximately 948,000 square feet purchased during 2006 for the future development of the Company's second corporate campus, and approximately 107,000 square feet for a data center in Newark, California. Outside the U.S., the Company owns additional facilities totaling approximately 169,000 square feet. The Company believes its existing facilities and equipment are well maintained and in good operating condition.

The Company has invested in internal capacity and strategic relationships with outside manufacturing vendors, and therefore believes it has adequate manufacturing capacity for the foreseeable future. The Company continues to make investments in capital equipment as needed to meet anticipated demand for its products.

Item 3. Legal Proceedings

The Company is subject to various legal proceedings and claims that are discussed below. The Company is also subject to certain other legal proceedings and claims that have arisen in the ordinary course of business and which have not been fully adjudicated. In the opinion of management, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate have a material adverse effect on its financial condition, liquidity or results of operations. However, the results of legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected. The Company settled certain matters during 2006 that did not individually or in the aggregate have a material impact on the Company's results of operations.

Allen v. Apple Computer, Inc.
On January 28, 2005, a plaintiff filed a purported nationwide class action in Los Angeles Superior Court alleging that a defect in the Company's 17-inch Studio Display monitors results in dimming of half of the screen and constant blinking of the power light. Plaintiff filed an amended complaint on October 24, 2005, adding additional named plaintiffs and expanding the alleged class to include purchasers of the 20-inch Apple Cinema Display and the 23-inch Apple Cinema HD Display. The amended complaint alleges that the displays have a purported defect that causes dimming of one-half of the screen, and that the Company misrepresented the quality of the displays and/or concealed the purported defect. Plaintiffs assert claims under California Business & Professions Code §17200 (unfair competition); California Business & Professions Code §17500 (false advertising) and the Consumer Legal Remedies Act. The amended complaint seeks remedies including damages and equitable relief. On November 14, 2005, the Company

filed an answer to the amended complaint as to the allegations regarding the 17-inch display and a demurrer/motion to strike as to the allegations regarding the 20-inch and 23-inch displays on the ground that plaintiffs failed to allege that they purchased those displays. At a status conference on November 1, 2005, the Court ordered Plaintiffs to amend their complaint. Plaintiff filed an amended complaint on December 12, 2005, and the Company answered on January 5, 2006 denying all allegations and asserting numerous affirmative defenses. The Company has reached a settlement in this matter, which was given preliminary approval by the Court on September 18, 2006. The final approval hearing is scheduled for February 15, 2007. Settlement of this matter will not have a material effect on the Company's financial position or results of operations.

Apple Computer, Inc. v. Burst.com, Inc.
The Company filed an action for declaratory judgment against Defendant Burst.com, Inc. on January 4, 2006 in the United States District Court for the Northern District of California. The Company seeks declaratory judgment that U.S. Patent Nos. 4,963,995, 5,164,839, 5,057,932 and 5,995,705 ("Burst patents") are invalid and not infringed by the Company. Burst filed an answer and counterclaim on April 17, 2006. Burst alleges that the following Apple products and services infringe U.S. Patent Nos. 4,963,995, 5,057,932, 5,164,839, and 5,995,705; iTunes Store, iPod devices, QuickTime products (including QuickTime player and QuickTime Streaming Server), iTunes software, other Apple software products (Final Cut Studio, GarageBand, iMovie, iDVD, iWeb), the use of the .Mac services and Apple computers and servers running iTunes, QuickTime, or the other named Apple software products. The Burst patents allegedly relate to methods and devices used for "burst" transmission of audio or video files. The case is in discovery. A claim construction hearing is set for February 8, 2007. Trial is set for February 26, 2008.

Apple Corps Ltd. v. Apple Computer, Inc.; Apple Computer, Inc. v. Apple Corps Ltd.
Plaintiff Apple Corps filed this action on July 4, 2003 in the High Court of Justice, Chancery Division, in London alleging that the Company has breached a 1991 agreement that resolved earlier trademark litigation between the parties regarding use of certain Apple marks. Plaintiff seeks an injunction, unspecified damages, and other relief. The Company filed a motion on October 13, 2003, challenging jurisdiction in the U.K. The Court denied this motion on April 7, 2004. The Company filed an appeal of the Court's decision but subsequently withdrew the appeal. In November 2004, Plaintiff served the Company with an Amended Bill of Particulars and on December 23, 2004, the Company filed a Defence. On November 24, 2005, Plaintiff filed a Re-Amended Bill of Particulars and the Company filed its Defence on December 16, 2005. Trial took place from March 29, 2006 through April 5, 2006. Judgment was given in favor of the Company on May 8, 2006 and Apple Corps was ordered to pay a portion of the Company's fees, the amount to be agreed or determined in a subsequent proceeding. Apple Corps has filed an appeal, which is scheduled to be heard in late February 2007.

On October 8, 2003, the Company filed a lawsuit against Apple Corps in the United States District Court for the Northern District of California requesting a declaratory judgment that the Company has not breached the 1991 agreement. Apple Corps challenged jurisdiction in the California case but the Court denied that challenge on March 25, 2004. Apple Corps subsequently prevailed on a motion to stay the California case during the pendency of the U.K. action. The Company has dismissed the California lawsuit without prejudice.

Bader v. Anderson, et al.
Plaintiff filed this purported shareholder derivative action against the Company and each of its then current executive officers and members of its Board of Directors on May 19, 2005 in Santa Clara County Superior Court asserting claims for breach of fiduciary duty, material misstatements and omissions, and violations of California Businesses & Professions Code §17200 (unfair competition). Plaintiff alleges that the Company's March 14, 2005, proxy statement was false and misleading for failure to disclose certain information relating to the Apple Computer, Inc. Performance Bonus Plan, which was approved by

shareholders at the annual meeting held on April 21, 2005. Plaintiff, who ostensibly brings suit on the Company's behalf, has made no demand on the Board of Directors and alleges that such demand is excused. Plaintiff seeks injunctive and other relief for purported injury to the Company. On July 27, 2005, Plaintiff filed an amended complaint alleging that, in addition to the purported derivative claims, adoption of the bonus plan and distribution of the proxy statement describing that plan also inflicted injury on her directly as an individual shareholder. On January 10, 2006, the Court sustained defendants' demurrer to the amended complaint, with leave to amend. Plaintiff filed a second amended complaint on February 7, 2006, and the Company filed a demurrer. After a hearing on June 13, 2006, the Court sustained the demurrer without leave to amend as to the non-director officers and with leave to amend as to the directors. On July 24, 2006, plaintiff filed a third amended complaint, which purports to bring claims derivatively as well as directly on behalf of a class of common stock holders who have been or will be harmed by virtue of the allegedly misleading proxy statement. In addition to reasserting prior causes of action, the third amended complaint includes a claim that the Company violated the terms of the plan, and a claim for waste related to restricted stock unit grants to certain officers in 2003 and 2004 and an option grant to the Company's CEO in January 2000. A demurrer that the Company filed to the third amended complaint as well as a motion to disqualify the Company's lawyers will be heard on January 30, 2007.

Baghdasarian, et al. v. Apple Computer, Inc.
Plaintiffs filed this action in Los Angeles County Superior Court on October 31, 2005, on behalf of a purported nationwide class of all purchasers of all Apple wireless products (router, modem, or adaptor) sold at any time. The complaint alleges that the Company misrepresented the transmission rates of these products. The complaint alleges causes of action for breach of express warranty and for violations of the Consumer Legal Remedies Act, California Business & Professions Code §17200 (unfair competition) and California Business & Professions Code §17500 (false advertising). The complaint seeks damages and equitable remedies. On December 15, 2005, the Company filed an answer denying all allegations and asserting numerous affirmative defenses. The parties have reached a tentative settlement, which is not expected to have a material effect on the Company's financial position or results of operations.

Barry et al. v. Apple Computer, Inc.
Two Plaintiffs filed this purported class action on May 16, 2006 in the United States District Court for the Northern District of California, San Jose Division, on behalf of a nationwide class of iPod purchasers between May 2002 and the present. The complaint alleged various problems with the iPod hard drive, including skipping and limited lifespan. Plaintiffs alleged violations of California Business & Professions Code §17200 (unfair competition), the Consumer Legal Remedies Act, the Song-Beverly Consumer Warranty Act and breach of warranties. The complaint sought damages and equitable relief. The plaintiffs voluntarily dismissed this case, without prejudice, on September 18, 2006.

Birdsong v. Apple Computer, Inc.; Patterson v. Apple Computer, Inc.
These federal court complaints allege that the Company's iPod music players, and the ear bud headphones sold with them, are inherently defective in design and are sold without adequate warnings concerning the risk of noise-induced hearing loss by iPod users. The Birdsong action was initially filed on January 30, 2006 in the United States District Court for the Western District of Louisiana on behalf of a purported Louisiana class of iPod purchasers and alleges violations of the Louisiana Products Liability Act, breaches of implied warranties, unjust enrichment, and negligent misrepresentation. The Patterson action was filed on January 31, 2006 in the United States District Court for the Northern District of California on behalf of a purported class of all iPod purchasers within the four-year period before January 31, 2006. That action alleged breaches of implied and express warranties, violations of California Business & Professions Code §17200 (unfair competition), California Business & Professions Code §17500 (false advertising), the Consumer Legal Remedies Act, breaches of express and implied warranties, negligent misrepresentation and unjust enrichment. The Birdsong action was transferred to the Northern District of California, and the

Patterson action was dismissed. An amended complaint was subsequently filed in Birdsong, dropping the Louisiana law-based claims and adding California law-based claims equivalent to those in Patterson. The Company filed a motion to dismiss on November 3, 2006. Plaintiffs will not oppose the motion but instead will file a second amended complaint by January 15, 2007.

A similar complaint, *Royer-Brennan v. Apple Computer, Inc. and Apple Canada, Inc.*, was filed in Montreal, Quebec, Canada, on February 1, 2006, seeking authorization to institute a class action on behalf of iPod purchasers in Quebec. A hearing on the motion for class certification is scheduled for February 8 and 9, 2007, although Plaintiff counsel has now requested that the hearing be delayed pending a ruling on the motion to dismiss in the U.S. case.

Branning et al. v. Apple Computer, Inc.
Plaintiffs originally filed this purported class action in San Francisco County Superior Court on February 17, 2005. The initial complaint alleged violations of California Business & Professions Code §17200 (unfair competition) and violation of the Consumer Legal Remedies Act (CLRA) regarding a variety of purportedly unfair and unlawful conduct including, but not limited to, allegedly selling used computers as new and failing to honor warranties. Plaintiffs also brought causes of action for misappropriation of trade secrets, breach of contract, and violation of the Song-Beverly Consumer Warranty Act. Plaintiffs requested unspecified damages and other relief. On May 9, 2005, the Court granted the Company's motion to transfer the case to Santa Clara County Superior Court. On May 2, 2005, Plaintiffs filed an amended complaint adding two new named plaintiffs and three new causes of action including a claim for treble damages under the Cartwright Act (California Business & Professions Code §16700 et seq.) and a claim for false advertising. The Company filed a demurrer to the amended complaint, which the Court sustained in its entirety on November 10, 2005. The Court granted Plaintiffs leave to amend and they filed an amended complaint on December 29, 2005. Plaintiffs' amended complaint added three plaintiffs and alleged many of the same factual claims as the previous complaints, such as alleged selling of used equipment as new, alleged failure to honor warranties and service contracts for the consumer plaintiffs, and alleged fraud related to the opening of the Apple retail stores. Plaintiffs continued to assert causes of action for unfair competition (§17200), violations of the CLRA, breach of contract, misappropriation of trade secrets, violations of the Cartwright Act and alleged new causes of action for fraud, conversion and breach of the implied covenant of good faith and fair dealing. The Company filed a demurrer to the amended complaint on January 31, 2006, which the Court sustained on March 3, 2006 on sixteen of seventeen causes of action. Plaintiffs filed an amended complaint adding one new plaintiff. The Company filed a demurrer, which was granted in part on September 9, 2006. Plaintiffs filed a further amended complaint on September 21, 2006. On October 2, 2006, the Company filed an answer denying all allegations and asserting numerous affirmative defenses. The case is in discovery.

Butzer, et al. v. Apple Computer, Inc.; Wirges v. Apple Computer, Inc.; Blackwell v. Apple Computer, Inc.
Plaintiffs filed the Butzer action on August 23, 2005 in the United States District Court for the Northern District of California, San Jose Division, on behalf of a purported nationwide class of all purchasers of the Company's PowerBook G4 portable computers. The complaint alleged defects in the memory of the computers. The complaint alleged that this purported defect extends to other series of the Company's portables and stated that plaintiffs reserved the right to amend the complaint to include these other series. Plaintiffs asserted claims for alleged violations of California Business & Professions Code §17200 (unfair competition), California Business & Professions Code §17500 (false advertising), the Consumer Legal Remedies Act (CLRA) and the Song-Beverly Consumer Warranty Act. The complaint sought remedies including restitution and/or damages and injunctive relief. The Wirges action was filed on January 20, 2006 in the United States District Court for the Eastern District of Arkansas, also on behalf of a purported nationwide class, and made similar allegations. Plaintiffs asserted claims for breach of warranties, violation of the Magnuson—Moss Act, strict products liability and unjust enrichment. The complaint sought restitution, damages and other remedies. The Blackwell action was filed on February 10, 2006 in the

United States District Court for the Northern District of California, on behalf of a purported nationwide class, and made identical allegations to those made in the Butzer case. Plaintiffs asserted claims for breach of express and implied warranties, violation of the CLRA, violation of the Song-Beverly Act, false advertising and unfair competition. The complaint sought restitution, an injunction and other remedies. The Company filed an answer to the Butzer complaint on October 19, 2005 denying all material allegations and asserting numerous affirmative defenses. The Company filed an answer to the Wirges action on February 28, 2006, and also filed a motion to transfer the Wirges case to the Northern District of California. The Company filed an answer to the Blackwell complaint on March 15, 2006 denying all material allegations and asserting numerous affirmative defenses. The Company has reached a settlement with the named plaintiffs in all three cases and these matters are concluded. Settlement of these matters did not have a material effect on the Company's financial position or results of operations.

Charoensak v. Apple Computer, Inc. (formerly Slattery v. Apple Computer, Inc.)
The original Plaintiff (Slattery) filed this purported class action on January 3, 2005 in the United States District Court for the Northern District of California alleging various claims including alleged unlawful tying of music purchased on the iTunes Store with the purchase of iPods and vice versa and unlawful acquisition or maintenance of monopoly market power. Plaintiff's complaint alleged violations of §§1 and 2 of the Sherman Act (15 U.S.C. §§1 and 2), California Business and Professions Code §16700 et seq. (the Cartwright Act), California Business and Professions Code §17200 (unfair competition), common law unjust enrichment and common law monopolization. Plaintiff sought unspecified damages and other relief. The Company filed a motion to dismiss on February 10, 2005. On September 9, 2005, the Court denied the motion in part and granted it in part. Plaintiff filed an amended complaint on September 23, 2005 and the Company filed an answer on October 18, 2005. On May 8, 2006, the Court heard Plaintiff's motion for leave to file a second amended complaint to substitute two new plaintiffs for Slattery. In August 2006, the court dismissed Slattery without prejudice and allowed plaintiffs to file an amended complaint naming two new plaintiffs (Charoensak and Rosen). On November 2, 2006, the Company filed an answer to the amended complaint denying all material allegations and asserting numerous affirmative defenses. The hearing on class certification is set for April 16, 2007.

Contois Music Technology LLC v. Apple Computer, Inc.
Plaintiff Contois Music Technology filed this action on June 13, 2005 in the United States District Court for Vermont, alleging infringement by the Company of U.S. Patent No. 5,864,868, entitled "Computer Control System and User Interface for Media Playing Devices." The complaint sought unspecified damages and other relief. The Company filed an answer on November 23, 2005 denying all material allegations and asserting numerous affirmative defenses. A Markman hearing was held on June 13, 2006 and the court issued a claim construction ruling on July 24, 2006. The parties agreed to a settlement and the case was dismissed on August 18, 2006. This matter is now concluded. Settlement of this matter did not have a material effect on the Company's financial position or results of operations.

Creative Technology Ltd. and Creative Labs, Inc. v. Apple Computer, Inc. (filed on May 15, 2006, International Trade Comission), *Creative Technology Ltd. v. Apple Computer, Inc.* (filed on May 15, 2006, United States District Court for the Northern District of California), *Apple Computer, Inc. v. Creative Technology Ltd. and Creative Labs, Inc.* (filed May 15, 2006, United States District Court for the Western District of Wisconsin), *Apple Computer, Inc. v. Creative Technology Ltd. and Creative Labs, Inc.* (filed on June 1, 2007, International Trade Comission), *Apple Computer, Inc. v. Creative Technology Ltd. and Creative Labs* (filed on June 1, 2006, United States District Court for the Eastern District of Texas)
On May 15, 2006, Creative Labs, Inc., and Creative Technology Ltd. (collectively "Creative") filed a complaint with the U.S. International Trade Commission ("ITC") alleging that the Company infringed U.S. patent number 6,928,433 ("'433 patent") and seeking an order permanently barring iPods from importation into the United States. On May 15, 2006, Creative also brought suit against the Company in

the United States District Court for the Northern District of California, also alleging that the iPod infringed the '433 patent. The District Court action was stayed pending resolution of the Creative ITC Action.

On May 15, 2006, the Company brought suit against Creative in the United States District Court for the Western District of Wisconsin ("Wisconsin Action"), alleging that Creative infringed U.S. patent number 5,479,602 ("'602 patent"), U.S. patent number 5,586,237 ("'237 patent"), U.S. patent number 5,898,434 ("'434 patent"), and U.S. patent number 6,731,312 ("'312 patent"). On May 17, 2006, the Company filed an amended complaint in the Wisconsin Action alleging that Creative also infringed U.S. patent number 5,341,293 ("'293 patent"), U.S. patent number 6,047,342 ("'342 patent"), and U.S. patent number 5,799,280 ("'280 patent").

On June 1, 2006, the Company brought suit against Creative in the United States District Court for the Eastern District of Texas, ("Texas Action"), alleging that Creative infringed U.S. patent number 6,157,363 ("'363 patent"), U.S. patent number 5,640,566 ("'566 patent"), and U.S. patent number 5,504,852 ("'852 patent"). On June 27, 2006, the Company filed an amended complaint in the Texas Action alleging that Creative also infringed U.S. patent number 7,046,230 ("'230 patent") and U.S. patent number 6,282,646 ("'646 patent"). At the suggestion of the District Court, the Company filed separate actions in the Eastern District of Texas regarding the Company's allegations relating to the '230 patent and the '646 patent.

On June 1, 2006, the Company filed a complaint with the ITC alleging that Creative infringed the '230 patent, the '293 patent, and the '434 patent. On June 5, 2006, the Company filed an amended complaint with the ITC alleging that Creative also infringed the '646 patent.

The parties reached a settlement of all of the above matters and all cases were dismissed as of October 13, 2006. These matters are concluded. Settlement of these matters did not have a material effect on the Company's financial position or results of operations.

Davis v. Apple Computer, Inc.

Plaintiff filed this purported class action in San Francisco County Superior Court on December 5, 2002, alleging that the Company engaged in unfair and deceptive business practices relating to its AppleCare Extended Service and Warranty Plan. Plaintiff asserts causes of action for violation of California Business & Professions Code §17200 (unfair competition), California Business & Professions Code §17500 (false advertising), breach of the Song-Beverly Warranty Act, intentional misrepresentation and concealment. Plaintiff requests unspecified damages and other relief. The Company filed a demurrer and motion to strike, which were granted, in part, and Plaintiff filed an amended complaint. The Company filed an answer on April 17, 2003 denying all allegations and asserting numerous affirmative defenses. Plaintiff subsequently amended his complaint. On October 29, 2003, the Company filed a motion to disqualify Plaintiff's counsel in his role as counsel to the purported class and to the general public. The Court granted the motion but allowed Plaintiff to retain substitute counsel. Plaintiff did engage new counsel for the general public, but not for the class. The Company moved to disqualify Plaintiff's new counsel and to have the Court dismiss the general public claims for equitable relief. The Court declined to disqualify Plaintiff's new counsel or to dismiss the equitable claims, but did confirm that the class action claims were dismissed. The Company appealed the ruling and the case was stayed pending the outcome of the appeal. The Court of Appeals denied the appeal on August 17, 2005, affirming the trial court's decision. The Company filed a Petition for review with the California Supreme Court, which was denied on November 23, 2005. The case was remanded back to the trial court. The parties have reached a settlement and the matter is concluded. Settlement of this matter did not have a material effect on the Company's financial position or results of operations.

European Commission Investigation
The European Commission has notified the Company it is investigating certain matters relating to the iTunes Store in the European Union ("EU"). The European Commission is investigating claims made by Which?, a United Kingdom (UK) consumer association, that the Company is violating EU competition law by charging more for online music in the UK than in Eurozone countries and preventing UK consumers from purchasing online music from the iTunes Store for Eurozone countries. The Which? claims were originally lodged with the UK Office of Fair Trading, which subsequently referred them to the European Commission. The European Commission is investigating the charges under Articles 81 and 82 of the European Commission Treaty.

Euro Tec Enterprises, Inc. et al. v. Apple Computer, Inc. et al.
This is a purported class action copyright infringement case filed on May 16, 2006 in the United States District Court for the Central District of California by certain independent music publishers against the Company and several other defendants for allegedly failing to secure a compulsory license for copyrighted musical compositions being sold as downloads. Plaintiffs' complaint seeks an injunction, damages and other relief. The Company filed an answer on July 28, 2006 denying all material allegations and asserting numerous affirmative defenses. The case is in discovery and is set for trial on November 13, 2007 if no class is certified or on June 10, 2008 if a class is certified. Plaintiffs filed an amended complaint on October 23, 2006 and the Company filed an amended answer on November 28, 2006 denying all material allegations and asserting numerous affirmative defenses.

Gillis et al. v. Apple Computer, Inc.
Plaintiffs filed this purported class action on December 23, 2005 in San Diego County Superior Court alleging the Company has misrepresented the hard drive capacity of two Powerbook G4 computers: the 12-inch, 1.5GHz computer with 512MB of memory and a 100GB hard drive; and the 15-inch, 1.67GHz computer with 1GB of memory and a 100GB hard drive. Plaintiffs alleged that the Company's standard disclosure on its packaging regarding hard drive size was not present on the packaging for these two models. The complaint alleged violations of the California Business & Professions Code §17200 (unfair competition), California Business & Professions Code §17500 (false advertising), the Consumer Legal Remedies Act, and causes of action for deceit and negligent misrepresentation. Plaintiffs sought restitution and other relief. On February 28, 2006, the Company filed a demurrer and a motion to strike. The Company withdrew the demurrer and motion to strike per stipulation. The Company has reached a Court-approved settlement with the Plaintiffs in this action and the matter is concluded. The settlement of this matter did not have a material effect on the Company's financial position or results of operations.

Goldberg, et al. v. Apple Computer, Inc., et al.
Plaintiffs filed this purported class action on September 22, 2003 in Los Angeles County Superior Court against the Company and other members of the computer industry on behalf of an alleged nationwide class of purchasers of certain computer hard drives. The case alleged violations of California Business & Professions Code §17200 (unfair competition), the Consumer Legal Remedies Act and false advertising related to the size of the drives. Plaintiffs alleged that calculation of hard drive size using the decimal method misrepresents the actual size of the drive. The complaint sought restitution and other relief. Plaintiffs filed an amended complaint on March 30, 2004 and the Company filed an answer on September 23, 2004, denying all allegations and asserting numerous affirmative defenses. Defendants filed a motion to strike portions of the complaint based on sales by resellers and filed a motion for judgment on the pleadings based upon Proposition 64. The Court granted both motions at a hearing on April 6, 2005. Plaintiffs thereafter filed an amended complaint on May 6, 2005. The Defendants filed a demurrer on June 6, 2005, which the Court granted in part and denied in part. Plaintiffs filed an amended complaint and the Company filed an answer on December 15, 2005 denying all allegations and asserting numerous assertive defenses. The Company reached a Court-approved settlement with the Plaintiffs in this action

and the matter is concluded. The settlement of this matter did not have a material effect on the Company's financial position or results of operations.

Gordon v. Apple Computer, Inc.
Plaintiff filed this purported class action on August 31, 2006 in the United States District Court for the Northern District of California, San Jose Division, on behalf of a purported nationwide class of consumers who purchased 65W Power Adapters for iBooks and Powerbooks between November 2002 and the present. The complaint alleges various problems with the 65W Adapter, including fraying, sparking and premature failure. Plaintiffs allege violations of California Business & Professions Code §17200 (unfair competition), the Consumer Legal Remedies Act, the Song-Beverly Consumer Warranty Act and breach of warranties. The complaint seeks damages and equitable relief. The Company filed an answer on October 20, 2006 denying the material allegations and asserting numerous affirmative defenses. Mediation is set for March 13, 2007.

Greaves v. Apple Computer, Inc.
On June 30, 2006 Plaintiff filed this purported class action in San Diego Superior Court on behalf of a purported class of California purchasers alleging discoloration of the MacBook case. Plaintiff asserts claims under California Business & Professions Code §17500 (false advertising), California Business & Professions Code §17200 (unfair competition), the Consumer Legal Remedies Act and misrepresentation. Plaintiff's complaint seeks damages and equitable relief. Plaintiff filed a First Amended Complaint on August 16, 2006. The Company filed an answer on October 3, 2006 denying all allegations and asserting numerous affirmative defenses.

Honeywell International, Inc., et al. v. Apple Computer, Inc., et al.
Plaintiffs Honeywell International, Inc. and Honeywell Intellectual Properties, Inc. filed this action on October 6, 2004 in the United States District Court in Delaware alleging infringement by the Company and other defendants of U.S. Patent 5,280,371 entitled "Directional Diffuser for a Liquid Crystal Display." Plaintiffs seek unspecified damages and other relief. The Company filed an answer on December 21, 2004 denying all material allegations and asserting numerous affirmative defenses. The Company has tendered the case to several LCD manufacturer suppliers. On May 18, 2005 the Court stayed the case against the Company and the other non-manufacturer defendants. Plaintiffs filed an amended complaint on November 7, 2005 adding additional defendants and expanding the scope of the accused products. Given the stay, the Company's response to the amended complaint is not yet due.

In re Apple Computer, Inc. Derivative Litigation (formerly Karant v. Jobs, et al. and Related Actions) (Federal Action)
On June 30, 2006, a putative derivative action captioned *Karant v. Jobs, et. al.*, was filed in the United States District Court for the Northern District of California, San Jose Division. A number of related actions were filed in the subsequent weeks and have been consolidated into a single action captioned *In re Apple Computer, Inc. Derivative Litigation*, Master File No. C-06-04128-JF before the Hon. Jeremy Fogel. A Consolidated Shareholder Derivative Complaint was filed on December 18, 2006. The action purports to assert claims on behalf of the Company against several current and former executive officers and members of the Board of Directors alleging improper backdating of stock option grants to maximize certain defendants' profits, failing to properly account for and take tax deductions for those grants, insider trading and issuing false financial statements. The Company is named as a nominal defendant. The consolidated complaint alleges various causes of action under federal and California law, including claims for unjust enrichment, breach of fiduciary duty, violation of the California Corporations Code, abuse of control, gross mismanagement, rescission, constructive fraud and waste of corporate assets, as well as claims under Sections 10(b), 14(a) and 20(a) of the Securities Exchange Act. Plaintiffs seek damages, disgorgement, restitution and imposition of a constructive trust. The actions were filed after the Company's

announcement on June 29, 2006 that an internal investigation had discovered irregularities related to the issuance of certain stock option grants made between 1997 and 2001, that a special committee of the Company's outside directors had retained independent counsel to perform an investigation, and that the Company had informed the Securities and Exchange Commission. The Company's response to the Consolidated Complaint is not yet due.

In re Apple Computer, Inc. Derivative Litigation (formerly Plumbers and Pipefitters v. Jobs, et al. and Related Actions) (State Action); Boston Retirement Board v. Apple Computer, Inc.
On July 5, 2006, a putative derivative action captioned *Plumbers and Pipefitters v. Jobs, et. al.*, was filed in California Superior Court for the County of Santa Clara. A number of related actions were filed in the subsequent weeks, and have been consolidated into a single action captioned *In re Apple Computer, Inc. Derivative Litigation*, No. 1:06CV066692, assigned to the Hon. Joseph Huber. These actions purport to assert claims on behalf of the Company against several current and former executive officers and members of the Board of Directors alleging improper backdating of stock option grants to maximize certain defendants' profits, failing to properly account for and take tax deductions for those grants and issuing false financial statements. The Company is named as a nominal defendant. A consolidated complaint was filed on October 5, 2006, alleging a variety of causes of action under California law, including claims for unjust enrichment, breach of fiduciary duty, violation of the California Corporations Code, abuse of control, accounting, constructive trust, rescission, deceit, gross mismanagement and waste of corporate assets. On December 7, 2006, the Court granted the Company's motion to stay these actions.

On November 3, 2006, the Boston Retirement Board, a purported shareholder, filed a petition for writ of mandate against the Company in California Superior Court for the County of Santa Clara County (*Boston Retirement Board v. Apple Computer Inc.*). The petition seeks to compel the Company to allow inspection of certain corporate records relating to the Company's option practices and the Special Committee's investigation. The Company's response to the petition is not yet due.

Lenzi v. Apple Canada, Inc.; Wolfe v. Apple Computer, Inc. and Apple Canada, Inc.; Hirst v. Apple Canada, Inc.; Hamilton v. Apple Computer, Inc. and Apple Canada, Inc.
Plaintiff filed a purported class action on June 7, 2005, in Superior Court, in Montreal, Quebec, Canada allegedly on behalf of Quebec customers claiming false advertising and breach of warranty relating to iPod battery life. Plaintiff sought authorization to institute a class action on behalf of Generations 1, 2 and 3 iPod owners in Quebec. On February 2, 2006, the Court dismissed Plaintiff's motion for authorization to institute a class action. Plaintiff has appealed this ruling, and the appeal will be heard on February 22, 2007.

Two similar complaints relative to iPod battery life, *Wolfe v. Apple* and *Hirst v. Apple*, were filed in Toronto, Ontario, Canada on August 15, 2005 and September 12, 2005, respectively. Both actions define the purported class as a national class consisting of all persons in Canada who have purchased or who own an iPod. Counsel has proposed an amended complaint to which the Company has not consented. In addition, a similar complaint regarding iPod battery life, *Hamilton v. Apple Computer, Inc. and Apple Canada, Inc.* was filed in Alberta, Calgary, Canada on October 5, 2005, purportedly on behalf of all purchasers of iPods in Alberta, Canada. That complaint has not been served.

MacTech Systems v. Apple Computer, Inc.; Macadam v. Apple Computer, Inc.; Computer International, Inc. v. Apple Computer, Inc.; Elite Computers and Software, Inc. v. Apple Computer, Inc.; The Neighborhood Computer Store v. Apple Computer, Inc.; MacAccessory Center, Inc. v. Apple Computer, Inc.; Creative Online Computer Services, Inc., DBA MacOnline v. Apple Computer, Inc.; MacGuys, Inc. v. Apple Computer, Inc. (all in Santa Clara County Superior Court)
Eight resellers filed similar lawsuits against the Company between late 2002 and early 2006 asserting various causes of action including breach of contract, fraud, negligent and intentional interference with

economic relationship, negligent misrepresentation, trade libel, unfair competition and false advertising. Plaintiffs requested unspecified damages and other relief. The Company answered the Computer International complaint on November 12, 2003, denying all allegations and asserting numerous affirmative defenses. The Company filed an answer in the Macadam case on December 3, 2004 denying all allegations and asserting numerous defenses. Three of the other Plaintiffs filed amended complaints on February 7, 2005, and on March 16, 2005 the Company filed answers to these claims denying all allegations and asserting numerous affirmative defenses. A sixth Plaintiff, MacAccessory Center, filed a complaint on February 23, 2005. The Company filed an answer to this complaint on April 20, 2005 denying all allegations and asserting numerous affirmative defenses. On February 28, 2006, MacGuys and Creative Online filed complaints against the Company. All of these cases with the exception of Macadam were coordinated for discovery (along with the Branning class action) in Santa Clara Superior Court. The Elite, Neighborhood Computer Store, MacTech and MacAccessory cases were set for trial on November 27, 2006. The Company has reached settlements with Computer International, MacTech Systems, Elite Computers and Software, Inc., MacAccessory Center, Inc., The Neighborhood Computer Store, Creative Online Computer Services, Inc., and MacGuys, Inc. and these matters are concluded. These settlements did not have a material effect on the Company's financial position or results of operations.

On October 1, 2003, one of the reseller Plaintiffs, Macadam, was deauthorized as an Apple reseller. Macadam filed a motion for a temporary order to reinstate it as a reseller, which the Court denied. The Court denied Macadam's motion for a preliminary injunction on December 19, 2003. On December 6, 2004, Macadam filed for Chapter 11 Bankruptcy in the Northern District of California, which placed a stay on the litigation as to Macadam only. The Company filed a claim in the bankruptcy proceedings on February 16, 2005. The Macadam bankruptcy case was converted to Chapter 7 (liquidation) on April 29, 2005. The Company has reached a settlement of the Macadam case with the Chapter 7 Bankruptcy Trustee. The Bankruptcy Court approved the settlement on July 17, 2006 over the objection of Tom Santos, MacAdam's principal. Santos has appealed the ruling approving the settlement.

On December 19, 2005, Tom Santos, who was an original plaintiff in the Macadam case, filed a Fifth Amended Complaint on his own behalf (not on behalf of Macadam) alleging fraud, violations of California Business & Professions Code §17200 (unfair competition), California Business & Professions Code §17500 (false advertising) and the Consumer Legal Remedies Act. The Company filed a demurrer to Santos' amended complaint and a special motion to strike the defamation cause of action on January 20, 2006. Those motions were heard on February 17, 2006, and the Court sustained the demurrer without leave to amend as to one cause of action, overruled the demurrer as to one cause of action and sustained the demurrer with leave to amend as to two causes of action. The Court also denied the special motion to strike. Santos filed a further amended complaint on July 14, 2006. The Company filed a demurrer, which was granted on September 9, 2006. Santos filed an amended complaint. The Company filed a motion to strike, which was granted in part and denied in part on December 15, 2006. The Company also filed a cross complaint against Santos on January 20, 2006 alleging violations of California Business & Professions Code §17200 and California Penal Code §502, fraud and deceit, and breach of contract.

Macsolutions, Inc. v. Apple Computer, Inc.
Plaintiff Macsolutions, Inc., a former Apple authorized reseller, filed this lawsuit against the Company on January 20, 2006 alleging breach of contract, fraud, misappropriation of trade secrets, intentional interference with economic advantage, violation of the Cartwright Act, violation of California Business & Professions Code §17200 (unfair competition) and fraudulent concealment. The factual allegations in this complaint are similar to those in the eight other reseller cases and the Branning class action. Principally, Plaintiffs allege that the Company treated Macsolutions unfairly compared to other resellers, that the Company has competed unfairly in opening the Apple retail stores, and has allegedly sold used goods as new. Macsolutions filed an amended complaint on June 5, 2006, adding Tech Data Corporation as a

defendant. The Company filed an answer on July 5, 2006 generally denying all allegations and asserting numerous affirmative defenses. The case is in discovery. The case is set for trial on June 18, 2007.

PhatRat Technology LLC v. Apple Computer, Inc.
Plaintiff PhatRat Technology LLC filed this action on October 24, 2006 in the United States District Court for the District of Colorado alleging infringement of U.S. Patent number 6,499,000 entitled "System and Method for Determining Loft Time, Speed, Height and Distance," U.S. Patent number 6,885,971 entitled "Methods and Systems for Assessing Athletics Performance," U.S. Patent number 6,963,818 entitled "Mobile Speedometer Systems and Associated Methods," and U.S. Patent number 7,092,846 entitled "Systems and Methods for Determining Performance Data," as well as allowed U.S. Patent Application number 11/358,508 entitled "Shoes Employing Monitoring Devices, and Associated Methods." Plaintiff asserts that the Nike+iPod products infringe these patents. The Company's response to the complaint is not yet due.

Premier International Associates LLC v. Apple Computer, Inc.
Plaintiff Premier International Associates LLC filed this action on November 3, 2005 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement by the Company of U.S. Patent numbers 6,243,725 and 6,763,345 both entitled "List Building System." The complaint seeks unspecified damages and other relief. The Company filed an answer on January 13, 2006 denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counter claims for a declaratory judgment of noninfringement and invalidity. A Markman hearing is set for May 17, 2007 and trial is scheduled for December 3, 2007.

Quantum Technology Management, Ltd. v. Apple Computer, Inc.
Plaintiff filed this action on December 21, 2005 in the United States District Court for the District of Maryland against the Company and Fingerworks, Ltd., alleging infringement of U.S. Patent number 5,730,165 entitled "Time Domain Capacitive Field Detector." The complaint seeks unspecified damages and other relief. On May 11, 2006, Quantum filed an amended complaint adding Cypress Semiconductor/MicroSystems, Inc. as a defendant. On July 31, 2006, the Company filed an answer denying all material allegations and asserting numerous affirmative defenses and also filed counterclaims for non-infringment and invalidity. On November 30, 2006 Plaintiff filed a reply to the Company's counterclaims and a More Definite Statement.

St-Germain v. Apple Canada, Inc.
Plaintiff filed this case in Montreal, Quebec, Canada, on August 5, 2005, seeking authorization to institute a class action for the refund by the Company of the Canadian Private Copying Levy that was applied to the iPod purchase price in Quebec between December 12, 2003 and December 14, 2004 but later declared invalid by the Canadian Court. The Company has completed a refund program for this levy. A class certification hearing took place January 13, 2006. On February 24, 2006, the Court granted class certification and notice was published during the last week of March 2006. Discovery is closed and the case is prepared for trial, which the Company anticipates will take place in 2007.

Tse v. Apple Computer, Inc. et al.
Plaintiff Ho Keung Tse filed this action against the Company and other defendants on August 5, 2005 in the United States District Court for the District of Maryland alleging infringement by the Company of U.S. Patent number 6,665,797 entitled "Protection of Software Again [sic] Against Unauthorized Use." The complaint seeks unspecified damages and other relief. The Company filed an answer on October 31, 2005 denying all material allegations and asserting numerous affirmative defenses. On October 28, 2005, the Company and the other defendants filed a motion to transfer the case to the Northern District of California, which was granted on August 31, 2006.

Tucker v. Apple Computer, Inc.
Plaintiff filed this purported class action on July 21, 2006 in the United States District Court for the Northern District of California alleging various claims including alleged unlawful tying of music and videos purchased on the iTunes Store with the purchase of iPods and vice versa and unlawful acquisition or maintenance of monopoly market power. The complaint alleges violations of §§1 and 2 of the Sherman Act (15 U.S.C. §§1 and 2), California Business & Professions Code §16700 et seq. (the Cartwright Act), California Business & Professions Code §17200 (unfair competition), and the California Consumer Legal Remedies Act. Plaintiff seeks unspecified damages and other relief. On November 3, 2006, the Company filed a motion to dismiss the complaint, which was heard on November 20, 2006. On December 20, 2006, the Court denied the motion to dismiss.

Union Federale des Consummateurs - Que Choisir v. Apple Computer France s.à.r.l. and iTunes s.à.r.l.
Plaintiff, a consumer association in France, filed this complaint on February 9, 2005 alleging that the above-listed entities are violating consumer law by (1) omitting to mention that the iPod is allegedly not compatible with music from online music services other than the iTunes Store and that the music from the iTunes Store is only compatible with the iPod and (2) allegedly tying the sales of iPods to the iTunes Store and vice versa. Plaintiff seeks damages, injunctive relief and other relief. The first hearing on the case took place on May 24, 2005. The Company's response to the complaint was served on November 8, 2005. Plaintiff's responsive pleading was filed on February 10, 2006. The Company filed a reply on June 6, 2006 and UFC filed a response on September 19, 2006.

Vitt v. Apple Computer, Inc.
Plaintiff filed this purported class action on November 7, 2006 in the United States District Court for the Central District of California on behalf of a purported nationwide class of all purchasers of the iBook G4 alleging that the computer's logic board fails at an abnormally high rate. The complaint alleges violations of California Business & Professions Code §17200 (unfair competition) and California Business & Professions Code §17500 (false advertising). Plaintiff seeks unspecified damages and other relief. The Company's response to the complaint is not yet due.

Vogel v. Jobs et al.
Plaintiff filed this purported class action on August 24, 2006, in the United States District Court for the Northern District of California against the Company and certain of the Company's current and former officers and directors alleging improper backdating of stock option grants to maximize certain defendants' profits, failing to properly account for those grants and issuing false financial statements. The lawsuit purports to be brought on behalf of all purchasers of the Company's stock from December 1, 2005 through August 11, 2006, and asserts claims under Sections 10(b) and 14(a) of the Securities Exchange Act as well as control person claims. A motion for appointment of lead plaintiff and counsel was scheduled to be heard on December 4, 2006 but was taken off calendar when the case was re-assigned to the Hon. Jeremy Fogel. The motion therefore is still pending. Defendants' responses to the complaint are not yet due.

Wimmer v. Apple Computer, Inc. (originally filed as *Tomczak v. Apple Computer, Inc.* on October 19, 2005 in the United States District Court for the Northern District of California, San Jose Division; amended complaint filed October 26, 2005); *Moschella, et al., v. Apple Computer, Inc.* (filed October 26, 2005 United States District Court for the Northern District of California, San Jose Division); *Calado, et al. v. Apple Computer, Inc.* (filed October 26, 2005, Los Angeles County Superior Court); *Kahan, et al., v. Apple Computer, Inc.* (filed October 31, 2005, United States District Court for the Southern District of New York); *Jennings, et al., v. Apple Computer, Inc.* (filed November 4, 2005, United States District Court for the Northern District of California, San Jose Division); *Rappel v. Apple Computer, Inc.* (filed on November 23, 2005, United States District Court for the District of New Jersey); *Mayo v. Apple Computer, Inc.* (filed on December 7, 2005, United States District Court for the Middle District of Louisiana); *Valencia v. Apple Computer, Inc.* (filed on December 22, 2005, United States District Court for the Northern District of California); *Williamson v. Apple Computer, Inc.* (filed on December 29, 2005, United States District Court for the Middle District of Louisiana); *Sioson v. Apple Computer, Inc.* (filed on February 9, 2006, San Mateo County Superior Court; First Amended Complaint filed March 16, 2006)

These federal and state court complaints allege that the Company's iPod nano was defectively designed so that it scratches excessively during normal use, rendering the screen unreadable. The federal actions were coordinated in the United States District Court for the Northern District of California and assigned to the Hon. Ronald Whyte pursuant to an April 17, 2006, order of the Judicial Panel on Multidistrict Litigation. Plaintiffs filed a First Consolidated and Amended Master Complaint on September 21, 2006, alleging violations of California and other states' consumer protection and warranty laws and claiming unjust enrichment. The Master Complaint alleges two putative plaintiff classes: (1) all U.S. residents (excluding California residents) who purchased an iPod nano that was not manufactured or designed using processes necessary to ensure normal resistance to scratching of the screen; and (2) all iPod nano purchasers other than U.S. residents who purchased an iPod nano that was not manufactured or designed using processes necessary to ensure normal resistance to scratching of the screen. Pursuant to stipulation, the Wimmer, Valencia, and Rappel federal complaints were dismissed without prejudice and the Mayo and Williamson complaints were administratively closed without prejudice. The Company answered the Master Complaint on November 20, 2006.

The two California state actions were coordinated on May 4, 2006, and assigned to the Hon. West in Los Angeles Superior Court. Plaintiffs filed a Consolidated Amended Class Action Complaint on June 8, 2006, alleging violations of California state consumer protection, unfair competition, false advertising, and warranty laws and claiming unjust enrichment. The Consolidated Complaint alleges a putative plaintiff class of all California residents who own an iPod nano containing a manufacturing defect that results in the nano being susceptible to excessive scratching. The Company answered the Consolidated Amended Complaint on October 6, 2006.

Two similar complaints, *Carpentier v. Apple Canada, Inc.*, and *Royer-Brennan v. Apple Computer, Inc. and Apple Canada, Inc.* were filed in Montreal, Quebec, Canada on October 27, 2005 and November 9, 2005, respectively, seeking authorization to institute class actions on behalf of iPod nano purchasers in Quebec. The Royer-Brennan file was stayed in May 2006 in favor of the Carpentier file, in which Apple's preliminary motion for leave to file evidence will be heard on December 18, 2006. No further dates have been set. A similar complaint, *Mund v. Apple Canada Inc. and Apple Computer, Inc.*, was filed in Ontario, Canada on January 9, 2006 seeking authorization to institute a class action on behalf of iPod nano purchasers in Canada. In the two Quebec class actions, a motion to stay the Royer-Brennan case is stayed in favor of the previously filed Carpentier case. In the Ontario Action, Apple Canada Inc. and Apple Computer, Inc., have served Notices of Intent to defend. On December 18, 2006, plaintiff's counsel advised that a substitution of attorneys will occur, most likely in January 2007. The file is now stayed, and the Company's motion to examine petitioner and for leave to file evidence at certification will be set after the new counsel appears.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of the Company's fiscal year ended September 30, 2006.

PART II

Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities

The Company's common stock is traded on the over-the-counter market and is quoted on the NASDAQ Global Select Market under the symbol AAPL and on the Frankfurt Stock Exchange under the symbol APCD.

Price Range of Common Stock
The price range per share of common stock presented below represents the highest and lowest sales prices for the Company's common stock on the NASDAQ Global Select Market during each quarter of the two most recent fiscal years.

On February 28, 2005, the Company effected a two-for-one stock split to shareholders of record as of February 18, 2005. All share and per share information has been retroactively adjusted to reflect the stock split.

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Fiscal 2006 price range per common share	$ 77.78-$50.16	$ 73.80-$55.41	$ 86.40-$57.67	$ 75.46-$47.87
Fiscal 2005 price range per common share	$ 53.20-$36.37	$ 43.74-$34.13	$ 45.06-$31.58	$ 34.22-$18.65

Holders
As of December 13, 2006, there were 29,317 shareholders of record.

Dividends
The Company did not declare or pay cash dividends in either 2006 or 2005. The Company anticipates that, for the foreseeable future, it will retain any earnings for use in the operation of its business.

Securities Authorized for Issuance under Equity Compensation Plans
The description of equity compensation plans required by Regulation S-K, Item 201(d) is incorporated herein by reference to Part III, Item 12 of this Form 10-K.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers
None.

Item 6. Selected Financial Data

The consolidated balance sheet as of September 24, 2005 and the consolidated statements of operations for the fiscal years ended September 24, 2005 and September 25, 2004 have been restated as set forth in the 2006 Form 10-K. The data for the consolidated balance sheets as of September 2004, 2003, and 2002 and the consolidated statements of operations for the fiscal years ended September 2003 and 2002 have been restated to reflect the impact of the stock-based compensation adjustments, but such restated data have not been audited and is derived from the books and records of the Company. The information set forth below is not necessarily indicative of results of future operations, and should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and related notes thereto included in Item 8 of this Form 10-K to fully understand factors that may affect the comparability of the information presented below. The information presented in the following tables has been adjusted to reflect the restatement of the Company's financial results, which is more fully described in the "Explanatory Note" immediately preceding Part I, Item 1 and in Note 2, "Restatement of Consolidated Financial Statements" in Notes to Consolidated Financial Statements of this Form 10-K.

The Company has not amended its previously-filed Annual Reports on Form 10-K or Quarterly Reports on Form 10-Q for the periods affected by this restatement. The financial information that has been previously filed or otherwise reported for these periods is superseded by the information in this Annual Report on Form 10-K, and the financial statements and related financial information contained in such previously-filed reports should no longer be relied upon.

Five fiscal years ended September 30, 2006 (In millions, except share and per share amounts)	2006	2005 As Restated (1)	2004 As Restated (1)	2003 As Restated (2)	2002 As Restated (2)
Net sales	$ 19,315	$ 13,931	$ 8,279	$ 6,207	$ 5,742
Net income	$ 1,989	$ 1,328	$ 266	$ 57	$ 42
Earnings per common share:					
Basic	$ 2.36	$ 1.64	$ 0.36	$ 0.08	$ 0.06
Diluted	$ 2.27	$ 1.55	$ 0.34	$ 0.08	$ 0.06
Cash dividends declared per common share	$ —	$ —	$ —	$ —	$ —
Shares used in computing earnings per share (in thousands):					
Basic	844,058	808,439	743,180	721,262	710,044
Diluted	877,526	856,878	774,776	723,352	721,445
Cash, cash equivalents, and short-term investments	$ 10,110	$ 8,261	$ 5,464	$ 4,566	$ 4,337
Total assets	$ 17,205	$ 11,516	$ 8,039	$ 6,817	$ 6,305
Long-term debt (including current maturities)	$ —	$ —	$ —	$ 304	$ 316
Total liabilities	$ 7,221	$ 4,088	$ 2,976	$ 2,594	$ 2,205
Shareholders' equity	$ 9,984	$ 7,428	$ 5,063	$ 4,223	$ 4,100

Net gains before taxes related to the Company's non-current debt and equity investments of $4 million and $10 million were recognized in 2004 and 2003, respectively. A net loss before taxes related to the Company's non-current debt and equity investments of $42 million was recognized in 2002. Net charges related to Company restructuring actions of $23 million, $26 million, and $30 million were recognized in 2004, 2003, and 2002, respectively. In 2003, settlement of the Company's forward stock purchase agreement resulted in a gain of $6 million. Net income during 2005 benefited by $81 million from the reversal of certain tax contingency reserves and adjustments to net deferred tax assets, including reductions to valuation allowances. Favorable cumulative-effect type adjustments from the adoption of new accounting standards, net of taxes of $1 million was recognized in 2003.

(1) See the "Explanatory Note" immediately preceding Part I, Item 1 and Note 2, "Restatement of Consolidated Financial Statements," in Notes to Consolidated Financial Statements of this Form 10-K.

(2) The Selected Financial Data for 2003 and 2002 has been restated to reflect adjustments related to stock-based compensation expense and the associated tax impact as further described in the "Explanatory Note" immediately preceding Part I, Item 1 of this Form 10-K. As a result of these adjustments, net income was reduced by $12 million and $23 million for the years ended September 27, 2003 and September 28, 2002, respectively as follows:

	Fiscal Year Ended September 27, 2003			Fiscal Year Ended September 28, 2002		
	As Reported	Adjustments	As Restated	As Reported	Adjustments	As Restated
Net sales	$ 6,207	$ —	$ 6,207	$ 5,742	$ —	$ 5,742
Cost of sales	4,499	1	4,500	4,139	3	4,142
Gross margin	1,708	(1)	1,707	1,603	(3)	1,600
Total operating expenses	1,709	15	1,724	1,586	26	1,612
Operating income (loss)	(1)	(16)	(17)	17	(29)	(12)
Income before accounting changes	68	(12)	56	65	(23)	42
Cumulative effects of accounting changes, net of income taxes	1	—	1	—	—	—
Net income	$ 69	$ (12)	$ 57	$ 65	$ (23)	$ 42
Earnings (loss) per common share before accounting changes:						
Basic	$ 0.09	$ (0.01)	$ 0.08	$ 0.09	$ (0.03)	$ 0.06
Diluted	$ 0.09	$ (0.01)	$ 0.08	$ 0.09	$ (0.03)	$ 0.06
Earnings per common share:						
Basic	$ 0.10	$ (0.02)	$ 0.08	$ 0.09	$ (0.03)	$ 0.06
Diluted	$ 0.09	$ (0.01)	$ 0.08	$ 0.09	$ (0.03)	$ 0.06

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This section and other parts of this Form 10-K contain forward-looking statements that involve risks and uncertainties. Forward-looking statements can also be identified by words such as "anticipates," "expects," "believes," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and the Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Risk Factors" above. The following discussion should be read in conjunction with the consolidated financial statements and notes thereto included in Item 8 of this Form 10-K. All information presented herein is based on the Company's fiscal calendar. Unless otherwise stated, references in this report to particular years or quarters refer to the Company's fiscal years ended in September and the associated quarters of those fiscal years. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

The following information has been adjusted to reflect the restatement of the Company's financial results, which is more fully described in the "Explanatory Note" immediately preceding Part I, Item 1 and in Note 2, "Restatement of Consolidated Financial Statements" in Notes to Consolidated Financial Statements of this Form 10-K. The net of tax impact of the adjustments, which amounted to $4 million in 2006, was recorded by the Company in its fourth quarter of 2006. The net of tax impact of the restatements on the Company's results of operations amounted to $7 million and $10 million in 2005 and 2004, respectively. The impact of these adjustments was not significant to the Company's operating results, trends, or liquidity for the annual or quarterly periods in 2006, 2005, and 2004.

Executive Overview

The Company designs, manufactures, and markets personal computers and related software, services, peripherals, and networking solutions. The Company also designs, develops, and markets a line of portable digital music players along with related accessories and services including the online distribution of third-party music, audio books, music videos, short films, television shows, movies, and iPod games. The Company's products and services include the Macintosh line of desktop and notebook computers, the iPod line of portable digital music players, the Xserve server and Xserve RAID storage products, a portfolio of consumer and professional software applications, the Mac OS X operating system, the iTunes Store, a portfolio of peripherals that support and enhance the Macintosh and iPod product lines, and a variety of other service and support offerings. The Company sells its products worldwide through its online stores, its retail stores, its direct sales force, and third-party wholesalers, resellers, and value-added resellers. In addition, the Company sells a variety of third-party Macintosh and iPod compatible products including application software, printers, storage devices, speakers, headphones, and various other accessories and supplies through its online and retail stores. The Company sells to education, consumer, creative professional, business, and government customers. A further description of the Company's products may be found in Part I, Item 1 of this Form 10-K under the heading "Business."

The Company believes that for both professionals and consumers the personal computer has become the center of an evolving digital lifestyle by integrating and enhancing the utility of advanced digital devices such as the Company's iPods, digital video and still cameras, televisions, CD and DVD players, cellular phones, personal digital assistants, and other consumer electronic devices. The attributes of the personal computer that enable this functionality include a high-quality user interface, easy access to relatively inexpensive data storage, the ability to run complex applications, and the ability to connect easily to a wide variety of other digital devices and to the Internet. The Company is the only participant in the personal computer industry that controls the design and development of the entire personal computer—from the hardware and operating system to sophisticated applications. This, along with its products' innovative industrial designs, intuitive ease-of-use, built-in graphics, multimedia and networking capabilities, uniquely positions the Company to offer innovative integrated digital lifestyle solutions.

The Company's business strategy leverages its ability, through the design and development of its own operating system, hardware, and many software applications and technologies, to bring to its customers around the world compelling new products and solutions with superior ease-of-use, seamless integration, and innovative industrial design.

The Company participates in several highly competitive markets, including personal computers with its Macintosh line of computers, consumer electronics with its iPod line of portable digital music players, and distribution of third-party digital content through its online iTunes Store. While the Company is widely recognized as an innovator in the personal computer and consumer electronic markets as well as a leader in the emerging market for distribution of digital content, these are all highly competitive markets that are subject to aggressive pricing and increased competition. To remain competitive, the Company believes increased investment in research and development ("R&D") and marketing and advertising is necessary to maintain and extend its position in the markets where it competes. The Company's R&D spending is focused on delivering timely updates and enhancements to its existing line of personal computers, displays, operating systems, software applications, and portable digital music players; developing new digital lifestyle consumer and professional software applications; and investing in new product areas such as rack-mount servers, RAID storage systems, and wireless technologies. The Company also believes investment in marketing and advertising programs is critical to increasing product and brand awareness.

In June 2005, the Company announced its plan to begin using Intel microprocessors in its computers. During 2006, the Company introduced new Intel-based models of the MacBook Pro, MacBook, Mac Pro, iMac, and Mac mini computers. The Company's transition to Intel microprocessors for Macintosh systems was completed in August 2006, and its transition for Xserve was completed in November 2006. The MacBook Pro, MacBook, Mac Pro, iMac, and Mac mini feature Mac OS X version 10.4 Tiger, iLife '06, and the Company's new translation technology, Rosetta, which allows most PowerPC-based Macintosh applications to run on Intel-based Macintosh computers. There are potential risks and uncertainties that may occur due to this transition, which are further discussed in Item 1A under the heading "Risk Factors."

The Company utilizes a variety of direct and indirect distribution channels. The Company believes sales of its innovative and differentiated products are enhanced by knowledgeable salespersons who can convey the value of the hardware, software, and peripheral integration, demonstrate the unique digital lifestyle solutions that are available only on Macintosh computers, and demonstrate the compatibility of the Macintosh with the Windows platform and networks. The Company further believes providing a high-quality sales and after-sales support experience is critical to attracting and retaining customers. To ensure a high-quality buying experience for its products in which service and education are emphasized, the Company has expanded and improved its distribution capabilities by opening its own retail stores in the U.S. and internationally. The Company had 165 stores open as of September 30, 2006.

The Company also staffs selected third-party stores with the Company's own employees to improve the buying experience through reseller channels. The Company has deployed Apple employees and contractors in reseller locations around the world including the U.S., Europe, Japan, and Australia. The Company also sells to customers directly through its online stores around the world.

To improve access to the iPod product line, the Company has significantly expanded the number of distribution points where iPods are sold. The iPod product line can be purchased in certain department stores, member-only warehouse stores, large retail chains, and specialty retail stores, as well as through the channels listed above.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles and the Company's discussion and analysis of its financial condition and results of operations require the Company's management to make judgments, assumptions, and estimates that affect the amounts reported in its consolidated financial statements and accompanying notes. Note 1 of the Notes to Consolidated Financial Statements of this Form 10-K describes the significant accounting policies and methods used in the preparation of the Company's consolidated financial statements. Management bases its estimates on historical experience and on various other assumptions it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates and such differences may be material.

Management believes the Company's critical accounting policies and estimates are those related to revenue recognition, allowance for doubtful accounts, inventory valuation and inventory purchase commitments, warranty costs, stock-based compensation, and income taxes. Management believes these policies to be critical because they are both important to the portrayal of the Company's financial condition and results, and they require management to make judgments and estimates about matters that are inherently uncertain. The Company's senior management has reviewed these critical accounting policies and related disclosures with the Audit and Finance Committee of the Company's Board of Directors.

Revenue Recognition

Net sales consist primarily of revenue from the sale of hardware, software, peripherals, digital content, and service and support contracts. The Company recognizes revenue pursuant to applicable accounting standards, including American Institute of Certified Public Accountants Statement of Position ("SOP") No. 97-2, *Software Revenue Recognition*, as amended, and SEC Staff Accounting Bulletin ("SAB") No. 104, *Revenue Recognition.*

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection is probable. Product is considered delivered to the customer once it has been shipped, and title and risk of loss have been transferred. For most of the Company's product sales, these criteria are met at the time the product is shipped. For online sales to individuals, for some sales to education customers in the U.S., and for certain other sales, the Company defers revenue until the customer receives the product because the Company retains a portion of the risk of loss on these sales during transit. If at the outset of an arrangement the Company determines the arrangement fee is not, or is presumed not to be, fixed or determinable, revenue is deferred and subsequently recognized as amounts become due and payable and all other criteria for revenue recognition have been met.

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end-user rebates, and other sales programs and volume-based incentives. For transactions involving price protection, the Company recognizes revenue net of the estimated amount to be refunded, provided the refund amount can be reasonably and reliably estimated and the other conditions for revenue recognition have been met. If refunds cannot be reliably estimated, revenue is not recognized until reliable estimates can be made or the price protection lapses. For customer incentive programs, the estimated cost of these programs is recognized at the later of the date at which the Company has sold the product or the date at which the program is offered. The Company also records reductions to revenue for expected future product returns based on the Company's historical experience. Future market conditions and product transitions may require the Company to increase customer incentive programs and incur incremental price protection obligations that could result in additional reductions to revenue at the time such programs are offered. Additionally, certain customer incentive programs require management to estimate the number of customers who will actually redeem the incentive based on historical experience and the specific terms and conditions of particular incentive programs. If a greater than estimated proportion of customers redeem such incentives, the Company would be required to record additional reductions to revenue, which could have a material adverse impact on the Company's results of operations.

Allowance for Doubtful Accounts

The Company distributes its products through third-party distributors and resellers and directly to certain education, consumer, and commercial customers. The Company generally does not require collateral from its customers; however, the Company will require collateral in certain instances to limit credit risk. In addition, when possible, the Company does attempt to limit credit risk on trade receivables with credit insurance for certain customers in Latin America, Europe, Asia, and Australia and by arranging with third-party financing companies to provide flooring arrangements and other loan and lease programs to the Company's direct customers. These credit-financing arrangements are directly between the third-party financing company and the end customer. As such, the Company generally does not assume any recourse or credit risk sharing related to any of these arrangements. However, considerable trade receivables that are not covered by collateral, third-party flooring arrangements, or credit insurance are outstanding with the Company's distribution and retail channel partners.

The allowance for doubtful accounts is based on management's assessment of the collectibility of specific customer accounts and includes consideration of the credit worthiness and financial condition of those specific customers. The Company records an allowance to reduce the specific receivables to the amount that is reasonably believed to be collectible. The Company also records an allowance for all other trade receivables based on multiple factors including historical experience with bad debts, the general economic environment, the financial condition of the Company's distribution channels, and the aging of such receivables. If there is a deterioration of a major customer's financial condition, if the Company becomes aware of additional information related to the credit worthiness of a major customer, or if future actual default rates on trade receivables in general differ from those currently anticipated, the Company may have to adjust its allowance for doubtful accounts, which would affect earnings in the period the adjustments were made.

Inventory Valuation and Inventory Purchase Commitments
The Company must order components for its products and build inventory in advance of product shipments. The Company records a write-down for inventories of components and products, including third-party products held for resale, which have become obsolete or are in excess of anticipated demand or net realizable value. The Company performs a detailed review of inventory each fiscal quarter that considers multiple factors including demand forecasts, product life cycle status, product development plans, current sales levels, and component cost trends. The personal computer and consumer electronic industries are subject to a rapid and unpredictable pace of product and component obsolescence and demand changes. If future demand or market conditions for the Company's products are less favorable than forecasted or if unforeseen technological changes negatively impact the utility of component inventory, the Company may be required to record additional write-downs which would negatively affect gross margins in the period when the write-downs were recorded.

The Company accrues reserves for estimated cancellation fees related to component orders that have been cancelled or are expected to be cancelled. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. These commitments typically cover the Company's requirements for periods ranging from 30 to 150 days. If there is an abrupt and substantial decline in demand for one or more of the Company's products or an unanticipated change in technological requirements for any of the Company's products, the Company may be required to record additional reserves for cancellation fees that would negatively affect gross margins in the period when the cancellation fees are identified.

Warranty Costs
The Company provides currently for the estimated cost for hardware and software warranties at the time the related revenue is recognized based on historical and projected warranty claim rates, historical and projected cost-per-claim, and knowledge of specific product failures that are outside of the Company's typical experience. Each quarter, the Company reevaluates its estimates to assess the adequacy of its recorded warranty liabilities considering the size of the installed base of products subject to warranty protection and adjusts the amounts as necessary. If actual product failure rates or repair costs differ from estimates, revisions to the estimated warranty liability would be required and could negatively affect the Company's results of operations.

The Company periodically provides updates to its applications and system software to maintain the software's compliance with specifications. The estimated cost to develop such updates is accounted for as warranty costs that are recognized at the time related software revenue is recognized. Factors considered in determining appropriate accruals related to such updates include the number of units delivered, the number of updates expected to occur, and the historical cost and estimated future cost of the resources necessary to develop these updates.

Stock-Based Compensation
The Company accounts for stock-based compensation in accordance with SFAS No. 123R. Under the provisions of SFAS No. 123R, stock-based compensation cost is estimated at the grant date based on the award's fair value as calculated by the Black-Scholes-Merton ("BSM") option-pricing model and is recognized as expense ratably over the requisite service period. The BSM model requires various highly

judgmental assumptions including volatility, forfeiture rates, and expected option life. If any of the assumptions used in the BSM model change significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period.

In connection with the Company's restatement of its consolidated financial statements, the Company has applied judgment in choosing whether to revise measurement dates for prior option grants. Information regarding the restatement, including ranges of possible additional stock-based compensation expense if other measurement dates had been selected for certain grants, is set forth in the "Explanatory Note" immediately preceding Part I, Item 1 and in Note 2, "Restatement of Consolidated Financial Statements" in Notes to Consolidated Financial Statements of this Form 10-K.

Income Taxes

The Company records a tax provision for the anticipated tax consequences of the reported results of operations. In accordance with SFAS No. 109, *Accounting for Income Taxes*, the provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. The Company records a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized.

Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets. In the event that all or part of the net deferred tax assets are determined not to be realizable in the future, an adjustment to the valuation allowance would be charged to earnings in the period such determination is made. Similarly, if the Company subsequently realizes deferred tax assets that were previously determined to be unrealizable, the respective valuation allowance would be reversed, resulting in a positive adjustment to earnings in the period such determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with management's expectations could have a material impact on the Company's results of operations and financial position.

Net Sales

Net sales and Macintosh unit sales by operating segment and net sales and unit sales by product follow (net sales in millions and unit sales in thousands):

	September 30, 2006	Change	September 24, 2005	Change	September 25, 2004
Net Sales by Operating Segment:					
Americas net sales	$ 9,307	41%	$ 6,590	64%	$ 4,019
Europe net sales	4,094	33%	3,073	71%	1,799
Japan net sales	1,208	31%	920	36%	677
Retail net sales	3,359	43%	2,350	98%	1,185
Other Segments net sales (a)	1,347	35%	998	67%	599
Total net sales	$ 19,315	39%	$ 13,931	68%	$ 8,279
Unit Sales by Operating Segment:					
Americas Macintosh unit sales	2,432	11%	2,184	30%	1,682
Europe Macintosh unit sales	1,346	18%	1,138	47%	773
Japan Macintosh unit sales	304	(3)%	313	8%	291
Retail Macintosh unit sales	886	45%	609	94%	314
Other Segments Macintosh unit sales (a)	335	16%	290	26%	230
Total Macintosh unit sales	5,303	17%	4,534	38%	3,290
Net Sales by Product:					
Desktops (b)	$ 3,319	(3)%	$ 3,436	45%	$ 2,373
Portables (c)	4,056	43%	2,839	11%	2,550
Total Macintosh net sales	7,375	18%	6,275	27%	4,923
iPod	7,676	69%	4,540	248%	1,306
Other music related products and services (d)	1,885	110%	899	223%	278
Peripherals and other hardware (e)	1,100	(2)%	1,126	18%	951
Software, service, and other sales (f)	1,279	17%	1,091	33%	821
Total net sales	$ 19,315	39%	$ 13,931	68%	$ 8,279
Unit Sales by Product:					
Desktops (b)	2,434	(3)%	2,520	55%	1,625
Portables (c)	2,869	42%	2,014	21%	1,665
Total Macintosh unit sales	5,303	17%	4,534	38%	3,290
Net sales per Macintosh unit sold (g)	$ 1,391	1%	$ 1,384	(7)%	$ 1,496
iPod unit sales	39,409	75%	22,497	409%	4,416
Net sales per iPod unit sold (h)	$ 195	(3)%	$ 202	(32)%	$ 296

Notes:

(a) Other Segments include Asia Pacific and FileMaker.

(b) Includes iMac, eMac, Mac mini, Mac Pro, Power Mac, and Xserve product lines.

(c) Includes MacBook, iBook, MacBook Pro, and PowerBook product lines.

(d) Consists of iTunes Store sales, iPod services, and Apple-branded and third-party iPod accessories.

(e) Includes sales of Apple-branded and third-party displays, wireless connectivity and networking solutions, and other hardware accessories.

(f) Includes sales of Apple-branded operating system, application software, third-party software, AppleCare, and Internet services.

(g) Derived by dividing total Macintosh net sales by total Macintosh unit sales.

(h) Derived by dividing total iPod net sales by total iPod unit sales.

Fiscal Year 2006 versus 2005

Net sales during 2006 increased 39% or $5.4 billion from 2005. This increase was due in part to the fact that 2006 spanned 53 weeks while 2005 spanned 52 weeks. Several other factors contributed to these increases including the following:

- Net sales of iPods increased $3.1 billion or 69% during 2006 compared to 2005. Unit sales of iPods totaled 39.4 million in 2006, which represents an increase of 75% from 22.5 million iPod units sold in 2005. Strong iPod sales during 2006 reflected significant sales of both the hard-drive based iPod that supports video, first introduced in October of 2005 and the iPod nano, introduced in September 2005, as well as continued expansion of iPod distribution points. During 2006, the net sales per iPod unit sold decreased by 3% compared to 2005 primarily due to an overall decrease in average selling prices for all iPods as well as a shift in product mix to the iPod nano. From the introduction of the iPod in 2002 through 2006, the Company has sold approximately 68 million iPods.
- Macintosh net sales increased $1.1 billion or 18% during 2006 compared to 2005. Macintosh unit sales increased by 769,000 units or 17% during 2006 compared to 2005. These increases were mainly due to strong demand for the Intel-based MacBook and MacBook Pro systems and reflect a shift in product mix to portable products in all of the Company's operating segments. Net sales and unit sales of the Company's portable products increased 43% and 42%, respectively, during 2006 compared to 2005. Macintosh desktop net sales and unit sales both decreased by 3% during 2006 compared to 2005. The decrease in sales of the Company's Macintosh desktops was due to declines in sales of the Company's professional-oriented desktop products. The Company believes the decline in the Company's professional-oriented desktop products was due to customers delaying purchases of such products in anticipation of the release of the Intel-based Mac Pro, which did not begin shipping until August 2006, and updated software applications capable of running on Intel-based Macintosh computers, and the trend toward portable computers. A slight increase of 1% during 2006 in net sales per Macintosh unit sold was due to a shift in mix to higher-priced portable products, partially offset by price reductions on certain Macintosh systems.
- Other music related products and services consists of sales associated with the iTunes Store and iPod services and accessories. Net sales of other music related products and services increased $986 million or 110% during 2006 compared to 2005. The increase was primarily due to increased net sales from the iTunes Store and Apple-branded and third-party iPod accessories and services. The increase in sales from the iTunes Store stemmed from significant growth in U.S. sales and the opening of The iTunes Store in Japan during August 2005 and Australia during October 2005. The increased sales from the iTunes Store were also attributable to the availability of videos, television shows, and feature-length movie downloads.
- Net sales of software, service, and other sales increased $188 million or 17% during 2006 compared to 2005. The growth was primarily attributable to increased net sales of AppleCare Protection Plan ("APP") extended service and support contracts and application software, partially offset by a decrease in sales of Mac OS X. Mac OS X sales were particularly high in 2005 due to the release of Mac OS X Tiger in April 2005.

Offsetting the favorable factors discussed above, the Company's net sales during 2006 were negatively impacted by the following:

- Net sales of peripherals and other hardware declined $26 million or 2% compared to 2005 primarily due to price decreases and a decrease in net sales of displays relating to a shift in mix from desktop to portable systems. The decrease in net sales of displays for 2006 is consistent with the overall decrease in unit sales of Macintosh professional desktop systems.

Fiscal Year 2005 versus 2004
During 2005, net sales increased 68% or $5.7 billion from 2004. Several factors contributed favorably to net sales during 2005:

- Net sales of iPods rose $3.2 billion or 248% during 2005 compared to 2004. Unit sales of iPods totaled 22.5 million in 2005, which represented an increase of 409% from the 4.4 million iPod units sold in 2004. Strong sales of iPods during 2005 were experienced in all of the Company's operating segments and was driven by strong demand for the iPod shuffle introduced in January 2005, the release of an updated version of the iPod mini in February 2005, the release of the iPod nano in September 2005, and expansion of the iPod's distribution network. Net sales per iPod unit sold decreased 32% primarily due to the introduction of the lower priced iPod shuffle in January 2005 and iPod mini pricing reductions in February 2005. From the introduction of the iPod in 2002 through 2005, the Company had sold approximately 28 million iPods.

- Net sales of other music related products and services increased $621 million or 223% during 2005 compared to 2004. The Company experienced strong growth in sales of iPod services and accessories consistent with the increase in overall iPod unit sales for 2005. The increased sales from the iTunes Store were primarily due to substantial growth of net sales in the U.S. and expansion in Europe, Canada, and Japan.

- Total Macintosh net sales increased $1.4 billion or 27% during 2005 compared to 2004. Unit sales of Macintosh systems increased 1.2 million units or 38% during 2005 compared to 2004. The increases in Macintosh net sales and unit sales related primarily to strong demand for the Company's desktop products, which was experienced in all of the Company's operating segments. The Company believes that the success of the iPod had a positive impact on Macintosh net sales by introducing new customers to the Company's other products. Desktop demand was stimulated in 2005 due to the iMac G5 and the introduction of the Mac mini in January 2005. Net sales and unit sales of desktop products increased 45% and 55%, respectively, during 2005 compared to 2004. Macintosh net sales and unit sales also included sales of the Company's portable products, which increased 11% and 21%, respectively, compared to 2004.

  Net sales per Macintosh unit sold decreased 7% on a year-over-year basis. The decrease was the result of changes in the overall unit mix towards relatively lower-priced consumer products, specifically the impact of the Mac mini product, and desktop and portable price reductions. This decrease was partially offset by an increase in the proportion of direct sales.

- Net sales of peripherals and other hardware rose by 18% during 2005 compared to 2004 primarily due to an increase in net sales of displays and other computer accessories. Net sales of other hardware include AirPort cards and base stations, Xserve RAID storage, iSight digital video cameras, and third-party hardware products.

- Net sales of software, service and other sales rose $270 million or 33% during 2005 compared to 2004. This growth was primarily attributable to increased net sales in APP extended service and support contracts, driven primarily by higher associated Macintosh computer sales. Additionally, the Company experienced increases in net sales of .Mac Internet service, professional and consumer applications, third-party software, and Mac OS X that was primarily attributable to the release of version 10.4 Tiger in April 2005.

Segment Operating Performance
The Company manages its business primarily on a geographic basis. The Company's reportable operating segments are comprised of the Americas, Europe, Japan, and Retail. The Americas, Europe, and Japan reportable segments do not include activities related to the Retail segment. The Americas segment includes both North and South America. The Europe segment includes European countries as well as the

Middle East and Africa. The Retail segment operated Apple-owned retail stores in the U.S., Canada, Japan, and the U.K. during 2006. Each reportable geographic operating segment provides similar hardware and software products and similar services. Further information regarding the Company's operating segments may be found in Note 11, "Segment Information and Geographic Data" in Notes to Consolidated Financial Statements of this Form 10-K.

Americas

During 2006, net sales in the Americas segment increased $2.7 billion, or 41%, compared to 2005. The main factors for this increase were significant increases in net sales of iPods, other music related products and services, Macintosh portable systems, and APP. Sales of iPods increased primarily due to the introduction of the updated iPod with video-playing capabilities in October 2005 and the iPod nano during September 2005. The increase in other music related products and services was due to increases in sales of Apple-branded and third-party iPod accessories and sales from the iTunes Store. The increase in sales of Macintosh portable systems in the Americas was due to strong sales of the Intel-based MacBook and MacBook Pro during 2006. The overall increase in net sales was partially offset by a decline in net sales of desktops, displays, and Mac OS X. The decrease in desktop products and displays net sales reflects the overall shift in product mix toward portable Macintosh systems. Mac OS X sales decreased from 2005 since the Company has not released a new version of Mac OS X since Tiger began shipping in April 2005. During 2006, the Americas segment represented approximately 48% of the Company's total net sales as compared to 47% in the same period of 2005. During 2006, U.S. education channel net sales and Macintosh unit sales increased by 13% and 11%, respectively, compared to 2005. Net sales from the higher education market grew 22% during 2006 compared to 2005 due to strong sales of Macintosh portable products and iPods. Net sales were relatively flat for K-12 due to continued budget constraints.

During 2005, net sales in the Americas segment grew 64% or $2.6 billion compared to 2004. The increase in net sales during 2005 was primarily attributable to the significant year-over-year increase in iPod sales, sales of other music related products and services, and strong sales of desktop and portable Macintosh systems. This increase was partially offset by a shift in sales to the Retail segment, which had 117 stores in the U.S. and Canada as of the end of 2005. Macintosh unit sales also increased by 30% in 2005 compared to 2004, driven primarily by strong sales of desktop systems largely attributable to strong sales from the updated iMac, which began shipping in September 2004, and the Mac mini, which was introduced in January 2005. During 2005 and 2004, the Americas segment represented approximately 47% and 49%, respectively, of the Company's total net sales and represented approximately 48% and 51%, respectively, of total Macintosh unit sales. The Company experienced an increase in both U.S. education channel net sales and unit sales of 21% for 2005 compared to 2004. Strength in higher education sales related primarily to strong iMac and portable system shipments. This strength drove year-over-year growth in net sales of 32% for the higher education channel during 2005. Despite challenges in the K-12 market from continued budget constraints and competitive pressures, the Company's K-12 net sales grew year-over-year by 11% during 2005 due to increased iBook sales and 1:1 education sales.

Europe

Europe segment net sales increased $1.0 billion or 33% during 2006 compared to 2005. Consistent with the Americas segment, these increases were a result of strong growth in iPod sales, other music related products and services, and Macintosh portable systems. Sales of iPods increased primarily due to the introduction of the updated iPod with video-playing capabilities in October 2005 and the iPod nano during September 2005. The increase in other music related products and services was due to increases in sales of Apple-branded and third-party iPod accessories and sales from the iTunes Store. The increase in sales of portable systems in Europe was due to strong sales of the Intel-based MacBook and MacBook Pro that were introduced during 2006. In addition, Europe also reported increased sales in APP related to the increase in Macintosh unit sales. These increases were partially offset by a decrease in desktop and

Mac OS X net sales during 2006 compared to 2005. The decrease in desktop net sales was due to the shift in product mix toward portable Macintosh systems. Mac OS X sales have decreased from 2005 since the Company has not released a new version of Mac OS X since Tiger began shipping in April 2005.

During 2005, net sales in the Europe segment grew $1.3 billion or 71% from 2004. Total Macintosh unit sales in Europe also experienced growth during the current year by increasing 47% in 2005 compared to 2004. Consistent with the Americas segment, Europe experienced strong net sales of desktop products, iPod, other music related products and services, and software and service sales. Demand in Europe during 2005 was particularly strong for the Company's desktop computers, which experienced a year-over-year increase of 56% from 2004. Similar to the results of the Company's other segments, net sales of iPods, peripherals and software were strong in 2005.

Japan

Japan's net sales increased $288 million or 31% during 2006 compared to 2005. The Japan segment experienced increased net sales in iPods, Macintosh portable products, and other music related products and services. Consistent with the Company's other segments, Japan experienced increases in sales of iPods due to the introduction of the iPod with video-playing capabilities and the iPod nano in October and September of 2005, respectively. Japan also experienced strong sales of the Intel-based MacBook and increased sales from the iTunes Store. These increases were partially offset by decreases in net sales of Macintosh desktop products, displays, and Mac OS X. The decreases in desktop products and displays reflect the overall shift in product mix toward portable Macintosh systems. Mac OS X sales have decreased from 2005 since the Company has not released a new version of Mac OS X since Tiger began shipping in April 2005. Total Macintosh unit sales during 2006 remained relatively flat compared to 2005. The relatively flat growth in Macintosh unit sales is partially attributable to Japan's overall slow consumer PC market growth. The Company is continuing to evaluate ways to improve its indirect and direct channel sales in Japan.

Japan's net sales and Macintosh unit sales were up 36% and 8%, respectively, during 2005 compared to 2004. Japan experienced increased net sales in desktop products, iPod, and other music related products and services. Desktop net sales and unit sales increased by 31% and 41%, respectively, and iPod sales increased by 220% during 2005 compared to 2004. The overall increase in net sales was partially offset by a decline in portable system net sales during 2005 compared to 2004, which the Company believes might have been attributable to a shift in sales from portables to the iMac G5 and Mac mini, and a shift to the Retail segment as a result of opening two additional stores in Japan during 2005.

Retail

The Company opened 41 new retail stores during 2006, including a total of 10 international stores in the U.K., Japan, and Canada, bringing the total number of open stores to 165 as of September 30, 2006. This compares to 124 open stores as of September 24, 2005 and 86 open stores as of September 25, 2004.

The Retail segment's net sales increased by 43% to $3.4 billion during 2006 compared to 2005. Retail segment Macintosh unit sales increased 45% during 2006 compared to 2005. With an average of 142 stores open during 2006, average revenue per store increased to $23.6 million compared to $22.4 million during 2005 and $15.6 million in 2004. The current year increase was primarily due to strong sales of Macintosh portable and desktop products, iPods, and other music related products and services. Sales of iPods increased primarily due to the introduction of the updated iPod with video-playing capabilities in October 2005 and the iPod nano during September 2005. The increase in other music related products and services was due to increased sales of Apple-branded and third-party iPod accessories. Macintosh portable and desktop sales increased due to strong sales of the Intel-based MacBook, MacBook Pro, and iMac.

As measured by the Company's operating segment reporting, the Retail segment reported operating income of $198 million during 2006 as compared to operating income of $151 million during 2005 and operating income of $39 million during 2004. This improvement was primarily attributable to the impact of opening new stores and the segment's year-over-year increase in average revenue per store, which resulted in higher leverage on occupancy, depreciation, and other fixed costs.

Expansion of the Retail segment has required and will continue to require a substantial investment in fixed assets and related infrastructure, operating lease commitments, personnel, and other operating expenses. Capital expenditures associated with the Retail segment were $200 million in 2006, bringing the total capital expenditures since inception of the Retail segment to approximately $729 million. As of September 30, 2006, the Retail segment had approximately 5,787 employees and had outstanding operating lease commitments associated with retail store space and related facilities of approximately $887 million. The Company would incur substantial costs if it were to close its retail stores. Such costs could adversely affect the Company's results of operations and financial condition.

Gross Margin

Gross margin for each of the last three fiscal years are as follows (in millions, except gross margin percentages):

	September 30, 2006	September 24, 2005 As Restated (1)	September 25, 2004 As Restated (1)
Net sales	$ 19,315	$ 13,931	$ 8,279
Cost of sales	13,717	9,889	6,022
Gross margin	$ 5,598	$ 4,042	$ 2,257
Gross margin percentage	29.0%	29.0%	27.3%

(1) See the "Explanatory Note" immediately preceding Part I, Item 1 and Note 2, "Restatement of Consolidated Financial Statements" in Notes to Consolidated Financial Statements of this Form 10-K.

Gross margin percentage of 29.0% in 2006 remained flat as compared to 2005. The Company experienced more favorable pricing on certain commodity components including LCD flat-panel displays and DRAM memory and higher overall revenue that provided for more leverage on fixed production costs, offset by an increase in lower margin iPod sales and other music-related services.

The Company anticipates that its gross margin and the gross margins of the personal computer and consumer electronics industries will be under pressure due to price competition. The Company expects gross margin percentage to decline sequentially in the first quarter of 2007 primarily as a result of a shift in the mix of revenue toward lower margin products such as the iPod and content from the iTunes Store.

The foregoing statements regarding the Company's expected gross margin percentage are forward-looking. There can be no assurance that current gross margin percentage will be maintained or targeted gross margin percentage levels will be achieved. In general, gross margins and margins on individual products, including iPods, will remain under significant downward pressure due to a variety of factors, including continued industry wide global pricing pressures, increased competition, compressed product life cycles, potential increases in the cost and availability of raw material and outside manufacturing services, and potential changes to the Company's product mix, including higher unit sales of consumer products with lower average selling prices and lower gross margins. In response to these competitive pressures, the Company expects it will continue to take pricing actions with respect to its products. Gross margins could also be affected by the Company's ability to effectively manage product quality and warranty costs and to stimulate demand for certain of its products. Due to the Company's significant international operations, financial results can be significantly affected in the short-term by fluctuations in exchange rates.

The Company orders components for its products and builds inventory in advance of product shipments. Because the Company's markets are volatile and subject to rapid technology and price changes, there is a risk the Company will forecast incorrectly and produce or order from third-parties excess or insufficient inventories of particular products or components. The Company's operating results and financial condition in the past have been and may in the future be materially adversely affected by the Company's ability to manage its inventory levels and outstanding purchase commitments and to respond to short-term shifts in customer demand patterns.

Gross margin percentage increased in 2005 to 29.0% of net sales from 27.3% of net sales in 2004. The Company's gross margin during 2005 increased due to more favorable pricing on certain commodity components including LCD flat-panel displays and DRAM memory; an increase in higher margin software sales; a favorable shift in direct sales related primarily to the Company's retail and online stores; and higher overall revenue that provided for more leverage on fixed production costs. These increases to gross margin were partially offset by an increase in lower margin iPod sales.

Operating Expenses
Operating expenses for each of the last three fiscal years are as follows (in millions, except for percentages):

	September 30, 2006	September 24, 2005 As Restated (1)	September 25, 2004 As Restated (1)
Research and development	$ 712	$ 535	$ 491
Percentage of net sales	4%	4%	6%
Selling, general, and administrative expenses	$ 2,433	$ 1,864	$ 1,430
Percentage of net sales	13%	13%	17%
Restructuring costs	$ —	$ —	$ 23

(1) See the "Explanatory Note" immediately preceding Part I, Item 1 and Note 2, "Restatement of Consolidated Financial Statements," in Notes to Consolidated Financial Statements of this Form 10-K.

Research and Development (R&D)
Expenditures for R&D increased 33% or $177 million to $712 million in 2006 compared to $535 million in 2005. The increase was due primarily to an increase in R&D headcount in the current year to support expanded R&D activities, an increase of $46 million in stock-based compensation recognized as R&D expense resulting from the adoption of SFAS No. 123R, and higher overall expenses due to the 14th week added to the first fiscal quarter of 2006 to realign the Company's fiscal quarters with calendar quarters. In addition, during 2005, the Company capitalized approximately $29.7 million of costs associated with the development of Mac OS X Tiger. No software development costs were capitalized during 2006. Further information related to the Company's capitalization of software development costs may be found in Part II, Item 8 of this Form 10-K at Note 1 of Notes to Consolidated Financial Statements. Despite the increase in expenditures, R&D as a percentage of net sales remained relatively flat in 2006 as compared to 2005 due to the significant increase in revenue. The Company continues to believe that focused investments in R&D are critical to its future growth and competitive position in the marketplace and are directly related to timely development of new and enhanced products that are central to the Company's core business strategy. As such, the Company expects to make further investments in R&D to remain competitive.

Selling, General, and Administrative Expense (SG&A)
Expenditures for SG&A increased $569 million or 31% during 2006 compared to 2005. These increases are due primarily to the Company's continued expansion of its Retail segment in both domestic and international markets, an increase of $50 million in stock-based compensation expense recognized as

SG&A expense resulting from the adoption of SFAS No. 123R, a current year increase in discretionary spending on marketing and advertising, higher direct and channel selling expenses resulting from the increase in net sales and employee salary merit increases, and the expenses associated with the 14th week added to the first fiscal quarter of 2006. Despite the increase in expenditures, SG&A as a percentage of total net sales in 2006 remained flat as compared to 2005.

Expenditures for SG&A increased $434 million or 30% during 2005 compared to 2004. These increases are due primarily to the Company's continued expansion of its Retail segment in both domestic and international markets, a current year increase in discretionary spending on marketing and advertising, and higher direct and channel selling expenses resulting from the increase in net sales and employee salary merit increases. SG&A as a percentage of total net sales in 2005 was 13%, down from 17% in 2004, which is due to the increase in total net sales of 68% for the Company during 2005.

Fiscal 2004 Restructuring Actions
During 2004, the Company recorded total restructuring charges of approximately $23.0 million, including approximately $14.0 million in severance costs, $5.5 million in asset impairments, and $3.5 million for lease cancellations. The lease cancellations relate to vacating a leased sales facility as a result of a European workforce reduction during 2004. Of the $23.0 million charges, $21.3 million had been utilized by the end of 2006, with the remainder consisting of $1.7 million for lease cancellations. These actions resulted in the termination of 452 positions.

Other Income and Expense
Other income and expense for each of the last three fiscal years are as follows (in millions):

	September 30, 2006	September 24, 2005	September 25, 2004
Gains on non-current investments, net	$ —	$ —	$ 4
Interest income	$ 394	$ 183	$ 64
Interest expense	—	—	(3)
Other income (expense), net	(29)	(18)	(8)
Interest and other income, net	$ 365	$ 165	$ 53
Total other income and expense	$ 365	$ 165	$ 57

Gains and Losses on Non-current Investments
The Company previously held significant investments in ARM Holdings plc (ARM), Akamai Technologies, Inc. (Akamai), and EarthLink Network, Inc. (EarthLink). The Company sold all of the remaining holdings in these non-current investments in 2004 and 2003. Pretax gains recorded upon the sale of these non-current investments were $4 million in 2004.

Interest and Other Income, Net
Total interest and other income, net increased $200 million or 121% to $365 million during 2006 compared to $165 million in 2005 and $53 million in 2004. These increases are attributable primarily to higher cash and short-term investment balances and increasing investment yields resulting from higher market interest rates and the 14th week added to the first fiscal quarter of 2006. The weighted average interest rate earned by the Company on its cash, cash equivalents, and short-term investments increased to 4.58% in 2006 compared to the 2.70% and 1.38% rates earned during 2005 and 2004, respectively. The current year increase in other income was partially offset by higher foreign currency hedging expenses.

Interest expense in 2004 consisted primarily of interest on the Company's $300 million aggregate principal amount unsecured notes, which were repaid upon their maturity in February 2004. The unsecured notes were sold at 99.925% of par for an effective yield to maturity of 6.51%. Total deferred gain resulting from the closure of debt swaps of approximately $23 million was fully amortized as of the notes' maturity in February 2004.

Provision for Income Taxes
The Company's effective tax rate for the year ended September 30, 2006 was approximately 29%. The Company's effective rate differs from the statutory federal income tax rate of 35% due primarily to certain undistributed foreign earnings for which no U.S. taxes are provided because such earnings are intended to be indefinitely reinvested outside the U.S. In addition, the Company recorded a tax benefit of $20 million due to settlement of prior year tax audits in the U.S., and a net benefit of $20 million resulting from the dividend repatriation under the American Jobs Creation Act of 2004 ("AJCA") and international tax planning strategies associated with the repatriation as further discussed below.

As of September 30, 2006, the Company had deferred tax assets arising from deductible temporary differences, tax losses, and tax credits of $739 million before being offset against certain deferred liabilities and a valuation allowance for presentation on the Company's balance sheet. Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets. As of September 30, 2006 and September 24, 2005, a valuation allowance of $5 million was recorded against the deferred tax asset for the benefits of state operating losses that may not be realized. The Company will continue to evaluate the realizability of the deferred tax assets quarterly by assessing the need for and amount of the valuation allowance.

On October 22, 2004, the AJCA was signed into law. The AJCA included a provision for the deduction of 85% of certain foreign earnings that were repatriated, as defined in the AJCA, within a specified time frame. Among other requirements, dividends qualifying for the 85% deduction must be reinvested in the United States in certain qualified investments pursuant to a domestic reinvestment plan approved by the CEO and Board of Directors. During 2006, the Company repatriated approximately $1.6 billion of foreign earnings. Of the earnings repatriated, $755 million is eligible for the reduced tax rate provided by the AJCA. Accordingly, the Company recorded a tax charge of $51 million related to the repatriation of foreign earnings under the provisions of the AJCA. In addition, the Company recorded a tax benefit of $71 million resulting from the implementation of tax planning strategies to recognize deferred tax assets that were previously not recognizable within certain foreign subsidiaries.

The Internal Revenue Service ("IRS") has substantially completed its field audit of the Company's federal income tax returns for the years 2002 through 2003 and proposed certain adjustments. The Company intends to contest certain of these adjustments through the IRS Appeals Office. Substantially all IRS audit issues for years prior to 2002 have been resolved. In addition, the Company is subject to audits by state, local, and foreign tax authorities. Management believes that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. Should any issues addressed in the Company's tax audits be resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs.

Quarterly Financial Information

The following tables set forth a summary of the Company's quarterly financial information for each of the four quarters in the years ended September 30, 2006 and September 24, 2005 (in millions, except share and per share amounts):

2006	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Net sales	$ 4,837	$ 4,370	$ 4,359	$ 5,749
Cost of sales (1)	3,425	3,045	3,062	4,185
Gross margin	1,412	1,325	1,297	1,564
Operating expenses:				
Research and development (1)	179	175	176	182
Selling, general, and administrative (1)	625	584	592	632
Total operating expenses	804	759	768	814
Operating income	608	566	529	750
Other income and expense	113	95	76	81
Income before provision for income taxes	721	661	605	831
Provision for income taxes	179	189	195	266
Net income	$ 542	$ 472	$ 410	$ 565
Earnings per common share:				
Basic	$ 0.63	$ 0.55	$ 0.49	$ 0.68
Diluted	$ 0.62	$ 0.54	$ 0.47	$ 0.65
Shares used in computing earnings per share (in thousands):				
Basic	854,187	851,375	840,910	830,781
Diluted	878,757	876,368	878,537	874,207

(1) Includes stock-based compensation expense, which was allocated as follows:

Cost of sales	$ 5	$ 6	$ 5	$ 5
Research and development	$ 13	$ 12	$ 13	$ 15
Selling, general, and administrative	$ 22	$ 19	$ 24	$ 24

The net of tax impact of the stock-based compensation adjustments in 2006, which amounted to $4 million, was recorded by the Company in its fourth quarter of 2006 and are described in the Explanatory Note immediately preceding Part I, Item 1 and Note 2, "Restatement of Consolidated Financial Statements," in Notes to Consolidated Financial Statements of this Form 10-K.

2005	Fourth Quarter As Restated (1)	Third Quarter As Restated (1)	Second Quarter As Restated (1)	First Quarter As Restated (1)
Net sales	$ 3,678	$ 3,520	$ 3,243	$ 3,490
Cost of sales (2)	2,643	2,476	2,275	2,495
Gross margin	1,035	1,044	968	995
Operating expenses:				
Research and development (2)	147	145	120	123
Selling, general, and administrative (2)	471	473	448	472
Total operating expenses	618	618	568	595
Operating income	417	426	400	400
Other income and expense	60	46	33	26
Income before provision for income taxes	477	472	433	426
Provision for income taxes	49	153	145	133
Net income	$ 428	$ 319	$ 288	$ 293
Earnings per common share:				
Basic	$ 0.52	$ 0.39	$ 0.36	$ 0.37
Diluted	$ 0.49	$ 0.37	$ 0.34	$ 0.35
Shares used in computing earnings per share (in thousands):				
Basic	821,420	815,092	808,172	789,032
Diluted	866,483	860,803	857,568	838,805

(1) See the "Explanatory Note" immediately preceding Part I, Item 1 and Note 2, "Restatement of Consolidated Financial Statements," in Notes to Consolidated Financial Statements of this Form 10-K.

(2) Includes stock-based compensation expense, which was allocated as follows:

Cost of sales	$ 1	$ —	$ 1	$ 1
Research and development	$ 1	$ 2	$ 2	$ 2
Selling, general, and administrative	$ 10	$ 10	$ 9	$ 10

The impact of the stock-based compensation adjustments as described in the Explanatory Note immediately preceding Part I, Item 1 and Note 2, "Restatement of Consolidated Financial Statements," in Notes to Consolidated Financial Statements of this Form 10-K was not significant to the interim balance sheets of 2006 and 2005.

The following tables present the effects of adjustments made to the Company's previously reported quarterly financial information during 2005 (in millions, except per share amounts):

	Three Months Ended September 24, 2005			Three Months Ended June 25, 2005		
	As Reported	Adjustments (1)	As Restated	As Reported	Adjustments (1)	As Restated
Net sales	$ 3,678	$ —	$ 3,678	$ 3,520	$ —	$ 3,520
Cost of sales (2)	2,643	—	2,643	2,476	—	2,476
Gross margin	1,035	—	1,035	1,044	—	1,044
Operating expenses:						
Research and development (2)	147	—	147	145	—	145
Selling, general, and administrative (2)	470	1	471	472	1	473
Total operating expenses	617	1	618	617	1	618
Operating income	418	(1)	417	427	(1)	426
Other income and expense	60	—	60	46	—	46
Income before provision for income taxes	478	(1)	477	473	(1)	472
Provision for income taxes	48	1	49	153	—	153
Net income	$ 430	$ (2)	$ 428	$ 320	$ (1)	$ 319
Earnings per common share:						
Basic	$ 0.52	$ —	$ 0.52	$ 0.39	$ —	$ 0.39
Diluted	$ 0.50	$ (0.01)	$ 0.49	$ 0.37	$ —	$ 0.37
Shares used in computing earnings per share (in thousands):						
Basic	821,420	—	821,420	815,092	—	815,092
Diluted	866,404	79	866,483	860,688	115	860,803

(1) See the "Explanatory Note" immediately preceding Part I, Item 1 and Note 2, "Restatement of Consolidated Financial Statements," in Notes to Consolidated Financial Statements of this Form 10-K.

(2) Includes stock-based compensation expense, which was allocated as follows:

Cost of sales	$ 1	$ —	$ 1	$ —	$ —	$ —
Research and development	$ 1	$ —	$ 1	$ 2	$ —	$ 2
Selling, general, and administrative	$ 9	$ 1	$ 10	$ 9	$ 1	$ 10

	Three Months Ended March 26, 2005			Three Months Ended December 25, 2004		
	As Reported	Adjustments (1)	As Restated	As Reported	Adjustments (1)	As Restated
Net sales	$ 3,243	$ —	$ 3,243	$ 3,490	$ —	$ 3,490
Cost of sales (2)	2,275	—	2,275	2,494	1	2,495
Gross margin	968	—	968	996	(1)	995
Operating expenses:						
Research and development (2)	119	1	120	123	—	123
Selling, general, and administrative (2)	447	1	448	470	2	472
Total operating expenses	566	2	568	593	2	595
Operating income	402	(2)	400	403	(3)	400
Other income and expense	33	—	33	26	—	26
Income before provision for income taxes	435	(2)	433	429	(3)	426
Provision for income taxes	145	—	145	134	(1)	133
Net income	$ 290	$ (2)	$ 288	$ 295	$ (2)	$ 293
Earnings per common share:						
Basic	$ 0.36	$ —	$ 0.36	$ 0.37	$ —	$ 0.37
Diluted	$ 0.34	$ —	$ 0.34	$ 0.35	$ —	$ 0.35
Shares used in computing earnings per share (in thousands):						
Basic	808,172	—	808,172	789,032	—	789,032
Diluted	857,011	557	857,568	838,174	631	838,805

(1) See the "Explanatory Note" immediately preceding Part I, Item 1 and Note 2, "Restatement of Consolidated Financial Statements," in Notes to Consolidated Financial Statements of this Form 10-K.

(2) Includes stock-based compensation expense, which was allocated as follows:

Cost of sales	$ 1	$ —	$ 1	$ —	$ 1	$ 1
Research and development	$ 1	$ 1	$ 2	$ 2	$ —	$ 2
Selling, general, and administrative	$ 8	$ 1	$ 9	$ 8	$ 2	$ 10

Recent Accounting Pronouncements

In September 2006, the SEC issued SAB No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements.* SAB No. 108 provides guidance on how prior year misstatements should be considered when quantifying misstatements in current year financial statements for purposes of determining whether the current year's financial statements are materially misstated. SAB No. 108 is effective for fiscal years ending after November 15, 2006. Although the Company will continue to evaluate the application of SAB No. 108, management does not currently believe adoption will have a material impact on the Company's results of operations or financial position.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements,* which defines fair value, provides a framework for measuring fair value, and expands the disclosures required for fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require fair value measurements; it does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and is required to be adopted by the Company beginning in the first quarter of fiscal 2009. Although the Company will continue to evaluate the application of SFAS No. 157, management does not currently believe adoption will have a material impact on the Company's results of operations or financial position.

In June 2006, the FASB issued FASB Interpretation No. ("FIN") 48, *Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement No. 109.* FIN No. 48 clarifies the accounting for uncertainty in income taxes by creating a framework for how companies should recognize, measure, present, and disclose in their financial statements uncertain tax positions that they have taken or expect to take in a tax return. FIN No. 48 is effective for fiscal years beginning after December 15, 2006 and is required to be adopted by the Company beginning in the first quarter of fiscal 2008. Although the Company will continue to evaluate the application of FIN No. 48, management does not currently believe adoption will have a material impact on the Company's results of operations or financial position.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections,* which replaces APB Opinion No. 20, *Accounting Changes* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements—An Amendment of APB Opinion No. 28.* SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principal unless it is not practicable. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005 and is required to be adopted by the Company in the first quarter of fiscal 2007. Although the Company will continue to evaluate the application of SFAS No. 154, management does not currently believe adoption will have a material impact on the Company's results of operations or financial position.

Liquidity and Capital Resources

The following table presents selected financial information and statistics for each of the last three fiscal years (dollars in millions):

	September 30, 2006	September 24, 2005 As Restated (1)	September 25, 2004 As Restated (1)
Cash, cash equivalents, and short-term investments	$ 10,110	$ 8,261	$ 5,464
Accounts receivable, net	$ 1,252	$ 895	$ 774
Inventory	$ 270	$ 165	$ 101
Working capital	$ 8,038	$ 6,813	$ 4,403
Days sales in accounts receivable (DSO) (a)	24	22	30
Days of supply in inventory (b)	7	6	5
Days payables outstanding (DPO) (c)	89	62	76
Annual operating cash flow	$ 2,220	$ 2,535	$ 934

(1) See the "Explanatory Note" immediately preceding Part I, Item 1 and Note 2, "Restatement of Consolidated Financial Statements," in Notes to Consolidated Financial Statements of this Form 10-K.

(a) DSO is based on ending net trade receivables and most recent quarterly net sales for each period.

(b) Days supply of inventory is based on ending inventory and most recent quarterly cost of sales for each period.

(c) DPO is based on ending accounts payable and most recent quarterly cost of sales adjusted for the change in inventory.

As of September 30, 2006, the Company had $10.11 billion in cash, cash equivalents, and short-term investments, an increase of $1.85 billion over the same balances at the end of 2005. The principal components of this increase were cash generated by operating activities of $2.22 billion, proceeds of $318 million from the issuance of common stock under stock plans, and excess tax benefits from stock-based compensation of $361 million, partially offset by cash used to purchase property, plant, and equipment of $657 million and repurchases of common stock of $355 million in conjunction with net-share settlements on vested restricted stock and restricted stock units. Cash generated from operating activities includes the impact of the $1.25 billion prepayment for NAND flash memory components. The Company's short-term investment portfolio is primarily invested in high credit quality, liquid investments. As of September 30, 2006, approximately $4.1 billion of the Company's cash, cash equivalents, and short-term investments were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S.

The Company believes its existing balances of cash, cash equivalents, and short-term investments will be sufficient to satisfy its working capital needs, capital expenditures, stock repurchase activity, outstanding commitments, and other liquidity requirements associated with its existing operations over the next 12 months.

Capital Expenditures
The Company's total capital expenditures were $657 million during 2006, consisting of $200 million for retail store facilities and equipment related to the Company's Retail segment, $263 million for real estate acquisitions for the Company's second corporate campus and for a new data center, and $194 million for corporate infrastructure, including information systems enhancements. The Company currently anticipates it will utilize approximately $675 million for capital expenditures during 2007, including approximately $360 million for expansion of the Company's Retail segment, approximately $50 million for real estate acquisitions including the Company's second corporate campus and its new data center, and approximately $265 million to support normal replacement of existing capital assets and enhancements to general information technology infrastructure.

Stock Repurchase Plan
In July 1999, the Company's Board of Directors authorized a plan for the Company to repurchase up to $500 million of its common stock. This repurchase plan does not obligate the Company to acquire any specific number of shares or acquire shares over any specified period of time. The Company has repurchased a total of 13.1 million shares at a cost of $217 million under this plan and was authorized to repurchase up to an additional $283 million of its common stock as of September 30, 2006.

Off-Balance Sheet Arrangements and Contractual Obligations
The Company has not entered into any transactions with unconsolidated entities whereby the Company has financial guarantees, subordinated retained interests, derivative instruments, or other contingent arrangements that expose the Company to material continuing risks, contingent liabilities, or any other obligation under a variable interest in an unconsolidated entity that provides financing, liquidity, market risk, or credit risk support to the Company.

The following table presents certain payments due by the Company under contractual obligations with minimum firm commitments as of September 30, 2006 and excludes amounts already recorded on the Company's balance sheet as current liabilities (in millions):

	Total	Payments Due in Less Than 1 Year	Payments Due in 1-3 Years	Payments Due in 4-5 Years	Payments Due in More Than 5 Years
Operating Leases	$ 1,154	$ 134	$ 268	$ 254	$ 498
Purchase Obligations	2,306	2,306	—	—	—
Asset Retirement Obligations	19	3	3	7	6
Other Obligations	39	29	10	—	—
Total	$ 3,518	$ 2,472	$ 281	$ 261	$ 504

Lease Commitments
As of September 30, 2006, the Company had total outstanding commitments on noncancelable operating leases of approximately $1.2 billion, $887 million of which related to the lease of retail space and related facilities. Lease terms on the Company's existing major facility operating leases range from 5 to 15 years.

Purchase Commitments with Contract Manufacturers and Component Suppliers
The Company utilizes several contract manufacturers to manufacture sub-assemblies for the Company's products and to perform final assembly and test of finished products. These contract manufacturers acquire components and build product based on demand information supplied by the Company, which typically covers periods ranging from 30 to 150 days. The Company also obtains individual components for its products from a wide variety of individual suppliers. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. Such purchase commitments typically cover the Company's forecasted component and manufacturing requirements for periods ranging from 30 to 150 days. As of September 30, 2006, the Company had outstanding third-party manufacturing commitments and component purchase commitments of approximately $2.3 billion.

During 2006, the Company entered into long-term supply agreements with Hynix Semiconductor, Inc., Intel Corporation, Micron Technology, Inc., Samsung Electronics Co., Ltd., and Toshiba Corporation to secure supply of NAND flash memory through calendar year 2010. As part of these agreements, the Company prepaid $1.25 billion for flash memory components during 2006. These prepayments will be applied to inventory purchases made over the life of each respective agreement.

Asset Retirement Obligations
The Company's asset retirement obligations are associated with commitments to return property subject to operating leases to original condition upon lease termination. As of September 30, 2006, the Company estimates that gross expected future cash flows of approximately $19 million will be required to fulfill these obligations.

Other Obligations
The Company's other obligations of approximately $39 million are primarily related to Internet and telecommunications services.

Indemnifications
The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against itself or an indemnified third-party and, in the opinion of management, does not have a liability related to unresolved infringement claims subject to indemnification that would have a material adverse effect on its financial condition, liquidity or results of operations.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate and Foreign Currency Risk Management

The Company regularly reviews its foreign exchange forward and option positions and its interest rate swap and option positions, both on a stand-alone basis and in conjunction with its underlying foreign currency and interest rate related exposures. However, given the effective horizons of the Company's risk management activities and the anticipatory nature of the exposures, there can be no assurance the hedges will offset more than a portion of the financial impact resulting from movements in either foreign exchange or interest rates. In addition, the timing of the accounting for recognition of gains and losses related to mark-to-market instruments for any given period may not coincide with the timing of gains and losses related to the underlying economic exposures and, therefore, may adversely affect the Company's operating results and financial position.

Interest Rate Risk

While the Company is exposed to interest rate fluctuations in many of the world's leading industrialized countries, the Company's interest income and expense is most sensitive to fluctuations in the general level of U.S. interest rates. In this regard, changes in U.S. interest rates affect the interest earned on the Company's cash, cash equivalents, and short-term investments as well as costs associated with foreign currency hedges.

The Company's short-term investment policy and strategy is to ensure the preservation of capital, meet liquidity requirements, and optimize return in light of the current credit and interest rate environment. A portion of the Company's cash is managed by external managers within the guidelines of the Company's investment policy and to an objective market benchmark. The Company's internal portfolio is benchmarked against external manager performance, allowing for differences in liquidity needs.

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's investment portfolio. The Company places its short-term investments in highly liquid securities issued by high credit quality issuers and, by policy, limits the amount of credit exposure to any one issuer. The Company's general policy is to limit the risk of principal loss and ensure the safety of invested funds by limiting market and credit risk. All highly liquid investments with initial maturities of three months or less are classified as cash equivalents; highly liquid investments with initial maturities greater than three months are classified as short-term investments. As of September 30, 2006, approximately $921 million of the Company's short-term investments had underlying maturities ranging from 1 to 5 years. As of September 24, 2005, $287 million of the Company's short-term investments had underlying maturities ranging from 1 to 5 years. The remainder all had underlying maturities of less than 12 months. The Company may sell its investments prior to their stated maturities for strategic purposes, in anticipation of credit deterioration or for duration management. The Company recognized net losses before taxes of $434,000 and $137,000 in 2006 and 2005, respectively, and a net gain before taxes of $1 million in 2004 as a result of such sales.

To provide a meaningful assessment of the interest rate risk associated with the Company's investment portfolio, the Company performed a sensitivity analysis to determine the impact a change in interest rates would have on the value of the investment portfolio assuming a 100 basis point parallel shift in the yield curve. Based on investment positions as of September 30, 2006, a hypothetical 100 basis point increase in interest rates across all maturities would result in a $15.2 million decline in the fair market value of the portfolio. As of September 24, 2005, a similar 100 basis point shift in the yield curve would have resulted in a $19.9 million decline in fair value. Such losses would only be realized if the Company sold the investments prior to maturity.

Foreign Currency Risk
In general, the Company is a net receiver of foreign currencies. Accordingly, changes in exchange rates, and in particular a strengthening of the U.S. dollar, may negatively affect the Company's net sales and gross margins as expressed in U.S. dollars. There is also a risk the Company will have to adjust local currency product pricing due to competitive pressures when there has been significant volatility in foreign currency exchange rates.

The Company may enter into foreign currency forward and option contracts with financial institutions to protect against foreign exchange risks associated with existing assets and liabilities, certain firmly committed transactions, forecasted future cash flows, and net investments in foreign subsidiaries. Generally, the Company's practice is to hedge a majority of its existing material foreign exchange transaction exposures. However, the Company may not hedge certain foreign exchange transaction exposures due to immateriality, prohibitive economic cost of hedging particular exposures, and limited availability of appropriate hedging instruments.

To provide a meaningful assessment of the foreign currency risk associated with certain of the Company's foreign currency derivative positions, the Company performed a sensitivity analysis using a value-at-risk ("VAR") model to assess the potential impact of fluctuations in exchange rates. The VAR model consisted of using a Monte Carlo simulation to generate 3,000 random market price paths. The VAR is the maximum expected loss in fair value, for a given confidence interval, to the Company's foreign exchange portfolio due to adverse movements in rates. The VAR model is not intended to represent actual losses but is used as a risk estimation and management tool. The model assumes normal market conditions. Forecasted transactions, firm commitments, and assets and liabilities denominated in foreign currencies were excluded from the model. Based on the results of the model, the Company estimates with 95% confidence a maximum one-day loss in fair value of $9.2 million as of September 30, 2006 compared to a maximum one-day loss of $10.0 million as of September 24, 2005. Because the Company uses foreign currency instruments for hedging purposes, losses incurred on those instruments are generally offset by increases in the fair value of the underlying exposures.

Actual future gains and losses associated with the Company's investment portfolio and derivative positions may differ materially from the sensitivity analyses performed as of September 30, 2006 due to the inherent limitations associated with predicting the changes in the timing and amount of interest rates, foreign currency exchanges rates, and the Company's actual exposures and positions.

Item 8. Financial Statements and Supplementary Data

All financial statement schedules have been omitted, since the required information is not applicable or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Consolidated Financial Statements and Notes thereto.

CONSOLIDATED BALANCE SHEETS

(In millions, except share amounts)

	September 30, 2006	September 24, 2005 As Restated(1)
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 6,392	$ 3,491
Short-term investments	3,718	4,770
Accounts receivable, less allowances of $52 and $46, respectively	1,252	895
Inventories	270	165
Deferred tax assets	607	331
Other current assets	2,270	648
Total current assets	14,509	10,300
Property, plant, and equipment, net	1,281	817
Goodwill	38	69
Acquired intangible assets, net	139	27
Other assets	1,238	303
Total assets	$ 17,205	$ 11,516
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	$ 3,390	$ 1,779
Accrued expenses	3,081	1,708
Total current liabilities	6,471	3,487
Non-current liabilities	750	601
Total liabilities	7,221	4,088
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value; 1,800,000,000 shares authorized; 855,262,568 and 835,019,364 shares issued and outstanding, respectively	4,355	3,564
Deferred stock compensation	—	(61)
Retained earnings	5,607	3,925
Accumulated other comprehensive income	22	—
Total shareholders' equity	9,984	7,428
Total liabilities and shareholders' equity	$ 17,205	$ 11,516

(1) See Note 2, "Restatement of Consolidated Financial Statements," in Notes to Consolidated Financial Statements.

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except share and per share amounts)

Three fiscal years ended September 30, 2006	2006	2005 As Restated (1)	2004 As Restated (1)
Net sales	$ 19,315	$ 13,931	$ 8,279
Cost of sales (2)	13,717	9,889	6,022
Gross margin	5,598	4,042	2,257
Operating expenses:			
Research and development (2)	712	535	491
Selling, general, and administrative (2)	2,433	1,864	1,430
Restructuring costs	—	—	23
Total operating expenses	3,145	2,399	1,944
Operating income	2,453	1,643	313
Other income and expense	365	165	57
Income before provision for income taxes	2,818	1,808	370
Provision for income taxes	829	480	104
Net income	$ 1,989	$ 1,328	$ 266
Earnings per common share:			
Basic	$ 2.36	$ 1.64	$ 0.36
Diluted	$ 2.27	$ 1.55	$ 0.34
Shares used in computing earnings per share (in thousands):			
Basic	844,058	808,439	743,180
Diluted	877,526	856,878	774,776

(1) See Note 2, "Restatement of Consolidated Financial Statements," in Notes to Consolidated Financial Statements.

(2) Includes stock-based compensation expense, which was allocated as follows:

	2006	2005	2004
Cost of sales	$ 21	$ 3	$ 3
Research and development	$ 53	$ 7	$ 6
Selling, general, and administrative	$ 89	$ 39	$ 37

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In millions, except share amounts which are in thousands)

	Common Stock		Deferred Stock Compensation	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares	Amount				
		As Restated (1)	As Restated (1)	As Restated (1)		As Restated (1)
Balances as of September 27, 2003 as previously reported	733,454	$ 1,926	$ (62)	$ 2,394	$ (35)	$ 4,223
Adjustments to opening shareholders' equity	—	85	(22)	(63)	—	—
Balance as of September 27, 2003 as restated	733,454	$ 2,011	$ (84)	$ 2,331	$ (35)	$ 4,223
Components of comprehensive income:						
Net income	—	—	—	266	—	266
Change in foreign currency translation	—	—	—	—	13	13
Change in unrealized gain on available-for-sale securities, net of tax	—	—	—	—	(5)	(5)
Change in unrealized loss on derivative investments, net of tax	—	—	—	—	12	12
Total comprehensive income						286
Issuance of stock-based compensation awards	—	63	(63)	—	—	—
Adjustment to common stock related to a prior year acquisition	(159)	(2)	—	—	—	(2)
Stock-based compensation	—	—	46	—	—	46
Common stock issued under stock plans	49,592	427	—	—	—	427
Tax benefit related to stock options	—	83	—	—	—	83
Balances as of September 25, 2004	782,887	$ 2,582	$ (101)	$ 2,597	$ (15)	$ 5,063
Components of comprehensive income:						
Net income	—	—	—	1,328	—	1,328
Change in foreign currency translation	—	—	—	—	7	7
Change in unrealized gain on derivative investments, net of tax	—	—	—	—	8	8
Total comprehensive income						1,343
Issuance of stock-based compensation awards	—	7	(7)	—	—	—
Stock-based compensation	—	—	47	—	—	47
Common stock issued under stock plans	52,132	547	—	—	—	547
Tax benefit related to stock options	—	428	—	—	—	428
Balances as of September 24, 2005	835,019	$ 3,564	$ (61)	$ 3,925	$ —	$ 7,428
Components of comprehensive income:						
Net income	—	—	—	1,989	—	1,989
Change in foreign currency translation	—	—	—	—	19	19
Change in unrealized gain on available-for-sale securities, net of tax	—	—	—	—	4	4
Change in unrealized loss on derivative investments, net of tax	—	—	—	—	(1)	(1)
Total comprehensive income						2,011
Common stock repurchased	(4,574)	(48)	—	(307)	—	(355)
Stock-based compensation	—	163	—	—	—	163
Deferred compensation	—	(61)	61	—	—	—
Common stock issued under stock plans	24,818	318	—	—	—	318
Tax benefit related to stock-based compensation	—	419	—	—	—	419
Balances as of September 30, 2006	855,263	$ 4,355	$ —	$ 5,607	$ 22	$ 9,984

(1) See Note 2, "Restatement of Consolidated Financial Statements," in Notes to Consolidated Financial Statements.

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)

Three fiscal years ended September 30, 2006	2006	2005 As Restated (1)	2004 As Restated (1)
Cash and cash equivalents, beginning of the year	$ 3,491	$ 2,969	$ 3,396
Operating Activities:			
Net income	1,989	1,328	266
Adjustments to reconcile net income to cash generated by operating activities:			
Depreciation, amortization and accretion	225	179	150
Stock-based compensation expense	163	49	46
Provision for deferred income taxes	53	50	19
Excess tax benefits from stock options	—	428	83
Gain on sale of PowerSchool net assets	(4)	—	—
Loss on disposition of property, plant, and equipment	15	9	7
Gains on sales of investments, net	—	—	(5)
Changes in operating assets and liabilities:			
Accounts receivable	(357)	(121)	(8)
Inventories	(105)	(64)	(45)
Other current assets	(1,626)	(150)	(176)
Other assets	(1,040)	(35)	(25)
Accounts payable	1,611	328	297
Other liabilities	1,296	534	325
Cash generated by operating activities	2,220	2,535	934
Investing Activities:			
Purchases of short-term investments	(7,255)	(11,470)	(3,270)
Proceeds from maturities of short-term investments	7,226	8,609	1,141
Proceeds from sales of investments	1,086	586	806
Purchases of long-term investments	(25)	—	—
Proceeds from sale of PowerSchool net assets	40	—	—
Purchases of property, plant, and equipment	(657)	(260)	(176)
Other	(58)	(21)	11
Cash generated by (used for) investing activities	357	(2,556)	(1,488)
Financing Activities:			
Payment of long-term debt	—	—	(300)
Proceeds from issuance of common stock	318	543	427
Excess tax benefits from stock-based compensation	361	—	—
Repurchases of common stock	(355)	—	—
Cash generated by financing activities	324	543	127
Increase (decrease) in cash and cash equivalents	2,901	522	(427)
Cash and cash equivalents, end of the year	$ 6,392	$ 3,491	$ 2,969
Supplemental cash flow disclosures:			
Cash paid during the year for interest	$ —	$ —	$ 10
Cash paid (received) for income taxes, net	$ 194	$ 17	$ (7)

(1) See Note 2, "Restatement of Consolidated Financial Statements," in Notes to Consolidated Financial Statements.

See accompanying Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1—Summary of Significant Accounting Policies

Apple Computer, Inc. and its wholly-owned subsidiaries (the Company) designs, manufactures, and markets personal computers and related software, services, peripherals, and networking solutions. The Company also designs, develops, and markets a line of portable digital music players along with related accessories and services including the online sale of third-party audio and video products. The Company sells its products worldwide through its online stores, its retail stores, its direct sales force, and third-party wholesalers, resellers, and value-added resellers. In addition, the Company sells a variety of third-party Macintosh and iPod compatible products including application software, printers, storage devices, speakers, headphones, and various other accessories and supplies through its online and retail stores. The Company sells to education, consumer, creative professional, business, and government customers.

Basis of Presentation and Preparation

The accompanying consolidated financial statements include the accounts of the Company. Intercompany accounts and transactions have been eliminated. The preparation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in these consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates. Certain prior year amounts in the consolidated financial statements and notes thereto have been reclassified to conform to the current year presentation.

Typically, the Company's fiscal year ends on the last Saturday of September. Fiscal years 2005 and 2004 were each 52-week years. However, approximately every six years, the Company reports a 53-week fiscal year to align its fiscal quarters with calendar quarters by adding a week to its first fiscal quarter. The Company added this additional week in the first fiscal quarter of its fiscal year 2006. All information presented herein is based on the Company's fiscal calendar.

Common Stock Split

On February 28, 2005, the Company effected a two-for-one stock split to shareholders of record as of February 18, 2005. All share and per share information has been retroactively adjusted to reflect the stock split.

Financial Instruments

Cash Equivalents and Short-term Investments

All highly liquid investments with maturities of three months or less at the date of purchase are classified as cash equivalents. Highly liquid investments with maturities greater than three months at the date of purchase are classified as short-term investments. The Company's debt and marketable equity securities have been classified and accounted for as available-for-sale. Management determines the appropriate classification of its investments in debt and marketable equity securities at the time of purchase and reevaluates the available-for-sale designations as of each balance sheet date. These securities are carried at fair value, with the unrealized gains and losses, net of taxes, reported as a component of shareholders' equity. The cost of securities sold is based upon the specific identification method.

Derivative Financial Instruments

The Company accounts for its derivative instruments as either assets or liabilities and carries them at fair value. Derivatives that are not defined as hedges in Statement of Financial Accounting Standards ("SFAS") No. 133, *Accounting for Derivative Instruments and Hedging Activities,* as amended, must be adjusted to fair value through earnings. If the derivative is a hedge, depending on the nature of the hedge,

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

changes in fair value will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings.

For derivative instruments that hedge the exposure to variability in expected future cash flows that are designated as cash flow hedges, the effective portion of the gain or loss on the derivative instrument is reported as a component of accumulated other comprehensive income in shareholders' equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of the gain or loss on the derivative instrument is recognized in current earnings. To receive hedge accounting treatment, cash flow hedges must be highly effective in offsetting changes to expected future cash flows on hedged transactions. For derivative instruments that hedge the exposure to changes in the fair value of an asset or a liability and that are designated as fair value hedges, the net gain or loss on the derivative instrument as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in earnings in the current period. The net gain or loss on the effective portion of a derivative instrument that is designated as an economic hedge of the foreign currency translation exposure of the net investment in a foreign operation is reported in the same manner as a foreign currency translation adjustment. For forward contracts designated as net investment hedges, the Company excludes changes in fair value relating to changes in the forward carry component from its definition of effectiveness. Accordingly, any gains or losses related to this component are recognized in current earnings.

Inventories
Inventories are stated at the lower of cost, computed using the first-in, first-out method, or market. If the cost of the inventories exceeds their market value, provisions are made currently for the difference between the cost and the market value. The Company's inventories consist primarily of finished goods for all periods presented.

Property, Plant, and Equipment
Property, plant, and equipment are stated at cost. Depreciation is computed by use of the straight-line method over the estimated useful lives of the assets, which for buildings is the lesser of 30 years or the remaining life of the underlying building, up to 5 years for equipment, and the shorter of lease terms or 10 years for leasehold improvements. The Company capitalizes eligible costs to acquire or develop internal-use software that are incurred subsequent to the preliminary project stage. Capitalized costs related to internal-use software are amortized using the straight-line method over the estimated useful lives of the assets, which range from 3 to 5 years. Depreciation and amortization expense on property and equipment was $180 million, $141 million, and $126 million during 2006, 2005, and 2004, respectively.

Asset Retirement Obligations
The Company records obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs in accordance with SFAS No. 143, *Accounting for Asset Retirement Obligations*. The Company reviews legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the assets. If it is determined that a legal obligation exists, the fair value of the liability for an asset retirement obligation is recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset and this additional carrying amount is depreciated over the life of the asset. The difference between the gross expected future cash flow and its

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

present value is accreted over the life of the related lease as an operating expense. All of the Company's existing asset retirement obligations are associated with commitments to return property subject to operating leases to original condition upon lease termination.

The following table reconciles changes in the Company's asset retirement liabilities for fiscal 2006 and 2005 (in millions):

Asset retirement liability as of September 25, 2004	$ 8.2
Additional asset retirement obligations recognized	2.8
Accretion recognized	0.7
Asset retirement liability as of September 24, 2005	$ 11.7
Additional asset retirement obligations recognized	2.5
Accretion recognized	0.5
Asset retirement liability as of September 30, 2006	$ 14.7

Long-Lived Assets Including Goodwill and Other Acquired Intangible Assets

The Company reviews property, plant, and equipment and certain identifiable intangibles, excluding goodwill, for impairment in accordance with SFAS No. 144, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of.* Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of these assets is measured by comparison of its carrying amount to future undiscounted cash flows the assets are expected to generate. If property, plant, and equipment and certain identifiable intangibles are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the assets exceeds its fair market value. For the three fiscal years ended September 30, 2006, the Company had no material impairment of its long-lived assets, except for the impairment of certain assets in connection with the restructuring actions described in Note 6 of these Notes to Consolidated Financial Statements.

SFAS No. 142, *Goodwill and Other Intangible Assets* requires that goodwill and intangible assets with indefinite useful lives should not be amortized but rather be tested for impairment at least annually or sooner whenever events or changes in circumstances indicate that they may be impaired. The Company performs its goodwill impairment tests on or about August 30 of each year. The Company did not recognize any goodwill or intangible asset impairment charges in 2006, 2005, or 2004. The Company established reporting units based on its current reporting structure. For purposes of testing goodwill for impairment, goodwill has been allocated to these reporting units to the extent it relates to each reporting unit.

SFAS No. 142 also requires that intangible assets with definite lives be amortized over their estimated useful lives and reviewed for impairment in accordance with SFAS No. 144. The Company is currently amortizing its acquired intangible assets with definite lives over periods ranging from 3 to 10 years.

Foreign Currency Translation

The Company translates the assets and liabilities of its international non-U.S. functional currency subsidiaries into U.S. dollars using exchange rates in effect at the end of each period. Revenue and expenses for these subsidiaries are translated using rates that approximate those in effect during the period. Gains and losses from these translations are credited or charged to foreign currency translation

Note 1—Summary of Significant Accounting Policies (Continued)

included in "accumulated other comprehensive income" in shareholders' equity. The Company's foreign manufacturing subsidiaries and certain other international subsidiaries that use the U.S. dollar as their functional currency remeasure monetary assets and liabilities at exchange rates in effect at the end of each period, and inventories, property, and nonmonetary assets and liabilities at historical rates. Gains and losses from these translations were insignificant and have been included in the Company's results of operations.

Revenue Recognition

Net sales consist primarily of revenue from the sale of hardware, software, peripherals, digital content, and service and support contracts. The Company recognizes revenue pursuant to applicable accounting standards, including American Institute of Certified Public Accountants Statement of Position ("SOP") No. 97-2, *Software Revenue Recognition*, as amended, and Securities and Exchange Commission ("SEC") Staff Accounting Bulletin ("SAB") No. 104, *Revenue Recognition*.

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection is probable. Product is considered delivered to the customer once it has been shipped and title and risk of loss have been transferred. For most of the Company's product sales, these criteria are met at the time the product is shipped. For online sales to individuals, for some sales to education customers in the U.S., and for certain other sales, the Company defers revenue until the customer receives the product because the Company legally retains a portion of the risk of loss on these sales during transit. If at the outset of an arrangement the Company determines the arrangement fee is not, or is presumed not to be, fixed or determinable, revenue is deferred and subsequently recognized as amounts become due and payable.

Revenue from service and support contracts is deferred and recognized ratably over the service coverage periods. These contracts typically include extended phone support, repair services, web-based support resources, diagnostic tools, and extend the service coverage offered under the Company's one-year limited warranty.

The Company sells software and peripheral products obtained from other companies. The Company establishes its own pricing and retains related inventory risk, is the primary obligor in sales transactions with its customers, and assumes the credit risk for amounts billed to its customers. Accordingly, the Company recognizes revenue for the sale of products obtained from other companies based on the gross amount billed.

Revenue on arrangements that include multiple elements such as hardware, software, and services is allocated to each element based on the relative fair value of each element. Each element's allocated revenue is recognized when revenue recognition criteria for that element have been met. Fair value is generally determined by vendor specific objective evidence ("VSOE"), which is based on the price charged when each element is sold separately. If the Company cannot objectively determine the fair value of any undelivered element included in a multiple-element arrangement, the Company defers revenue until all elements are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered elements. When the fair value of a delivered element has not been established, the Company uses the residual method to recognize revenue if the fair value of all undelivered elements is determinable. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is allocated to the delivered elements and is recognized as revenue.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end-user rebates, and other sales programs and volume-based incentives. The estimated cost of these programs is accrued as a reduction to revenue in the period the Company has sold the product and committed to a plan. The Company also records reductions to revenue for expected future product returns based on the Company's historical experience.

Generally, the Company does not offer specified or unspecified upgrade rights to its customers in connection with software sales or the sale of extended warranty and support contracts. When the Company does offer specified upgrade rights, the Company defers revenue for the fair value of the specified upgrade right until the future obligation is fulfilled or when the right to the specified upgrade expires. Additionally, a limited number of the Company's software products are available with maintenance agreements that grant customers rights to unspecified future upgrades over the maintenance term on a when and if available basis. Revenue associated with such maintenance is recognized ratably over the maintenance term.

Allowance for Doubtful Accounts

The Company records its allowance for doubtful accounts based upon its assessment of various factors. The Company considers historical experience, the age of the accounts receivable balances, credit quality of the Company's customers, current economic conditions, and other factors that may affect customers' ability to pay.

Shipping Costs

For all periods presented, amounts billed to customers related to shipping and handling are classified as revenue, and the Company's shipping and handling costs are included in cost of sales.

Warranty Expense

The Company provides for the estimated cost of hardware and software warranties at the time the related revenue is recognized. The Company assesses the adequacy of its preexisting warranty liabilities and adjusts the amounts as necessary based on actual experience and changes in future estimates.

Software Development Costs

Research and development costs are expensed as incurred. Development costs of computer software to be sold, leased, or otherwise marketed are subject to capitalization beginning when a product's technological feasibility has been established and ending when a product is available for general release to customers pursuant to SFAS No. 86, *Computer Software to be Sold, Leased, or Otherwise Marketed*. In most instances, the Company's products are released soon after technological feasibility has been established. Therefore, costs incurred subsequent to achievement of technological feasibility are usually not significant, and generally all software development costs have been immediately expensed.

In 2004, the Company began incurring substantial development costs associated with Mac OS X version 10.4 Tiger ("Tiger") subsequent to achievement of technological feasibility as evidenced by public demonstration in August 2004 and the subsequent release of a developer beta version of the product. The Company capitalized approximately $29.7 million and $4.5 million during 2005 and 2004, respectively, of costs associated with the development of Tiger. In accordance with SFAS No. 86, amortization of this asset to cost of sales began in April 2005 when the Company began shipping Tiger and is being recognized on a straight-line basis over a three-year estimated useful life.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

During 2004, the Company incurred substantial development costs associated with FileMaker Pro 7 subsequent to achievement of technological feasibility as evidenced by public demonstration and release of a developer beta version, and prior to the release of the final version of the product in March 2004. Therefore, during 2004, the Company capitalized approximately $2.3 million of costs associated with the development of FileMaker Pro 7. In accordance with SFAS No. 86, amortization of this asset to cost of sales began in March 2004 when the Company began shipping FileMaker Pro 7 and is being recognized on a straight-line basis over a three-year estimated useful life.

Total amortization related to capitalized software development costs was $17.8 million, $15.7 million, and $10.7 million in 2006, 2005, and 2004, respectively.

Advertising Costs
Advertising costs are expensed as incurred. Advertising expense was $338 million, $287 million, and $206 million for 2006, 2005, and 2004, respectively.

Stock-Based Compensation
On September 25, 2005, the Company adopted SFAS No. 123 (revised 2004) ("SFAS No. 123R"), *Share-Based Payment*, which addresses the accounting for stock-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. In January 2005, the SEC issued SAB No. 107, which provides supplemental implementation guidance for SFAS No. 123R. SFAS No. 123R eliminates the ability to account for stock-based compensation transactions using the intrinsic value method under Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees*, and instead generally requires that such transactions be accounted for using a fair-value-based method. The Company uses the Black-Scholes-Merton ("BSM") option-pricing model to determine the fair-value of stock-based awards under SFAS No. 123R, consistent with that used for pro forma disclosures under SFAS No. 123, *Accounting for Stock-Based Compensation*. The Company has elected to use the modified prospective transition method as permitted by SFAS No. 123R and accordingly prior periods have not been restated to reflect the impact of SFAS No. 123R. The modified prospective transition method requires that stock-based compensation expense be recorded for all new and unvested stock options, restricted stock, restricted stock units, and employee stock purchase plan shares that are ultimately expected to vest as the requisite service is rendered beginning on September 25, 2005, the first day of the Company's fiscal year 2006. Stock-based compensation expense for awards granted prior to September 25, 2005 is based on the grant-date fair-value as determined under the pro forma provisions of SFAS No. 123. The Company recognized incremental stock-based compensation expense of $117 million during 2006 as a result of the adoption of SFAS No. 123R. Diluted earnings per common share was reduced by $0.10 for the year ended September 30, 2006 due to the adoption of SFAS No. 123R. In accordance with SFAS No. 123R, beginning in 2006 the Company has presented excess tax benefits from the exercise of stock-based compensation awards as a financing activity in the consolidated statement of cash flows.

No stock-based compensation costs have been capitalized as of September 30, 2006. The income tax benefit related to stock-based compensation expense was $39 million for the year ended September 30, 2006. As of September 30, 2006, $375.2 million of total unrecognized compensation cost related to stock options and restricted stock units is expected to be recognized over a weighted-average period of 2.91 years.

Note 1—Summary of Significant Accounting Policies (Continued)

SFAS No. 123R prohibits recognition of a deferred tax asset for an excess tax benefit that has not been realized. The Company will recognize a benefit from stock-based compensation in equity if an incremental tax benefit is realized by following the ordering provisions of the tax law. In addition, the Company accounts for the indirect effects of stock-based compensation on the research tax credit, the foreign tax credit, and the domestic manufacturing deduction through the income statement.

Prior to the adoption of SFAS No. 123R, the Company measured compensation expense for its employee stock-based compensation plans using the intrinsic value method prescribed by APB Opinion No. 25. The Company applied the disclosure provisions of SFAS No. 123 as amended by SFAS No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure,* as if the fair-value-based method had been applied in measuring compensation expense. Under APB Opinion No. 25, when the exercise price of the Company's employee stock options was equal to the market price of the underlying stock on the date of the grant, no compensation expense was recognized.

The following table illustrates the effect on net income after taxes and net income per common share as if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation during 2005 and 2004 (in millions, except per share amounts):

	2005 As Restated (1)	2004 As Restated (1)
Net income	$ 1,328	$ 266
Add: Stock-based employee compensation expense included in reported net income, net of tax	45	43
Deduct: Stock-based employee compensation expense determined under the fair value based method for all awards, net of tax	(118)	(148)
Net income—pro forma	$ 1,255	$ 161
Net income per common share		
Basic	$ 1.64	$ 0.36
Diluted	$ 1.55	$ 0.34
Net income per common share—pro forma		
Basic	$ 1.55	$ 0.22
Diluted	$ 1.47	$ 0.21

(1) See Note 2, "Restatement of Consolidated Financial Statements."

Further information regarding stock-based compensation can be found in Note 9.

Earnings Per Common Share

Basic earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the dilutive potential shares of common stock had been issued. The dilutive effect of outstanding options, restricted stock, and restricted stock units is reflected in diluted earnings per share by application of the treasury stock method. Under the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

treasury stock method, an increase in the fair market value of the Company's common stock can result in a greater dilutive effect from outstanding options, restricted stock, and restricted stock units. Additionally, the exercise of employee stock options and the vesting of restricted stock and restricted stock units can result in a greater dilutive effect on earnings per share.

The following table sets forth the computation of basic and diluted earnings per share:

Three fiscal years ended September 30, 2006	2006	2005 As Restated (1)	2004 As Restated (1)
Numerator (in millions):			
Net income	$ 1,989	$ 1,328	$ 266
Denominator (in thousands):			
Weighted-average shares outstanding, excluding unvested restricted stock	844,058	808,439	743,180
Effect of dilutive options, restricted stock units and unvested restricted stock	33,468	48,439	31,596
Denominator for diluted earnings per share	877,526	856,878	774,776
Basic earnings per share	$ 2.36	$ 1.64	$ 0.36
Diluted earnings per share	$ 2.27	$ 1.55	$ 0.34

Potentially dilutive securities representing approximately 3.9 million, 12.7 million (as restated(1)), and 8.9 million (as restated(1)) shares of common stock for the years ended September 30, 2006, September 24, 2005, and September 25, 2004, respectively, were excluded from the computation of diluted earnings per share for these periods because their effect would have been antidilutive. These potentially dilutive securities include stock options, unvested restricted stock, and restricted stock units.

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(1) See Note 2, "Restatement of Consolidated Financial Statements.".

Comprehensive Income

Comprehensive income consists of two components: net income and other comprehensive income. Other comprehensive income refers to revenue, expenses, gains, and losses that under generally accepted accounting principles are recorded as an element of shareholders' equity but are excluded from net income. The Company's other comprehensive income is comprised of foreign currency translation adjustments from those subsidiaries not using the U.S. dollar as their functional currency, unrealized gains and losses on marketable securities categorized as available-for-sale, and net deferred gains and losses on certain derivative instruments accounted for as cash flow hedges.

Segment Information

The Company reports segment information based on the "management" approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of the Company's reportable segments. Information about the Company's products, major customers, and geographic areas on a company-wide basis is also disclosed.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2—Restatement of Consolidated Financial Statements

The Company is restating its consolidated balance sheet as of September 24, 2005, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the fiscal years ended September 24, 2005 and September 25, 2004, and each of the quarters in fiscal year 2005.

Previously filed annual reports on Form 10-K and quarterly reports on Form 10-Q affected by the restatements have not been amended and should not be relied on.

On June 29, 2006, the Company announced that an internal review had discovered irregularities related to the issuance of certain stock option grants made between 1997 and 2001, including a grant to its Chief Executive Officer ("CEO") Steve Jobs. The Company also announced that a Special Committee of outside directors ("Special Committee") had been formed and had hired independent counsel to conduct a full investigation of the Company's past stock option granting practices.

As a result of the internal review and the independent investigation, management has concluded, and the Audit and Finance Committee of the Board of Directors agrees, that incorrect measurement dates were used for financial accounting purposes for certain stock option grants made in prior periods. Therefore, the Company has recorded additional non-cash stock-based compensation expense and related tax effects with regard to past stock option grants, and the Company is restating previously filed financial statements in this Form 10-K. These adjustments, after tax, amounted to $4 million, $7 million, and $10 million in fiscal years 2006, 2005 and 2004, respectively. The adjustment to 2006 was recorded in the fourth quarter of fiscal year 2006 due to its insignificance.

The independent counsel and its forensic accountants ("Investigative Team") reviewed the facts and circumstances surrounding stock option grants made on 259 dates. Based on a review of the totality of evidence and the applicable law, the Special Committee found no misconduct by current management. The Special Committee's investigation identified a number of grants for which grant dates were intentionally selected in order to obtain favorable exercise prices. The terms of these and certain other grants, as discussed below, were finalized after the originally assigned grant dates. The Special Committee concluded that the procedures for granting, accounting for, and reporting stock option grants did not include sufficient safeguards to prevent manipulation. Although the investigation found that CEO Steve Jobs was aware or recommended the selection of some favorable grant dates, he did not receive or financially benefit from these grants or appreciate the accounting implications. The Special Committee also found that the investigation had raised serious concerns regarding the actions of two former officers in connection with the accounting, recording and reporting of stock option grants.

Based on the evidence and findings from the Company's internal review and the Special Committee's independent investigation, an analysis was performed of the measurement dates for the 42,077 stock option grants made on 259 dates between October 1996 and January 2003 (the "relevant period"). The Company believes that the analysis was properly limited to the relevant period. In addition to analyzing all grants made during the relevant period, the Company sampled certain grants between 1994 and 1997 and found none that required accounting adjustments. The first grants for which stock-based compensation expense is required are dated December 29, 1997. The Company also examined grants made after the relevant period and found none that required accounting adjustments. Moreover, in the years after 2002, Apple made significant changes in its stock option granting practices in response to evolving legal, regulatory and accounting requirements.

Consistent with the accounting literature and recent guidance from the Securities and Exchange Commission ("SEC"), the grants during the relevant period were organized into categories based on grant

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2—Restatement of Consolidated Financial Statements (Continued)

type and process by which the grant was finalized. The Company analyzed the evidence related to each category of grants including, but not limited to, electronic and physical documents, document metadata, and witness interviews. Based on the relevant facts and circumstances, the Company applied the controlling accounting standards to determine, for every grant within each category, the proper measurement date. If the measurement date is not the originally assigned grant date, accounting adjustments were made as required, resulting in stock-based compensation expense and related tax effects.

The 42,077 grants were classified as follows: (1) 17 grants to persons elected or appointed to the Board of Directors ("director grants"); (2) 3,892 grants to employees under the Monday/Tuesday Plan described below ("Monday/Tuesday grants"); (3) 27,096 grants made in broad-based awards to large numbers of employees, usually on an annual basis ("focal grants"); (4) 9,988 other grants ratified at meetings of the Board or Compensation Committee ("meeting grants"); (5) 1,082 other grants ratified by unanimous written consent ("UWC") of the Board or Compensation Committee ("other UWC grants"); and (6) two grants to the CEO ("CEO grants"). All references to the number of option shares, option exercise prices, and share prices in this Note 2 have not been adjusted for any subsequent stock splits.

With the exception of director grants, all stock option grants were subject to ratification by the Board or Compensation Committee at a meeting or by UWC. Following approval of the grants at a meeting or by UWC, the Company's legal staff would prepare a Secretary's Certificate certifying the ratification of the grants. Based on the facts and circumstances described below, the Company has concluded that the recipients and terms of certain grants were fixed for accounting purposes before ratification pursuant to parameters previously approved by the Board or Compensation Committee through the Monday/Tuesday Plan and the focal process. As further discussed below, within these parameters, management had the authority to determine the recipients and terms for each grant. Thus, the Company has concluded that the measurement dates for these grants occurred when management's process for allocating these grants was completed and the grants were ready for ratification, which was considered perfunctory. With regard to all other grants, the Company has concluded that the grants were finalized and the measurement dates occurred when the grants were ratified. For many grants, however, the dates of ratification cannot be established because the dates the UWCs were executed by the Board or Compensation Committee members or received by the Company are not available. For such grants, the Company has concluded that the date of the preparation of the Secretary's Certificate is the best alternative for determining the actual date of ratification.

As discussed below, the Company's analysis determined that the originally assigned grant dates for 6,428 grants on 42 dates are not the proper measurement dates. Accordingly, after accounting for forfeitures, the Company has recognized stock-based compensation expense of $105 million on a pre-tax basis over the respective awards' vesting terms. No adjustments were required for the remaining 35,649 grants. The adjustments were determined by category as follows:

Director Grants—Seventeen director grants were made during the relevant period. Two director grants were made pursuant to a 1997 plan that dated the grants on the enactment of the plan. The remaining fifteen grants were automatically made under the Director Stock Option Plan for non-employee directors, which was approved by shareholders in 1998, on the date of a director's election or appointment to the Board and on subsequent anniversaries, beginning on the fourth anniversary. Accordingly, the analysis determined that the originally assigned grant date for each director grant is the measurement date, and no accounting adjustments are required.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2—Restatement of Consolidated Financial Statements (Continued)

Monday/Tuesday Grants—Beginning in December 1998, 3,892 new hire grants and grants for promotion and retention purposes ("promotion/retention grants") were made during the relevant period under the "Monday/Tuesday Plan." Under the Monday/Tuesday Plan, new hire grants made within pre-established guidelines approved by the Board or Compensation Committee were dated on the Monday that the recipient started work (or the following Monday, if the recipient started on another day). The Company's analysis showed this process to be reliable with very low error rates. Promotion/retention grants, also based on pre-established guidelines, were made generally on the first Tuesday of each month. The Company has concluded that the new hire and promotion/retention grants made pursuant to the Monday/Tuesday Plan within pre-established guidelines do not require adjustment, with the exception of six grants that were erroneously dated before the employees' start dates. For 120 new hire and promotion/retention grants made outside the guidelines, however, the Company has concluded that the measurement dates are the dates of ratification by the Board or Compensation Committee rather than the dates used for grants within guidelines. Accordingly, based on the methodology described above, the Company has recognized stock-based compensation expense of $6 million from 126 grants.

Focal Grants—During the relevant period, 27,096 focal grants were made to employees typically on an annual basis as part of an extensive process that required several months to complete. Pursuant to limits, guidelines and practices previously approved by the Board or Compensation Committee, managers throughout the Company would make recommendations for grants to employees in their areas of responsibility. After senior management had determined that the grants were made in accordance with these established limits, guidelines and practices, management treated the grants as final when they were submitted to the Board or Compensation Committee for ratification. The Company has concluded that for 5,595 grants on five dates, the originally assigned grant dates are not the proper measurement dates. For these grants, management's process for finalizing the grants was completed after the originally assigned grant dates. As a result, the Company has recognized $29 million of stock-based compensation expense. For two of the five grant dates comprising 3,744 grants, the evidence shows that the grants were finalized and the measurement date occurred one day after the originally assigned grant dates. The grants on these two dates represent more than $16 million of the total $29 million of stock-based compensation expense resulting from focal grants.

Other Meeting Grants—During the relevant period, meetings of the Board or Compensation Committee were held to ratify 9,988 grants that are not Monday/Tuesday, focal or CEO grants. The grant dates and measurement dates for these grants are the meeting dates when the grants were ratified, with the exception of 46 grants. Forty-two of these 46 grants are dated concurrent with a meeting that considered and approved certain grants, but the evidence indicates that all of the grants may not have been finalized until a later date. One of the 46 grants was approved and dated at another meeting, but the recipient, who was becoming employed by the Company as part of a corporate acquisition, did not start until a later date. Two other grants were approved before the employees' start dates. Another grant was mistakenly cancelled and subsequently reinstated, requiring an accounting adjustment. Thus, for these 46 grants the Company has concluded that the originally assigned grant dates are not the proper measurement dates. As a result, the Company has recognized $2 million of stock-based compensation expense.

Other UWC Grants—During the relevant period, 1,082 grants were approved by UWCs for a variety of purposes, including executive recruitment, retention, promotion and new hires outside the Monday/Tuesday process. These grants were not made pursuant to pre-established guidelines adopted by the Board or Compensation Committee. Therefore, the Company has concluded that these grants were

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2—Restatement of Consolidated Financial Statements (Continued)

not finalized for accounting purposes until ratification by the Board or Compensation Committee. Accordingly, for 660 grants, the Company has concluded that the originally assigned grant dates are not the proper measurement dates. As a result, the Company has recognized $48 million of stock-based compensation expense.

CEO Grants—During the relevant period, the Company made two grants to CEO Steve Jobs. The first grant, dated January 12, 2000, was for 10 million option shares. The second grant, dated October 19, 2001, was for 7.5 million option shares. Both grants were cancelled in March 2003 prior to being exercised, when Mr. Jobs received 5 million shares of restricted stock.

With respect to the grant dated January 12, 2000, the Board on December 2, 1999, authorized a special "CEO Compensation Committee" to grant Mr. Jobs up to 15 million shares. The evidence indicates that the CEO Compensation Committee finalized the terms of the grant on January 12, 2000, although the Committee's action was memorialized in a UWC transmitted on January 18, 2000. Because the measurement date is the originally assigned grant date, the Company has not recognized any stock-based compensation expense from this grant. If the Company had determined that the measurement date was the date when the UWC was executed or received, then additional stock-based compensation would have been recognized.

The grant dated October 19, 2001 was originally approved at a Board meeting on August 29, 2001, with an exercise price of $17.83. The terms of the grant, however, were not finalized until December 18, 2001. The grant was dated October 19, 2001, with an exercise price of $18.30. The approval for the grant was improperly recorded as occurring at a special Board meeting on October 19, 2001. Such a special Board meeting did not occur. There was no evidence, however, that any current member of management was aware of this irregularity. The Company has recognized $20 million in stock-based compensation expense for this grant, reflecting the difference between the exercise price of $18.30 and the share price on December 18, 2001 of $21.01.

The incremental impact from recognizing stock-based compensation expense resulting from the investigation of past stock option grants is as follows (dollars in millions):

Fiscal Year	Pre-Tax Expense (Income)	After Tax Expense
1998	$ (1)	$—
1999	8	6
2000	13	9
2001	19	13
2002	29	23
2003	16	12
Total 1998 – 2003 impact	84	63
2004	13	10
2005	7	7
2006	1	4
Total	$ 105	$ 84

Additionally, the Company has restated the pro forma expense under Statement of Financial Accounting Standards (SFAS) No. 123 in Note 1 to reflect the impact of these adjustments.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2—Restatement of Consolidated Financial Statements (Continued)

The following table presents the effects of the stock-based compensation and related tax adjustments made to the Company's previously reported consolidated balance sheet as of September 24, 2005 (in millions, except share amounts):

	September 24, 2005		
	As Reported	Adjustments	As Restated
ASSETS:			
Current assets:			
Cash and cash equivalents	$ 3,491	$ —	$ 3,491
Short-term investments	4,770	—	4,770
Accounts receivable, less allowance of $46	895	—	895
Inventories	165	—	165
Deferred tax assets	331	—	331
Other current assets	648	—	648
Total current assets	10,300	—	10,300
Property, plant, and equipment, net	817	—	817
Goodwill	69	—	69
Acquired intangible assets, net	27	—	27
Other assets	338	(35)	303
Total assets	$ 11,551	(35)	$ 11,516
LIABILITIES AND SHAREHOLDERS' EQUITY:			
Current liabilities:			
Accounts payable	$ 1,779	$ —	$ 1,779
Accrued expenses	1,705	3	1,708
Total current liabilities	3,484	3	3,487
Non-current liabilities	601	—	601
Total liabilities	4,085	3	4,088
Commitments and contingencies			
Shareholders' equity:			
Common stock, no par value; 1,800,000,000 shares authorized; 835,019,364 shares issued and outstanding	3,521	43	3,564
Deferred stock compensation	(60)	(1)	(61)
Retained earnings	4,005	(80)	3,925
Accumulated other comprehensive income	—	—	—
Total shareholders' equity	7,466	(38)	7,428
Total liabilities and shareholders' equity	$ 11,551	(35)	$ 11,516

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2—Restatement of Consolidated Financial Statements (Continued)

The following table presents the effects of the stock-based compensation and related tax adjustments made to the Company's previously reported consolidated statements of operations (in millions, except share and per share amounts):

	Fiscal Year Ended September 24, 2005			Fiscal Year Ended September 25, 2004		
	As Reported	Adjustments	As Restated	As Reported	Adjustments	As Restated
Net sales	$ 13,931	$ —	$ 13,931	$ 8,279	$ —	$ 8,279
Cost of sales (1)	9,888	1	9,889	6,020	2	6,022
Gross margin	4,043	(1)	4,042	2,259	(2)	2,257
Operating expenses:						
Research and development (1)	534	1	535	489	2	491
Selling, general, and administrative (1)	1,859	5	1,864	1,421	9	1,430
Restructuring costs	—	—	—	23	—	23
Total operating expenses	2,393	6	2,399	1,933	11	1,944
Operating income	1,650	(7)	1,643	326	(13)	313
Other income and expense	165	—	165	57	—	57
Income before provision for income taxes	1,815	(7)	1,808	383	(13)	370
Provision for income taxes	480	—	480	107	(3)	104
Net income	$ 1,335	$ (7)	$ 1,328	$ 276	$ (10)	$ 266
Earnings per common share:						
Basic	$ 1.65	$ (0.01)	$ 1.64	$ 0.37	$ (0.01)	$ 0.36
Diluted	$ 1.56	$ (0.01)	$ 1.55	$ 0.36	$ (0.02)	$ 0.34
Shares used in computing earnings per share (in thousands):						
Basic	808,439	—	808,439	743,180	—	743,180
Diluted	856,780	98	856,878	774,622	154	774,776

(1) Includes stock-based compensation expense, which was allocated as follows:

Cost of sales	$ 2	$ 1	$ 3	$ 1	$ 2	$ 3
Research and development	$ 6	$ 1	$ 7	$ 4	$ 2	$ 6
Selling, general, and administrative	$ 34	$ 5	$ 39	$ 28	$ 9	$ 37

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2—Restatement of Consolidated Financial Statements (Continued)

The following table presents the cumulative adjustments of each component of shareholders' equity at the end of each fiscal year (in millions):

Fiscal Year	Common Stock	Deferred Stock Compensation	Retained Earnings	Net Impact to Shareholders' Equity
1998	$ 26	$ (27)	$ —	$ (1)
1999	36	(32)	(6)	(2)
2000	56	(43)	(15)	(2)
2001	81	(49)	(28)	4
2002	105	(49)	(51)	5
2003	85	(22)	(63)	—
2004	68	(8)	(73)	(13)
2005	43	(1)	(80)	(38)

Note 3—Financial Instruments

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses approximate their fair value due to the short maturities of those instruments.

Cash, Cash Equivalents and Short-Term Investments

The following table summarizes the fair value of the Company's cash and available-for-sale securities held in its short-term investment portfolio, recorded as cash and cash equivalents or short-term investments (in millions):

	September 30, 2006	September 24, 2005
Cash	$ 200	$ 127
U.S. Treasury and Agency securities	52	89
U.S. Corporate Securities	4,309	2,030
Foreign Securities	1,831	1,245
Total cash equivalents	6,192	3,364
U.S. Treasury and Agency securities	447	216
U.S. Corporate Securities	2,701	3,662
Foreign Securities	570	892
Total short-term investments	3,718	4,770
Total cash, cash equivalents, and short-term investments	$ 10,110	$ 8,261

The Company's U.S. corporate securities consist primarily of commercial paper, certificates of deposit, time deposits, and corporate debt securities. Foreign securities consist primarily of foreign commercial paper, certificates of deposit, and time deposits with foreign institutions, most of which are denominated in U.S. dollars. The Company had net unrealized losses totaling $687,000 on its investment portfolio, primarily related to investments with stated maturities less than 1 year, as of September 30, 2006, and net unrealized losses of $5.9 million on its investment portfolio, approximately half of which related to investments with stated maturities less than 1 year, as of September 24, 2005. The Company may sell its investments prior to their stated maturities for strategic purposes, in anticipation of credit deterioration, or

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3—Financial Instruments (Continued)

for duration management. The Company recognized net losses before taxes of $434,000 and $137,000 in 2006 and 2005, respectively, and a net gain before taxes of $1 million in 2004 as a result of such sales. These net gains were included in interest and other income, net.

As of September 30, 2006 and September 24, 2005, approximately $921 million and $287 million, respectively, of the Company's short-term investments had underlying maturities ranging from 1 to 5 years. The remaining short-term investments as of September 30, 2006 and September 24, 2005 had maturities less than 12 months.

In accordance with FASB Staff Position ("FSP") FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments,* the following table shows the gross unrealized losses and fair value for those investments that were in an unrealized loss position as of September 30, 2006 and September 24, 2005, aggregated by investment category and the length of time that individual securities have been in a continuous loss position (in millions):

	2006					
	Less than 12 Months		12 Months or Greater		Total	
Security Description	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and Agency Securities	$ 234	$—	$ 26	$—	$ 260	$—
U.S. Corporate Securities	943	—	102	(1)	1,045	(1)
Foreign Securities	164	—	34	—	198	—
Total	$ 1,341	$—	$ 162	$ (1)	$ 1,503	$ (1)

	2005					
	Less than 12 Months		12 Months or Greater		Total	
Security Description	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and Agency securities	$ 160	$ (1)	$ 2	$—	$ 162	$ (1)
U.S. corporate securities	3,960	(4)	25	—	3,985	(4)
Foreign Securities	1,382	(1)	1	—	1,383	(1)
Total	$ 5,502	$ (6)	$ 28	$—	$ 5,530	$ (6)

The unrealized losses on the Company's investments during 2006 in U.S. Government securities and during 2005 in U.S. Government securities, U.S. corporate securities, and foreign securities were caused primarily by changes in interest rates. The Company typically invests in highly-rated securities with low probabilities of default. The Company's investment policy requires investments to be rated single-A or better. Therefore, the Company considers the declines to be temporary in nature. As of September 30, 2006, the Company does not consider the investments to be other-than-temporarily impaired.

Market values were determined for each individual security in the investment portfolio. When evaluating the investments for other-than-temporary impairment, the Company reviews factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer, and the Company's ability and intent to hold the investment for a period of time, which may be sufficient for anticipated recovery in market value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3—Financial Instruments (Continued)

Accounts Receivable

Trade Receivables

The Company distributes its products through third-party distributors and resellers and directly to certain education, consumer, and commercial customers. The Company generally does not require collateral from its customers; however, the Company will require collateral in certain instances to limit credit risk. In addition, when possible, the Company does attempt to limit credit risk on trade receivables with credit insurance for certain customers in Latin America, Europe, Asia, and Australia and by arranging with third-party financing companies to provide flooring arrangements and other loan and lease programs to the Company's direct customers. These credit-financing arrangements are directly between the third-party financing company and the end customer. As such, the Company generally does not assume any recourse or credit risk sharing related to any of these arrangements. However, considerable trade receivables that are not covered by collateral, third-party flooring arrangements, or credit insurance are outstanding with the Company's distribution and retail channel partners. No customer accounted for more than 10% of trade receivables as of September 30, 2006 or September 24, 2005.

The following table summarizes the activity in the allowance for doubtful accounts (in millions):

	September 30, 2006	September 24, 2005	September 25, 2004
Beginning allowance balance	$ 46	$ 47	$ 49
Charged to costs and expenses	17	8	3
Deductions(a)	(11)	(9)	(5)
Ending allowance balance	$ 52	$ 46	$ 47

(a) Represents amounts written off against the allowance, net of recoveries.

Vendor Non-Trade Receivables

The Company has non-trade receivables from certain of its manufacturing vendors resulting from the sale of raw material components to these manufacturing vendors who manufacture sub-assemblies or assemble final products for the Company. The Company purchases these raw material components directly from suppliers. These non-trade receivables, which are included in the consolidated balance sheets in other current assets, totaled $1.6 billion and $417 million as of September 30, 2006 and September 24, 2005, respectively. The Company does not reflect the sale of these components in net sales and does not recognize any profits on these sales until the products are sold through to the end customer at which time the profit is recognized as a reduction of cost of sales.

Derivative Financial Instruments

The Company uses derivatives to partially offset its business exposure to foreign exchange risk. Foreign currency forward and option contracts are used to offset the foreign exchange risk on certain existing assets and liabilities and to hedge the foreign exchange risk on expected future cash flows on certain forecasted revenue and cost of sales. From time to time, the Company enters into interest rate derivative agreements to modify the interest rate profile of certain investments and debt. The Company's accounting policies for these instruments are based on whether the instruments are designated as hedge or non-hedge instruments. The Company records all derivatives on the balance sheet at fair value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3—Financial Instruments (Continued)

The following table shows the notional principal, net fair value, and credit risk amounts of the Company's foreign currency instruments as of September 30, 2006 and September 24, 2005 (in millions):

	September 30, 2006			September 24, 2005		
	Notional Principal	Fair Value	Credit Risk Amounts	Notional Principal	Fair Value	Creit Risk Amounts
Foreign exchange instruments qualifying as accounting hedges:						
Spot/Forward contracts	$ 351	$ 6	$ 6	$ 662	$ 10	$ 10
Purchased options	$ 1,256	$ 9	$ 9	$ 1,668	$ 17	$ 17
Sold options	$ 80	$ (1)	$—	$ 1,087	$ (5)	$—
Foreign exchange instruments other than accounting hedges:						
Spot/Forward contracts	$ 1,103	$ 2	$ 2	$ 833	$ (3)	$ 1
Purchased options	$ 167	$ 1	$—	$ 115	$—	$—
Sold options	$ —	$—	$—	$ —	$—	$—

The notional principal amounts for derivative instruments provide one measure of the transaction volume outstanding as of year-end, and do not represent the amount of the Company's exposure to credit or market loss. The credit risk amounts shown in the table above represents the Company's gross exposure to potential accounting loss on these transactions if all counterparties failed to perform according to the terms of the contract, based on then-current currency exchange rates at each respective date. The Company's exposure to credit loss and market risk will vary over time as a function of currency exchange rates.

The estimates of fair value are based on applicable and commonly used pricing models and prevailing financial market information as of September 30, 2006 and September 24, 2005. Although the table above reflects the notional principal, fair value, and credit risk amounts of the Company's foreign exchange instruments, it does not reflect the gains or losses associated with the exposures and transactions that the foreign exchange instruments are intended to hedge. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

Foreign Exchange Risk Management

The Company may enter into foreign currency forward and option contracts with financial institutions to protect against foreign exchange risk associated with existing assets and liabilities, certain firmly committed transactions, forecasted future cash flows, and net investments in foreign subsidiaries. Generally, the Company's practice is to hedge a majority of its existing material foreign exchange transaction exposures. However, the Company may not hedge certain foreign exchange transaction exposures due to immateriality, prohibitive economic cost of hedging particular exposures, or limited availability of appropriate hedging instruments.

To help protect gross margins from fluctuations in foreign currency exchange rates, the Company's U.S. dollar functional subsidiaries hedge a portion of forecasted foreign currency revenue, and the Company's non-U.S. dollar functional subsidiaries selling in local currencies hedge a portion of forecasted inventory purchases not denominated in the subsidiaries' functional currency. Other comprehensive income

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3—Financial Instruments (Continued)

associated with hedges of foreign currency revenue is recognized as a component of net sales in the same period as the related sales are recognized, and other comprehensive income related to inventory purchases is recognized as a component of cost of sales in the same period as the related costs are recognized. Typically, the Company hedges portions of its forecasted foreign currency exposure associated with revenue and inventory purchases over a time horizon of up to 6 months.

Derivative instruments designated as cash flow hedges must be de-designated as hedges when it is probable that the forecasted hedged transaction will not occur in the initially identified time period or within a subsequent 2 month time period. Deferred gains and losses in other comprehensive income associated with such derivative instruments are immediately reclassified into earnings in other income and expense. Any subsequent changes in fair value of such derivative instruments are also reflected in current earnings unless they are re-designated as hedges of other transactions. The Company recognized a net gain of approximately $421,000 in 2006 and net losses of $1.6 million and $2.8 million in 2005 and 2004, respectively, in other income and expense related to the loss of hedge designation on discontinued cash flow hedges due to changes in the Company's forecast of future net sales and cost of sales and due to prevailing market conditions. As of September 30, 2006, the Company had a net deferred gain associated with cash flow hedges of approximately $2.8 million, net of taxes, substantially all of which is expected to be reclassified to earnings by the end of the second quarter of fiscal 2007.

The net gain or loss on the effective portion of a derivative instrument designated as a net investment hedge is included in the cumulative translation adjustment account of accumulated other comprehensive income within shareholders' equity. For the years ended September 30, 2006 and September 24, 2005, the Company had net gains of $7.4 million and $673,000, respectively, included in the cumulative translation adjustment.

The Company may also enter into foreign currency forward and option contracts to offset the foreign exchange gains and losses generated by the re-measurement of certain assets and liabilities recorded in non-functional currencies. Changes in the fair value of these derivatives are recognized in current earnings in other income and expense as offsets to the changes in the fair value of the related assets or liabilities. Due to currency market movements, changes in option time value can lead to increased volatility in other income and expense.

Note 4—Consolidated Financial Statement Details (in millions)

Other Current Assets

	2006	2005
Vendor non-trade receivables	$ 1,593	$ 417
NAND flash memory prepayments	208	—
Other current assets	469	231
Total other current assets	$ 2,270	$ 648

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4—Consolidated Financial Statement Details (in millions) (Continued)

Property, Plant, and Equipment

	2006	2005
Land and buildings	$ 626	$ 361
Machinery, equipment, and internal-use software	595	470
Office furniture and equipment	94	81
Leasehold improvements	760	569
	2,075	1,481
Accumulated depreciation and amortization	(794)	(664)
Net property, plant, and equipment	$ 1,281	$ 817

Other Assets

	2006	2005 As Restated(1)
Long-term NAND flash memory prepayments	$ 1,042	$ —
Non-current deferred tax assets	—	148
Capitalized software development costs, net	21	38
Other assets	175	117
Total other assets	$ 1,238	$ 303

Accrued Expenses

	2006	2005 As Restated(1)
Deferred revenue—current	$ 746	$ 501
Accrued warranty and related costs	284	188
Accrued marketing and distribution	298	221
Accrued compensation and employee benefits	221	167
Other accrued tax liability	388	196
Deferred margin on component sales	324	26
Other current liabilities	820	409
Total accrued expenses	$ 3,081	$ 1,708

Non-Current Liabilities

	2006	2005
Deferred tax liabilities	$ 381	$ 308
Deferred revenue—non-current	355	281
Other non-current liabilities	14	12
Total non-current liabilities	$ 750	$ 601

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4—Consolidated Financial Statement Details (in millions) (Continued)

Other Income and Expense

	2006	2005	2004
Gains on non-current investments, net	$ —	$ —	$ 4
Interest income	$ 394	$ 183	$ 64
Interest expense	—	—	(3)
Other income (expense), net	(29)	(18)	(8)
Total interest and other income, net	365	165	53
Total other income and expense	$ 365	$ 165	$ 57

(1) See Note 2, "Restatement of Consolidated Financial Statements."

Note 5—Goodwill and Other Intangible Assets

The Company is currently amortizing its acquired intangible assets with definite lives over periods ranging from 3 to 10 years.

The following table summarizes the components of gross and net intangible asset balances (in millions):

	September 30, 2006			September 24, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Goodwill	$ 38	$ —	$ 38	$ 69	$ —	$ 69
Acquired technology	181	(42)	139	61	(34)	27
Total acquired intangible assets	$					

EXHIBIT 6

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended September 29, 2007

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ____________ to ____________
Commission file number 000-10030

APPLE INC.
(Exact name of registrant as specified in its charter)

California (State or other jurisdiction of incorporation or organization)	**942404110** (I.R.S. Employer Identification No.)
1 Infinite Loop **Cupertino, California** (Address of principal executive offices)	**95014** (Zip Code)

Registrant's telephone number, including area code: **(408) 996-1010**

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, no par value (Title of class)	The NASDAQ Global Select Market (Name of exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Note—Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

The aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant, as of March 31, 2007, was approximately $74,499,000,000 based upon the closing price reported for such date on the NASDAQ Global Select Market. For purposes of this disclosure, shares of common stock held by persons who hold more than 5% of the outstanding shares of common stock and shares held by executive officers and directors of the registrant have been excluded because such persons may be deemed to be affiliates. This determination of executive officer or affiliate status is not necessarily a conclusive determination for other purposes.

875,540,274 shares of Common Stock Issued and Outstanding as of November 2, 2007

The Business section and other parts of this Annual Report on Form 10-K ("Form 10-K") contain forward-looking statements that involve risks and uncertainties. Many of the forward-looking statements are located in "Management's Discussion and Analysis of Financial Condition and Results of Operations." Forward-looking statements provide current expectations of future events based on certain assumptions and include any statement that does not directly relate to any historical or current fact. Forward-looking statements can also be identified by words such as "anticipates," "believes," "estimates," "expects," "intends," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and the Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Risk Factors" under Part I, Item 1A of this Form 10-K. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

PART I

Item 1. Business

Company Background

Apple Inc. and its wholly-owned subsidiaries (collectively "Apple" or the "Company") design, manufacture, and market personal computers, portable digital music players, and mobile communication devices and sells a variety of related software, services, peripherals, and networking solutions. The Company sells its products worldwide through its online stores, its retail stores, its direct sales force, and third-party wholesalers, resellers, and value-added resellers. In addition, the Company sells a variety of third-party Macintosh ("Mac"), iPod and iPhone compatible products, including application software, printers, storage devices, speakers, headphones, and various other accessories and peripherals through its online and retail stores. The Company sells to education, consumer, creative professional, business, and government customers. The Company's fiscal year is the 52 or 53-week period that ends on the last Saturday of September. Unless otherwise stated, all information presented in this Form 10-K is based on the Company's fiscal calendar.

Business Strategy

The Company is committed to bringing the best personal computing, portable digital music and mobile communication experience to students, educators, creative professionals, businesses, government agencies, and consumers through its innovative hardware, software, peripherals, services, and Internet offerings. The Company's business strategy leverages its unique ability to design and develop its own operating system, hardware, application software, and services to provide its customers new products and solutions with superior ease-of-use, seamless integration, and innovative industrial design. The Company believes continual investment in research and development is critical to the development and enhancement of innovative products and technologies. In addition to evolving its personal computers and related solutions, the Company continues to capitalize on the convergence of the personal computer, digital consumer electronics and mobile communications by creating and refining innovations, such as the iPod, iPhone, iTunes Store, and Apple TV. The Company's strategy also includes expanding its distribution network to effectively reach more of its targeted customers and provide them with a high-quality sales and post-sales support experience.

Digital Lifestyle

The Company believes that for both professionals and consumers the personal computer has become the center of an evolving digital lifestyle by integrating with and enhancing the utility of advanced digital devices such as the Company's iPods, iPhones, digital video and still cameras, televisions, personal digital assistants, and other digital devices. The attributes of the personal computer that enable this functionality include a high-quality user interface, easy access to relatively inexpensive data storage, the ability to run complex applications, and the ability to connect easily to a wide variety of other digital devices and to the Internet. The Company is the only participant in the personal computer industry that controls the design and development of the entire personal computer—from the hardware and operating system to sophisticated software applications. This, along with its products' creative industrial designs, intuitive ease-of-use, and built-in graphics, multimedia and networking capabilities, positions the Company to offer innovative integrated digital lifestyle solutions.

Expanded Distribution

The Company believes a high-quality buying experience with knowledgeable salespersons who can convey the value of the Company's products and services greatly enhances its ability to attract and retain customers. The Company sells many of its products and resells certain third-party products in most of its major markets directly to consumers, education customers, and businesses through its retail and online stores. The Company has also invested in programs to enhance reseller sales, including the Apple Sales Consultant Program, which places Apple employees and contractors at selected third-party reseller locations. The Company believes providing direct contact with its targeted customers is an efficient way to demonstrate the advantages of its Mac computers and other products over those of its competitors.

At the end of fiscal 2007, the Company had opened a total of 197 of its own retail stores, including 174 stores in the U.S. and a total of 23 stores in Canada, Japan, U.K. and Italy. The Company has typically located its stores at high-traffic locations in quality shopping malls and urban shopping districts.

One of the goals of the retail initiative is to expand the Company's installed base through sales to customers who currently do not already own the Company's products. By operating its own stores and locating them in desirable high-traffic locations, the Company is better positioned to control the customer buying experience and attract new customers. The stores are designed to simplify and enhance the presentation and marketing of the Company's products and related solutions. To that end, retail store configurations have evolved into various sizes in order to accommodate market-specific demands. The stores employ experienced and knowledgeable personnel who provide product advice and certain support services. The stores offer a wide selection of third-party hardware, software, and various other accessory products and peripherals selected to complement the Company's own products.

Education

Throughout its history, the Company has focused on the use of technology in education and has been committed to delivering tools to help educators teach and students learn. The Company believes effective integration of technology into classroom instruction can result in higher levels of student achievement, especially when used to support collaboration, information access, and the expression and representation of student thoughts and ideas. The Company has designed a range of products and services to address the needs of education customers. These products and services include the Company's Mac computers, iPods, iTunes, and Apple TV, in addition to various solutions for video creation and editing, wireless networking, professional development, and one-to-one (1:1) learning. A 1:1 learning solution typically consists of a portable computer for every student and teacher along with the installation of a wireless network.

Creative Professionals

Creative professionals constitute one of the Company's most important markets for both hardware and software products. This market is also important to many third-party developers who provide Mac-compatible hardware and software solutions. Creative customers utilize the Company's products for a variety of activities including digital video and film production and editing; digital video and film special effects, compositing and titling; digital still photography and workflow management; graphic design, publishing, and print production; music creation and production; audio production and sound design; and web design, development, and administration.

The Company designs its high-end hardware solutions, including servers, desktops, and portable Mac systems, to incorporate the power, expandability, and features desired by creative professionals. The Company's operating system, Mac OS X, incorporates powerful graphics and audio technologies and features developer tools to optimize system and application performance when running creative solutions provided by the Company or third-party developers.

Other

In addition to consumer, education and creative professional markets, the Company provides hardware and software products and solutions for customers in the information technology, science, business, and government markets.

Business Organization

The Company manages its business primarily on a geographic basis. The Company's reportable operating segments consist of the Americas, Europe, Japan, and Retail. The Americas, Europe, and Japan reportable segments do not include activities related to the Retail segment. The Americas segment includes both North and South America. The Europe segment includes European countries as well as the Middle East and Africa. The Retail segment operates Apple-owned retail stores in the U.S., Canada, Japan, the U.K. and Italy. Each reportable geographic operating segment and the Retail operating segment provide similar hardware and software products and similar services. Further information regarding the Company's operating segments may be found in Part II, Item 7 of this Form 10-K under the heading "Segment Operating Performance," and in Part II, Item 8 of this Form 10-K in Notes to Consolidated Financial Statements at Note 9, "Segment Information and Geographic Data."

Products

The Company offers a range of personal computing products including desktop and portable personal computers, related devices and peripherals, and various third-party hardware and software products. In addition, the Company offers software products including Mac OS® X, the Company's proprietary operating system software for the Mac®; server software and related solutions; professional application software; and consumer, education and business oriented application software. The Company also designs, develops and markets to Mac and Windows users its family of iPod® digital music players and its iPhone™ mobile communication device, along with related accessories and services including the online distribution of third-party content through the Company's iTunes Store™. The Company's primary products are discussed below.

Hardware Products

The Company offers a range of personal computing products including desktop and notebook computers, server and storage products, related devices and peripherals, and various third-party hardware products. The Company's Mac desktop and portable systems feature Intel microprocessors, the Company's Mac OS X Version 10.5 Leopard™ ("Mac OS X Leopard") operating system that became available in October 2007 and iLife® suite of software for creation and management of digital photography, music, movies, DVDs, and website. The Company's transition from PowerPC to Intel microprocessors for Mac systems was completed in August 2006, and its transition for Xserve® was completed in November 2006. There are potential risks and uncertainties associated with the transition to Intel microprocessors, which are further discussed in Item 1A of this Form 10-K under the heading "Risk Factors."

MacBook® Pro

The MacBook Pro family of notebook computers is designed for professionals and advanced consumer users. First introduced in January 2006, the MacBook Pro includes a 15-inch or 17-inch widescreen display, a built-in iSight® video camera, Front Row™ with the Apple Remote, and the MagSafe® magnetic power adapter. In June 2007, the Company updated its MacBook Pro models to include the latest Intel Core 2 Duo processors and the Nvidia GeForce 8600M GT graphics controller. MacBook Pro includes up to 4GB of 667MHz DDR2 main memory with an 800 MHz frontside bus, a Serial ATA hard drive, and a slot-loading double-layer SuperDrive®. In addition, every MacBook Pro features a 1-inch thin aluminum enclosure and includes AirPort Extreme® 802.11n wireless networking, Bluetooth 2.0+EDR, Gigabit

Ethernet, USB 2.0 and FireWire® ports, audio input and output ports, a DVI video-out port, an ExpressCard/34 slot, scrolling trackpad, and backlit keyboard.

MacBook®

The MacBook is designed for consumer and education users. First introduced in May 2006, the MacBook includes a 13-inch widescreen display, a built-in iSight video camera and the MagSafe magnetic power adapter. In May 2007, the Company updated its MacBook models with faster Intel Core 2 Duo processors running at up to 2.16GHz, Intel integrated graphics, support for up to 4GB of 667MHz DDR2 main memory, a Serial ATA hard drive, and a slot-loading Combo optical drive or double-layer SuperDrive. In addition, MacBook models include AirPort Extreme 802.11n wireless networking, Bluetooth 2.0+EDR, Gigabit Ethernet, USB 2.0 and FireWire ports, audio input and output ports, a mini-DVI video output port, and scrolling trackpad.

Mac® Pro

The Mac Pro desktop computer is targeted at business and professional users and is designed to meet the performance, expansion, and networking needs of the most demanding Mac user. The Mac Pro features two Intel Xeon dual-core or quad-core processors running at up to 3.0GHz, with 4MB and 8MB of shared Level 2 cache and independent 1.33GHz front-side buses, 667MHz fully buffered memory, and a 256-bit wide memory architecture. The Mac Pro also features a direct attach storage solution for snap-in installation of up to four 750GB Serial ATA hard drives for a total of 3TB of internal storage. Every Mac Pro includes three full-length PCI Express expansion slots and one double-wide PCI Express graphics slot to support double-wide graphics cards. The Mac Pro also includes dual Ethernet ports, optical digital input and output ports, analog audio input and output ports, and multiple FireWire 400, FireWire 800 and USB 2.0 ports.

iMac®

The iMac desktop computer is targeted at consumer, education and business customers. In August 2007, the Company updated the iMac to include 2.0GHz, 2.4GHz or 2.8GHz Intel Core 2 Duo processors, up to 4 GB of 667 MHz DDR2 SDRAM, a faster graphics card using ATI Radeon HD 2400 XT or ATI Radeon HD 2600 PRO graphics, and slot-loading double-layer SuperDrive. All iMac models include a built-in iSight video camera, AirPort Extreme 802.11n wireless networking, Bluetooth 2.0+EDR, built-in Gigabit Ethernet, USB 2.0 and Fire Wire ports, and mini-DVI video out.

Mac® mini

In February 2006, the Company introduced the Intel-based Mac mini that includes Front Row with the Apple Remote. The Mac mini offers 1GB of 667MHz memory expandable to 2GB and either a 1.83GHz or 2.0GHz Intel processor. Every Mac mini includes built-in Gigabit Ethernet, AirPort Extreme 802.11g wireless networking, Bluetooth 2.0+EDR, a total of four USB 2.0 ports, and one FireWire 400 port. Mac mini includes a full-size DVI interface and a VGA-out adapter to connect to a variety of displays, including televisions, and features both analog and digital audio outputs.

Xserve® and Xserve RAID Storage System

Xserve is a 1U rack-mount server powered by two dual-core 64-bit Intel Xeon processors running at up to 3.0GHz and features Mac OS® X Server 10.5, which became available in October 2007. Xserve supports up to 32GB of RAM, remote management and internal serial attached SCSI ("SAS") or serial ATA ("SATA") storage drives of up to 2.25TB, with optional internal hardware RAID. The Company's Xserve RAID storage system delivers up to 10.5TB of Fiber Channel attached hardware RAID storage capacity and also expanded support for Mac OS X and heterogeneous environments.

Music Products and Services

The Company offers its iPod® line of portable digital music players and related accessories to Mac and Windows users. All iPods work with the Company's iTunes® digital music management software ("iTunes software") available for both Mac and Windows-based computers.

The Company also provides an online service to distribute third-party music, audio books, music videos, short films, television shows, movies, podcasts and iPod games through its iTunes Store. In addition to the Company's own iPod accessories, thousands of third-party iPod compatible products are available, either through the Company's online and retail stores or from third parties, including portable and desktop speaker systems, headphones, car radio solutions, voice recorders, cables and docks, power supplies and chargers, and carrying cases and armbands.

iPod® shuffle

The iPod shuffle weighs half an ounce and features an aluminum design and a built-in clip. The iPod shuffle contains 1GB of flash memory capable of holding up to 240 songs and provides up to 12 hours of battery life. The iPod shuffle includes a shuffle switch feature that allows users to listen to their music in random order or in the order of their playlist synced through iTunes. iPod shuffle works with iTunes' patent-pending AutoFill option that automatically selects songs to fill the iPod shuffle from a user's iTunes library.

iPod® nano

In September 2007, the Company introduced a new version of its flash-memory-based iPod nano featuring a larger two-inch display with 204 pixels per inch and a new user interface featuring Cover Flow®. The new iPod nano comes in an all metal design made with anodized aluminum and polished stainless steel and has up to 24 hours of battery life. The iPod nano includes the Click Wheel, a smaller and lighter design and brighter color screen than its predecessor, and new iPod games. The iPod nano is available in 4GB and 8GB configurations and in a variety of colors.

iPod® classic

In September 2007, the Company introduced the new iPod classic. The iPod classic is an upgraded version of the original iPod, the Company's hard-drive based portable digital music player. The iPod classic is available in an 80GB model capable of holding up to 20,000 songs or 100 hours of video and a 160GB model capable of holding up to 40,000 songs or 200 hours of video. The iPod classic features up to 40 hours of battery life and includes a new all-metal enclosure and a 2.5-inch color screen that can display album artwork, photos, and video content including music videos, video and audio podcasts, short films, television shows, movies, and games.

iPod® touch

In September 2007, the Company introduced the iPod touch, a new flash-memory-based iPod that is 8 mm thin and features the Company's Multi-Touch™ user interface on a 3.5-inch widescreen display. The iPod touch includes Wi-Fi wireless networking and additional applications such as Safari™, Google Search or Yahoo! oneSearch, and the new iTunes Wi-Fi Music Store. The iPod touch is available in 8GB and 16 GB configurations and features up to 22 hours of audio playback and up to five hours of video playback. The iPod touch's user interface is based on the Multi-Touch™ display allowing users to control the device with a touchscreen.

iTunes® 7

iTunes is a digital media player application for playing, downloading, and organizing digital music and video files. iTunes is available for both Mac and Windows-based computers. Within iTunes, the user can connect to the iTunes Store™, a service that allows customers to find, purchase, and download third-party digital music, audio books, music videos, short films, television shows and movies, and iPod games. In

September 2007, the Company introduced the iTunes Wi-Fi Music Store offering users the ability to browse, search, preview, purchase, and download songs and albums from their iPod touch or iPhone over a Wi-Fi network. Customers can search the contents of the store catalog to locate works by title, artist, or album, or browse the entire contents of the store by genre. Originally introduced in the U.S. in April 2003, the iTunes Store now serves customers in 22 countries.

iPhone™

In January 2007, the Company announced iPhone™, a handheld device that combines in a single product a mobile phone, a widescreen iPod with touch controls, and an Internet communications device. iPhone's user interface is based on the Multi-Touch™ display allowing users to control the device with a touchscreen. iPhone lets users make calls by tapping on a name or number in their address book, a favorites list, or a call log as well as select and listen to voicemail messages in any order. iPhone also allows users to purchase and download songs and albums from the iTunes Wi-Fi Music Store directly onto their iPhone and play their iTunes® content, including movies, television shows, music, photos and podcasts, with the touch of a finger. iPhone features desktop-class email, web browsing, searching, and maps. iPhone is compatible with a Mac or PC and automatically syncs content from a user's iTunes library, as well as contacts, bookmarks, and email accounts. iPhone is a quad-band GSM phone featuring EDGE and Wi-Fi wireless technologies for data networking, Bluetooth 2.0, a built-in 2 megapixel camera, a 3.5-inch touch screen with 480-by-320 resolution at 160 pixels per inch, and providing up to 8 hours of talk time, 6 hours of Internet use, 7 hours of video playback or 24 hours of audio playback. AT&T Mobility LLC ("AT&T") is the exclusive U.S. cellular network carrier for iPhone. The Company began shipping iPhone in the U.S. on June 29, 2007. On November 9, 2007, the Company began shipping iPhone in the U.K. and Germany, and expects to ship the iPhone in France on November 29, 2007. O2 Limited ("O2"), T-Mobile International AG & Co. KG ("T-Mobile"), and France Telecom ("Orange") are the exclusive cellular network carriers for iPhone in the U.K., Germany, and France, respectively. The Company has entered into agreements with each exclusive cellular network carrier related to cellular network services and the purchase and sale of iPhone and iPhone related products. These agreements entitle the Company to receive certain payments from these carriers.

In addition to the Company's own iPhone accessories, third-party iPhone compatible products are available, either through the Company's online and retail stores or from third parties, including headsets, cables and docks, power supplies, and carrying cases.

Peripheral Products

The Company sells a variety of Apple-branded and third-party Mac-compatible peripheral products directly to end-users through its retail and online stores, including printers, storage devices, computer memory, digital video and still cameras, and various other computing products and supplies.

Displays

The Company manufactures a family of widescreen flat panel displays including the 30-inch Apple Cinema HD Display™, a widescreen active-matrix LCD with 2560-by-1600 pixel resolution, the 23-inch Apple Cinema HD Display with 1920-by-1200 pixel resolution and the 20-inch Apple Cinema Display® with 1680-by-1050 pixel resolution. These displays feature built-in dual FireWire and dual USB 2.0 ports and use the industry standard DVI interface for a pure digital connection with the Company's latest Mac Pro, MacBook Pro, Mac mini and MacBook systems. The Cinema Displays feature an aluminum design with a thin bezel, suspended by an aluminum stand that allows viewing angle adjustment.

Apple TV™

In January 2007, the Company announced Apple TV, a device that permits users to wirelessly play iTunes content on a widescreen television. Compatible with a Mac or Windows-based computer, Apple TV includes either a 40GB or 160GB hard drive capable of storing up to 200 hours of video, 36,000 songs, 25,000 photos, or a combination of each and is capable of displaying content in high definition resolution up to 720p. Apple TV connects to a broad range of widescreen televisions and home theater systems and comes standard with high-definition multimedia interface, component video, and both analog and digital optical audio ports. Using high-speed AirPort® 802.11n wireless networking, Apple TV can auto-sync content from one computer or stream content from up to five additional computers directly to a television. The Company began shipping Apple TV in March 2007.

Software Products and Computer Technologies

The Company offers a range of software products for education, creative professional, consumer, business and government customers, including Mac OS X, the Company's proprietary operating system software for the Mac; server software and related solutions; professional application software; and consumer, education, and business oriented application software.

Operating System Software

Mac OS® X is built on an open-source UNIX-based foundation. Mac OS X Leopard is the sixth major release of Mac OS X and became available in October 2007. Leopard includes 300 new features and introduces a new desktop with Stacks, a new way to easily access files from the Dock; a redesigned Finder™ that lets users quickly browse and share files between multiple Macs; Quick Look, a new way to instantly see files without opening an application; Spaces™, an intuitive new feature used to create groups of applications and instantly switch between them; and Time Machine™, an effortless way to automatically back up everything on a Mac.

Application Software

iLife® '08

In August 2007, the Company introduced iLife '08, the latest release of its consumer-oriented digital lifestyle application suite, which features iPhoto®, iDVD®, GarageBand®, iWeb™, iTunes® and iMovie® '08. All of these applications are Universal, meaning that they run natively on both Intel and PowerPC-based Mac computers ("Universal").

> iPhoto® is the Company's consumer-oriented digital photo software application. iPhoto '08 adds new features for organizing and browsing photos, including event-based grouping, new professional quality image editing tools, and enables publishing to .Mac Web Gallery. .Mac Web Gallery, is fully integrated with iPhoto '08 and iMovie '08, allowing .Mac users to share photos and movies over the web. iPhoto '08 features print, photo book, greeting card, and calendar layout tools and integrated online ordering services.
>
> iMovie® '08 is a new version of the Company's consumer-oriented digital video editing software application. iMovie® '08 provides new tools for quick movie creation and video enhancements, including transitions, titles, music and sound effects. Projects in iMovie® '08 can also be published to .Mac Web Gallery.
>
> iDVD® is the Company's consumer-oriented software application that enables users to turn iMovie files, QuickTime® files, and digital pictures into interactive DVDs that can be played on most consumer DVD players. iDVD '08 features 10 new Apple-designed menu themes in both widescreen (16:9) and standard (4:3) formats.
>
> GarageBand® is the Company's consumer-oriented music creation software application that allows users to play, record and create music using a simple interface. With GarageBand, software instruments, digital audio recordings and looping tracks can be arranged and edited to create songs. GarageBand '08 allows users to export finished songs to their iTunes library, or publish a podcast through iWeb and .Mac that includes artwork, sound effects, and music jingles.

iWeb™ allows users to create online photo albums, blogs and podcasts, and to customize websites using editing tools. iWeb'08 offers new features to make websites more interactive by adding live web widgets, which are snippets of live content from other websites, such as Google Maps, targeted ads using Google AdSense and photos or movies from .Mac Web Galleries.

iLife '08 also includes iTunes®, the Company's digital music jukebox software application that allows users to purchase a variety of digital content available through the Company's iTunes Store. iTunes organizes content using searching, browsing, and playlists, and provides integration with the complete family of iPods and iPhone.

iWork™ '08

In August 2007, the Company introduced iWork '08, a new version of the Company's integrated productivity suite designed to help users create, present, and publish documents, presentations and spreadsheets. iWork '08 includes updates to Pages® '08 for word processing and page layout, Keynote® '08 for presentations, and introduces Numbers '08 for spreadsheets. All of these programs are Universal and feature advanced image tools, including enhanced photo masking, resizable picture frames and edges, and Instant Alpha, which easily removes the background of a photo.

Final Cut Studio® 2

In April 2007, the Company introduced Final Cut Studio® 2, an upgraded version of the Company's video production suite designed for professionals. Final Cut Studio 2 features Final Cut Pro® 6 for video editing, DVD Studio Pro® 4 for DVD authoring, Motion 3 for real-time motion graphics, Soundtrack® Pro 2 for audio editing and sound design, Color for color grading and finishing, and Compressor 3 for encoding media in multiple formats. All of these applications are Universal. The Company also offers Final Cut Express HD 3.5, a consumer version of the Company's movie making software.

Logic® Studio

In September 2007, the Company introduced Logic Studio, a comprehensive suite of professional tools used by musicians and professionals to create, perform, and record music. Logic Studio features Logic® Pro 8, an upgraded version of the Company's music creation and audio production software; MainStage™, a new live performance application; Soundtrack® Pro 2, a professional audio post production software; Studio Instruments, made up of 40 instrument plug-ins; Studio Effects, with 80 professional effect plug-ins; and studio Sound Library. In addition, the Company offers Logic® Express 8, a standalone version of the Logic® Pro 8 application that provides an easy entry into professional music production. All of these applications are Universal.

FileMaker® Pro

The FileMaker Pro database software is Universal and offers relational databases and desktop-to-web publishing capabilities. In July 2007, the Company introduced FileMaker Pro 9 featuring a new Quick Start screen, which stores users' favorites and gives them access to the new videos in the FileMaker Learning Center; Conditional Formatting, which highlights data based on parameters the user sets; and the ability to email a link to other FileMaker users to instantly access a database.

Internet Software and Services

The Company is focused on delivering seamless integration with and access to the Internet throughout the Company's products and services. The Company's Internet solutions adhere to many industry standards to provide an optimized user experience.

Safari™

In October 2007, the Company made available Safari 3, a web browser compatible with Windows XP, Windows Vista and Mac OS X. Safari 3 includes built-in Google search; SnapBack™ to instantly return to search results; a way to name, organize and present bookmarks; tabbed browsing; and automatic "pop-up" ad blocking.

QuickTime®

QuickTime, the Company's multimedia software for Mac or Windows-based computers, features streaming of live and stored video and audio over the Internet and playback of high-quality audio and video on computers. QuickTime 7 features H.264 encoding and can automatically determine a user's connection speed to ensure they are getting the highest-quality content stream possible. QuickTime 7 also delivers multi-channel audio and supports audio formats, including AIFF, WAV, MOV, MP4 (AAC only), CAF, and AAC/ADTS.

The Company offers several other QuickTime products. QuickTime 7 Pro, a suite of software tools, allows creation and editing of Internet-ready audio and video files. QuickTime 7 Pro allows users to create H.264 video, capture audio and video, create multi-channel audio, and export multiple files while playing back or editing video.

.Mac®

The Company's .Mac offering is a suite of Internet services that for an annual fee provides Mac users with a powerful set of Internet tools. .Mac services include: internet message access protocol ("IMAP") mail, an ad-free email service; website hosting for publishing web sites from iWeb; iDisk, a virtual hard drive accessible anywhere with Internet access; .Mac Sync, which keeps Safari bookmarks, iCal® calendars, Address Book information, Keychain®, and Mac OS X Mail preferences up-to-date across multiple Mac computers; and Groups which allows people to use a group email list and website. The current version of .Mac provides combined iDisk and email storage of up to 10GB for individuals and 20GB for families. In August 2007, the Company announced updates to its .Mac online service, including .Mac Web Gallery, a new service for .Mac members to share photos and movies on the Internet. .Mac Web Gallery lets members share photos and movies directly from iLife '08 with anyone on a Mac, PC or iPhone.

Wireless Connectivity and Networking

AirPort Extreme®

AirPort Extreme is the Company's wireless networking technology. AirPort Extreme Base Station includes 802.11n Wi-Fi wireless networking and supports up to 50 users. Air Port Extreme operates at either 2.4 GHz or 5 GHz frequencies, providing compatibility with most Wi-Fi devices. The current AirPort Extreme Base Station works with both Mac and Windows computers, includes multiple Gigabit Ethernet ports and supports USB printer sharing to allow multiple users to wirelessly share USB printers connected directly to the base station. All Macs have either built-in or optional wireless networking client hardware and software that communicates with Airport Extreme or Airport Express Base Stations.

AirPort® Express®

AirPort Express is the first 802.11g standard mobile base station that can be plugged directly into the wall for wireless Internet connections and USB printing. Airport Express also features analog and digital audio outputs that can be connected to a stereo and AirTunes™ music networking software that works with iTunes, giving users a way to wirelessly stream iTunes music from their Mac or Windows-based computer to any room in the house. AirPort Express features a single piece design weighing 6.7 ounces.

Product Support and Services

AppleCare® offers a range of support options for the Company's customers. These options include assistance that is built into software products, printed and electronic product manuals, online support including comprehensive product information as well as technical assistance, and the AppleCare

Protection Plan. The AppleCare Protection Plan is a fee-based service that typically includes three years of phone support and hardware repairs, dedicated web-based support resources, and user diagnostic tools.

Markets and Distribution

The Company's customers are primarily in the education, creative professional, consumer, and business markets. The Company distributes its products through wholesalers, resellers, national and regional retailers and cataloguers. No individual customer accounted for more than 10% of net sales in 2007, 2006, or 2005. The Company also sells many of its products and resells certain third-party products in most of its major markets directly to consumers, education customers, and businesses through its own sales force and retail and online stores.

Competition

The Company is confronted by aggressive competition in all areas of its business. The markets for consumer electronics, personal computers, related software and peripheral products, digital music devices and related services, and mobile communication devices are highly competitive. These markets are characterized by rapid technological advances in both hardware and software that have substantially increased the capabilities and use of personal computers, other digital electronic devices, and mobile communication devices that have resulted in the frequent introduction of new products with competitive price, feature, and performance characteristics. Over the past several years, price competition in these markets has been particularly intense. The Company's competitors who sell personal computers based on other operating systems have aggressively cut prices and lowered their product margins to gain or maintain market share. The Company's financial condition and operating results can be adversely affected by these and other industry-wide downward pressures on gross margins. The principal competitive factors include price, product features, relative price/performance, product quality and reliability, design innovation, availability of software and peripherals, marketing and distribution capability, service and support, and corporate reputation. Further, as the personal computer industry and its customers place more reliance on the Internet, an increasing number of Internet devices that are smaller, simpler, and less expensive than traditional personal computers may compete for market share with the Company's products.

The Company's music products and services have faced significant competition from other companies promoting their own digital music and content products and services, including those offering free peer-to-peer music and video services. The Company believes it currently retains a competitive advantage by offering superior innovation and integration of the entire solution including the hardware (personal computer and iPod), software (iTunes), and distribution of content (iTunes Store and iTunes Wi-Fi Music Store). However, the Company expects competition in this space to intensify as competitors attempt to imitate the Company's approach to tightly integrating these elements within their own offerings or, alternatively, collaborate with each other to offer solutions that are more integrated than those they currently offer. Some of these current and potential competitors have substantial resources and may be able to provide such products and services at little or no profit or even at a loss to compete with the Company's offerings.

The Company is currently focused on market opportunities related to mobile communication devices including the iPhone. The mobile communications industry is highly competitive with several large, well-funded, and experienced competitors. The Company faces competition from mobile communication device companies that may attempt to imitate some of the iPhone's functions and applications within their own smart phones. This industry is characterized by aggressive pricing practices, frequent product introductions, evolving design approaches and technologies, rapid adoption of technological and product advancements by competitors, and price sensitivity on the part of consumers.

The Company's future financial condition and operating results are substantially dependent on the Company's ability to continue to develop improvements to the Mac platform and to the Company's hardware, software and services related to consumer electronic devices, including iPods, and mobile communication devices, including iPhone.

Raw Materials

Although most components essential to the Company's business are generally available from multiple sources, certain key components including, but not limited to, microprocessors, enclosures, certain LCDs, certain optical drives, and application-specific integrated circuits ("ASICs") are currently obtained by the Company from single or limited sources. Some key components, while currently available to the Company from multiple sources, are at times subject to industry-wide availability constraints and pricing pressures. In addition, the Company uses some components uncommon to the rest of the personal computer, consumer electronics and mobile communication industries, and new products introduced by the Company often initially utilize custom components obtained from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. If the supply of a key or single-sourced component to the Company were to be delayed or curtailed or in the event a key manufacturing vendor delayed shipment of completed products to the Company, the Company's ability to ship related products in desired quantities and in a timely manner could be adversely affected. The Company's business and financial performance could also be adversely affected depending on the time required to obtain sufficient quantities from the original source, or to identify and obtain sufficient quantities from an alternative source. Continued availability of these components may be affected if suppliers were to decide to concentrate on the production of common components instead of components customized to meet the Company's requirements. The Company attempts to mitigate these potential risks by working closely with these and other key suppliers on product introduction plans, strategic inventories, coordinated product introductions, and internal and external manufacturing schedules and levels. Consistent with industry practice, the Company acquires components through a combination of formal purchase orders, supplier contracts, and open orders based on projected demand information. The Company's purchase commitments typically cover its requirements for periods ranging from 30 to 150 days.

The Company believes there are several component suppliers and manufacturing vendors whose loss to the Company could have a material adverse effect upon the Company's business and financial condition. At this time, such vendors include Agere Systems, Inc., Ambit Microsystems Corporation, Amperex Technology Limited, ASUSTeK Corporation, ATI Technologies, Inc., Atheros Communications Inc., AU Optronics Corporation, Broadcom Corporation, Chi Mei Optoelectronics Corporation, Cypress Semiconductor Corporation, Hitachi Global Storage Technologies, Hon Hai Precision Industry Co., Ltd., Infineon Technologies AG, Intel Corporation, Inventec Appliances Corporation, LG. Phillips Co., Ltd., Matsushita, Murata Manufacturing Co., Ltd., National Semiconductor Corporation, NVIDIA Corp., Inc., Quanta Computer, Inc., Renesas Semiconductor Co. Ltd., Samsung Electronics, Sony Corporation, Synaptics, Inc., Texas Instruments, and Toshiba Corporation. Certain of these vendors are the sole-sourced supplier of components and manufacturing outsourcing for many of the Company's key products, including but not limited to, assembly of most of the Company's portable Mac computers, iPods, and iPhones.

Research and Development

Because the personal computer, consumer electronics, and mobile communication industries are characterized by rapid technological advances, the Company's ability to compete successfully is heavily dependent upon its ability to ensure a continual and timely flow of competitive products, services, and technologies to the marketplace. The Company continues to develop new products and technologies and to enhance existing products in the areas of computer hardware and peripherals, consumer electronics products, mobile communication devices, system software, applications software, networking and communications software and solutions, and Internet services and solutions. The Company may expand the range of its product offerings and intellectual property through licensing and/or acquisition of third-party business and technology. The Company's research and development expenditures totaled $782 million, $712 million, and $535 million in 2007, 2006, and 2005, respectively.

Patents, Trademarks, Copyrights and Licenses

The Company currently holds rights to patents and copyrights relating to certain aspects of its computer systems, iPods, iPhone, peripherals, software, and services. In addition, the Company has registered, and/or has applied to register, trademarks and service marks in the U.S. and a number of foreign countries for "Apple," the Apple logo, "Macintosh," "Mac," "iPod," "iTunes," "iTunes Store," "iPhone," and numerous other trademarks and service marks. Although the Company believes the ownership of such patents, copyrights, trademarks and service marks is an important factor in its business and that its success does depend in part on the ownership thereof, the Company relies primarily on the innovative skills, technical competence, and marketing abilities of its personnel.

Many of the Company's products are designed to include intellectual property obtained from third-parties. While it may be necessary in the future to seek or renew licenses relating to various aspects of its products and business methods, the Company believes, based upon past experience and industry practice, such licenses generally could be obtained on commercially reasonable terms; however, there is no guarantee that such licenses could be obtained at all. Because of technological changes in the computer industry, current extensive patent coverage, and the rapid rate of issuance of new patents, it is possible certain components of the Company's products and business methods may unknowingly infringe existing patents or intellectual property rights of others. From time to time, the Company has been notified that it may be infringing certain patents or other intellectual property rights of third-parties.

Foreign and Domestic Operations and Geographic Data

The U.S. represents the Company's largest geographic marketplace. Approximately 60% of the Company's net sales in 2007 came from sales to customers inside the U.S. Final assembly of products sold by the Company is currently performed in the Company's manufacturing facility in Cork, Ireland, and by external vendors in Fremont, California; Fullerton, California; Taiwan; the Republic of Korea ("Korea"); the People's Republic of China ("China"); and the Czech Republic. Currently, the supply and manufacture of many critical components used in the Company's products is performed by sole-sourced third-party vendors in the U.S., China, Japan, Korea, and Singapore. Final assembly of substantially all of the Company's portable products, including MacBook Pro, MacBook, iPod, and iPhone, is performed by sole-sourced third-party vendors in China. Margins on sales of the Company's products in foreign countries, and on sales of products that include components obtained from foreign suppliers, can be adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including tariffs and antidumping penalties.

Information regarding financial data by geographic segment is set forth in Part II, Item 8 of this Form 10-K and in Notes to Consolidated Financial Statements at Note 9, "Segment Information and Geographic Data."

Seasonal Business

The Company has historically experienced increased net sales in its first and fourth fiscal quarters compared to other quarters in its fiscal year due to seasonal demand related to the holiday season and the beginning of the school year. This historical pattern should not be considered a reliable indicator of the Company's future net sales or financial performance.

Warranty

The Company offers a basic limited parts and labor warranty on most of its hardware products, including Mac computers, iPods and iPhones. The basic warranty period is typically one year from the date of purchase by the end-user. The Company also offers a 90-day basic warranty for its service parts used to repair the Company's hardware products. In addition, consumers may purchase extended service coverage on most of the Company's hardware products in all of its major markets.

Backlog

In the Company's experience, the actual amount of product backlog at any particular time is not a meaningful indication of its future business prospects. In particular, backlog often increases in anticipation of or immediately following new product introductions as dealers anticipate shortages. Backlog is often reduced once dealers and customers believe they can obtain sufficient supply. Because of the foregoing, backlog should not be considered a reliable indicator of the Company's ability to achieve any particular level of revenue or financial performance.

Environmental Laws

Compliance with federal, state, local, and foreign laws enacted for the protection of the environment has to date had no material effect on the Company's capital expenditures, earnings, or competitive position. In the future, these laws could have a material adverse effect on the Company.

Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations including, in some instances, the requirement to provide customers the ability to return product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have recently been passed in several jurisdictions in which the Company operates including various countries within Europe and Asia, certain Canadian provinces and certain states within the U.S. Although the Company does not anticipate any material adverse effects in the future based on the nature of its operations and the thrust of such laws, there is no assurance that such existing laws or future laws will not have a material adverse effect on the Company's financial condition or operating results.

Employees

As of September 29, 2007, the Company had approximately 21,600 full-time equivalent employees and an additional 2,100 temporary equivalent employees and contractors.

Available Information

The Company's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are filed with the U.S. Securities and Exchange Commission ("SEC"). Such reports and other information filed by the Company with the SEC are available on the Company's website at http://www.apple.com/investor when such reports are available on the SEC website. The public may read and copy any materials filed by the Company with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy, and information statements and other information regarding issuers that file electronically with the SEC at http://www.sec.gov. The contents of these websites are not incorporated into this filing. Further, the Company's references to the URLs for these websites are intended to be inactive textual references only.

Item 1A. Risk Factors

Because of the following factors, as well as other factors affecting the Company's financial condition and operating results, past financial performance should not be considered to be a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

The matters relating to the Company's past stock option practices and the restatement of the Company's consolidated financial statements may result in additional litigation and government enforcement actions.

The findings from the Company's investigation into its past stock option granting practices and the resulting restatement of prior financial statements in its 2006 Form 10-K have exposed the Company to greater risks associated with litigation, regulatory proceedings and government enforcement actions. As described in Part I, Item 3, "Legal Proceedings," several derivative complaints and a class action complaint have been filed in state and federal courts against the Company and certain current and former directors and executive officers pertaining to allegations relating to past stock option grants. The Company has provided the results of its investigation to the SEC and the United States Attorney's Office for the Northern District of California, and the Company has responded to their requests for documents and additional information. The Company intends to continue to provide its full cooperation.

On April 24, 2007, the SEC filed an enforcement action against two former officers of the Company. In announcing the lawsuit, the SEC stated that it would not bring an enforcement action against the Company based in part on the Company's "swift, extensive, and extraordinary cooperation in the Commission's investigation." According to the SEC's statement, the Company's "cooperation consisted of, among other things, prompt self-reporting, an independent internal investigation, the sharing of the results of that investigation with the government, and the implementation of new controls designed to prevent the recurrence of fraudulent conduct."

No assurance can be given regarding the outcomes from litigation, regulatory proceedings, or government enforcement actions relating to the Company's past stock option practices. These and related matters have required, and will continue to require, the Company to incur substantial expenses for legal, accounting, tax, and other professional services, and may divert management's attention from the Company's business. If the Company is subject to adverse findings, it could be required to pay damages and penalties and might face additional remedies that could harm its financial condition and operating results.

Global markets for personal computers, digital music devices, mobile communication devices, and related peripherals and services are highly competitive and subject to rapid technological change. If the Company is unable to compete effectively in these markets, its financial condition and operating results could be materially adversely affected.

The Company competes in global markets that are highly competitive and characterized by aggressive price cutting, with its resulting downward pressure on gross margins, frequent introduction of new products and products, short product life cycles, evolving industry standards, continual improvement in product price/performance characteristics, rapid adoption of technological and product advancements by competitors, and price sensitivity on the part of consumers.

The Company's ability to compete successfully depends heavily on its ability to ensure a continuing and timely introduction of new innovative products and technologies to the marketplace. The Company believes it is unique in that it designs and develops virtually the entire solution for its personal computers, consumer electronics, and mobile communication devices, including the hardware, operating system, several software applications, and related services. As a result, the Company must make significant investments in research and development. By contrast, many of the Company's competitors seek to compete aggressively on price and maintain very low cost structures. If the Company is unable to continue to develop and sell innovative new products with attractive margins, its financial condition and operating results may be materially adversely affected.

In the market for personal computers and peripherals, the Company faces a significant number of competitors, many of which have broader product lines and larger installed customer bases. There has also been a trend toward consolidation that has resulted in larger and potentially stronger competitors. Price competition has been particularly intense as competitors selling Windows-based personal computers have aggressively cut prices and lowered product margins. The Company also faces increased competition in certain of its key market segments, including consumer, education, professional and consumer digital video editing, and design and publishing. An increasing number of Internet devices that include software applications and are smaller and simpler than traditional personal computers compete for market share with the Company's existing products.

The Company is currently the only maker of hardware using the Mac OS. The Mac OS has a minority market share in the personal computer market, which is dominated by makers of computers using competing operating systems, most notably Windows. The Company's financial condition and operating results substantially depend on its ability to continually develop improvements to the Mac platform to maintain perceived design and functional advantages. Use of unauthorized copies of the Mac OS on other companies' hardware products may result in decreased demand for the Company's hardware products, and materially adversely affect its financial condition and operating results.

The Company is currently focused on opportunities related to digital content distribution, consumer electronic devices, including iPod and Apple TV, and mobile communication devices, including iPhone. The Company faces substantial competition from companies that have significant technical, marketing, distribution, and other resources, as well as established hardware, software, and digital content supplier relationships, and also competes with illegitimate ways to obtain digital content. The Company expects competition to intensify as competitors attempt to imitate the Company's approach to providing these components seamlessly within their individual offerings or work collaboratively to offer integrated solutions. Some current and potential competitors have substantial resources and experience, and they may be able to provide such products and services at little or no profit or even at a loss. There can be no assurance the Company will be able to continue to provide products and services that effectively compete.

To remain competitive and stimulate customer demand, the Company must successfully manage frequent product introductions and transitions.

Due to the highly volatile and competitive nature of the personal computer, consumer electronics and mobile communication industries, the Company must continually introduce new products and technologies, enhance existing products, and effectively stimulate customer demand for new and upgraded products. The success of new product introductions depends on a number of factors, including timely and successful completion of development efforts, market acceptance, the Company's ability to manage the risks associated with new products and production ramp issues, the availability of application software for new products, the effective management of purchase commitments and inventory levels in line with anticipated product demand, the availability of products in appropriate quantities and costs to meet anticipated demand, and the risk that new products may have quality or other defects in the early stages of introduction. Accordingly, the Company cannot determine in advance the ultimate effect new product introductions and transitions will have on financial condition and operating results.

The Company faces substantial inventory and other asset risk.

The Company records a write-down for product and component inventories that have become obsolete or are in excess of anticipated demand or net realizable value and accrues necessary reserves for cancellation fees for orders of products and components that have been cancelled. The Company also reviews its long-lived assets for impairment whenever events or changed circumstances indicate the carrying amount of an asset may not be recoverable. If the Company determines that impairment exists, it records a write-down equal to the amount by which the carrying value of the assets exceeds its fair market value. Although the Company believes its inventory, asset, and related provisions are currently adequate, given the rapid and unpredictable pace of product obsolescence in the global personal computer, consumer electronics, and mobile communication industries, no assurance can be given that the Company will not incur additional inventory or asset related charges. Such charges have had, and may have, a material adverse effect on the Company's financial condition and operating results.

The Company must order components for its products and build inventory in advance of product announcements and shipments. Because the Company's markets are volatile, competitive and subject to rapid technology and price changes, there is a risk the Company will forecast incorrectly and order or produce excess or insufficient inventories of components or products. Consistent with industry practice, components are normally acquired through a combination of purchase orders, supplier contracts, and open orders based on projected demand. Such purchase commitments typically cover forecasted component and manufacturing requirements for 30 to 150 days. The Company's financial condition and operating results have been in the past and may in the future be materially adversely affected by the Company's ability to manage its inventory levels and respond to short-term shifts in customer demand patterns.

Future operating results depend upon the Company's ability to obtain key components, including microprocessors and NAND flash memory, at favorable prices and in sufficient quantities.

Because the Company currently obtains certain key components, including microprocessors, enclosures, certain LCDs, certain optical drives, and application-specific integrated circuits ("ASICs"), from single or limited sources, the Company is subject to significant supply and pricing risks. Many of these and other key components that are available from multiple sources, including NAND flash memory, DRAM memory, and certain LCDs, are subject at times to industry-wide shortages and significant commodity pricing fluctuations. The Company has entered into certain agreements for the supply of critical components at favorable pricing, but there is no guarantee that the Company will be able to extend or renew these agreements on favorable terms upon expiration or otherwise obtain favorable pricing in the future. Therefore, the Company remains subject to significant risks of supply shortages and/or price increases that can have a material adverse effect on its financial condition and operating results. The Company expects to experience decreases in its gross margin percentage in fiscal year 2008, as compared to levels achieved during fiscal year 2007, due in part to current and expected future price increases for certain components. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Gross Margin."

The Company's new products often use custom components from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. Where a component or product uses new technologies, initial capacity constraints may exist until the suppliers' yields have matured. The Company and other producers in the personal computer, consumer electronics and mobile communication industries also compete for various components with other industries that have experienced increased demand for their products. The Company uses some custom components that are not common to the rest of the personal computer, consumer electronics or mobile communication industries. Continued availability of these components at acceptable prices may be affected if producers decide to concentrate on the production of components other than those customized to meet the Company's requirements. If the supply of a key component for a new or existing product were delayed or constrained, or if such components were available only at significantly higher prices, the Company's financial condition and operating results could be materially adversely affected.

The Company depends on component and product manufacturing and logistics services provided by third parties, many of whom are located outside of the U.S.

Most of the Company's components and products are manufactured in whole or in part by third-party manufacturers, most of which are located outside of the U.S. A significant concentration of this outsourced manufacturing is currently performed by only a few third-party manufacturers, often in single locations. The Company has also outsourced much of its transportation and logistics management. While these arrangements may lower operating costs, they also reduce the Company's direct control over production and distribution. It is uncertain what effect such diminished control will have on the quality or quantity of products or services, or the Company's flexibility to respond to changing conditions. In addition, the Company relies on third-party manufacturers to adhere to the Company's supplier code of conduct. Although arrangements with such manufacturers may contain provisions for warranty expense reimbursement, the Company may remain responsible to the consumer for warranty service in the event of product defects. Any unanticipated product defect or warranty liability, whether pursuant to arrangements with contract manufacturers or otherwise, could have a material adverse effect on the Company's reputation, financial condition and operating results.

Final assembly of the Company's products is currently performed in the Company's manufacturing facility in Cork, Ireland, and by external vendors in California, Korea, China and the Czech Republic. Currently, the supply and manufacture of many critical components is performed by sole-sourced third-party vendors in the U.S., China, Japan, Korea, and Singapore. Sole-sourced third- party vendors in China perform final assembly of substantially all of the Company's portable products, including MacBook Pros, MacBooks, iPods and iPhones. If manufacturing or logistics in these locations is disrupted for any reason, including natural disasters, information technology system failures, military actions or economic, business, labor, environmental, public health, or political issues, the Company's financial condition and operating results could be materially adversely affected.

The Company relies on third-party digital content, which may not be available to the Company on commercially reasonable terms or at all.

The Company contracts with third parties to offer their digital content through the Company's iTunes Store. The Company pays substantial fees to obtain the rights to this content. The Company's licensing arrangements with these third parties are short-term and do not guarantee the continuation or renewal of these arrangements on reasonable terms, if at all. Some third-party content providers currently or may in the future offer competing products and services, and could take action to make it more difficult or impossible for the Company to license their content in the future. Other content owners, providers or distributors may seek to limit the Company's access to, or increase the total cost of, such content. If the Company is unable to continue to offer a wide variety of content at reasonable prices with acceptable usage rules, or continue to expand its geographic reach, the Company's financial condition and operating results may be materially adversely affected.

Many third-party content providers require that the Company provide certain digital rights management ("DRM") and other security solutions. If these requirements change, the Company may have to develop or license new technology to provide these solutions. There is no assurance the Company will be able to develop or license such solutions at a reasonable cost and in a timely manner. In addition, certain countries have passed or may propose legislation that would force the Company to license its DRM, which could lessen the protection of content and subject it to piracy and could also affect arrangements with the Company's content providers.

The Company relies on access to third-party patents and intellectual property, and the Company's future results could be materially adversely affected if it is alleged or found to have infringed intellectual property rights.

Many of the Company's products are designed to include third-party intellectual property, and it may be necessary in the future to seek or renew licenses relating to various aspects of its products and business methods. Although the Company believes that, based on past experience and industry practice, such licenses generally could be obtained on commercially reasonable terms, there is no assurance that the necessary licenses would be available on acceptable terms or at all.

Because of technological changes in the global personal computer, consumer electronics and mobile communication industries, current extensive patent coverage, and the rapid issuance of new patents, it is possible that certain components of the Company's products and business methods may unknowingly infringe the patents or other intellectual property rights of third parties. From time to time, the Company has been notified that it may be infringing such rights. Responding to such claims, regardless of their merit, can consume significant time and expense, and several pending claims are in various stages of evaluation. In certain cases, the Company may consider the desirability of entering into licensing agreements, although no assurance can be given that such licenses can be obtained on acceptable terms or that litigation will not occur. If there is a temporary or permanent injunction prohibiting the Company from marketing or selling certain products or a successful claim of infringement against the Company requires it to pay royalties to a third party, the Company's financial condition and operating results could be materially adversely affected. Information regarding certain claims and litigation related to alleged patent infringement and other matters is set forth in Part I, Item 3, "Legal Proceedings." In management's opinion, the Company does not have a potential liability for damages or royalties from any known current legal proceedings or claims related to the infringement of patent or other intellectual property rights that would individually or in the aggregate have a material adverse effect on its financial condition and operating results. However, the results of such legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of the matters related to infringement of patent or other intellectual property rights of others described in Part I, Item 3, "Legal Proceedings," or should several of these matters be resolved against the Company in the same reporting period, the Company's financial condition and operating results could be materially adversely affected.

With the June 2007 introduction of iPhone, the Company has begun to compete with mobile communication device companies that hold significant patent portfolios. Regardless of the scope or validity of such patents or the merits of any potential patent claims by competitors, the Company may have to engage in protracted litigation, enter into expensive agreements or settlements and/or modify its products. Any of these events could have a material adverse impact on the Company's financial condition and operating results.

The Company's products experience quality problems from time to time that can result in decreased sales and operating margin.

The Company sells highly complex hardware and software products that can contain defects in design and manufacture. Sophisticated operating system software and applications, such as those sold by the Company, often contain "bugs" that can unexpectedly interfere with the software's operation. Defects may also occur in components and products the Company purchases from third parties. There can be no assurance that the Company will be able to detect and fix all defects in the hardware and software it sells. Failure to do so could result in lost revenue, harm to reputation, and significant warranty and other expenses, and could have a material adverse impact on the Company's financial condition and operating results.

The Company expects its quarterly revenue and operating results to fluctuate for a variety of reasons.

The Company's profit margins vary among its products and its distribution channels. The Company's software, accessories, and service and support contracts generally have higher gross margins than certain of the Company's other products, including third-party content from the iTunes Store. Gross margins on the Company's hardware products vary across product lines and can change over time as a result of product transitions, pricing and configuration changes, and component, warranty, and other cost fluctuations. The Company's direct sales generally have higher associated gross margins than its indirect sales through its channel partners. In addition, the Company's gross margin and operating margin percentages, as well as overall profitability, may be materially adversely impacted as a result of a shift in product, geographic or channel mix, or new product announcements. The Company generally sells more products during the third month of each quarter than it does during either of the first two months. This sales pattern can produce pressure on the Company's internal infrastructure during the third month of a quarter and may adversely affect the Company's ability to predict its financial results accurately. Furthermore, the Company has typically experienced greater net sales in the first and fourth fiscal quarters compared to other quarters in the fiscal year due to seasonal demand related to the holiday season and the beginning of the school year. Developments late in a quarter, such as lower-than-anticipated demand for the Company's products, an internal systems failure, or failure of one of the Company's key logistics, components supply, or manufacturing partners, could have a material adverse impact on the Company's financial condition and operating results.

The Company currently relies on a single cellular network carrier for iPhone in each of the U.S., U.K., Germany and France.

AT&T, O2, T-Mobile and Orange are the Company's cellular network carriers for iPhone in the U.S., U.K., Germany and France, respectively. If these carriers cannot successfully compete with other carriers in their markets for any reason, including but not limited to the quality and coverage of wireless voice and data services, performance and timely build-out of advanced wireless networks, and pricing and terms of end-user contracts, iPhone sales may be adversely affected. Because the Company's agreements require each carrier to make revenue-generating payments to the Company, a carrier's non-performance under or termination of an agreement, or its inability to attract and retain iPhone customers, could have a material adverse effect on the Company's future financial condition and operating results. If, contrary to the Company's license agreements or product specifications, an iPhone is "unlocked" from an authorized carrier's network, the Company would not receive payments related to that iPhone from such carrier, which could have a material adverse effect on the Company's future financial condition and operating results. The Company may choose to enter into arrangements with carriers in other countries or regions, and the same risks described above would also apply to those arrangements.

The Company is subject to risks associated with laws, regulations and industry-imposed standards related to mobile communications devices.

Laws and regulations related to mobile communications devices in the many jurisdictions in which the Company operates are extensive and subject to change. Such changes, which could include but are not limited to restrictions on production, manufacture, distribution, and use of the device, locking the device to a carrier's network, or mandating the use of the device on more than one carrier's network, may have a material adverse effect on the Company's financial condition and operating results.

Mobile communication devices, such as iPhone, are subject to certification and regulation by governmental and standardization bodies, as well as by cellular network carriers for use on their networks. These certification processes are extensive and time consuming, and could result in additional testing requirements, product modifications or delays in product shipment dates, which may have a material adverse effect on the Company's financial condition and operating results.

Failure of information technology systems and breaches in data security could adversely affect the Company's financial condition and operating results.

Information technology system failures and breaches of data security could disrupt the Company's operations by causing delays or cancellation of customer orders, impeding the manufacture or shipment of products, or resulting in the unintentional disclosure of customer or Company information. Management has taken steps to address these concerns by implementing sophisticated network security and internal control measures. There can be no assurance, however, that a system failure or data security breach will not have a material adverse effect on the Company's financial condition and operating results.

The Company's stock price may be volatile.

The Company's stock has at times experienced substantial price volatility as a result of variations between its actual and anticipated financial results and as a result of announcements by the Company and its competitors. The stock market as a whole has also experienced extreme price and volume fluctuations that have affected the market price of many technology companies in ways that may have been unrelated to these companies' operating performance. Furthermore, the Company believes its stock price reflects high future growth and profitability expectations. If the Company fails to meet these expectations its stock price may significantly decline.

Economic conditions, political events, war, terrorism, public health issues, natural disasters and other circumstances could materially adversely affect the Company.

The Company's operations and performance depend significantly on worldwide economic conditions. War, terrorism, geopolitical uncertainties, public health issues, and other business interruptions have caused and could cause damage or disruption to international commerce and the global economy, and thus may have a strong negative effect on the Company, its suppliers, logistics providers, manufacturing vendors and customers. The Company's business operations are subject to interruption by natural disasters, fire, power shortages, terrorist attacks, and other hostile acts, labor disputes, public health issues, and other events beyond its control. Such events could decrease demand for the Company's products, make it difficult or impossible for the Company to make and deliver products to its customers or to receive components from its suppliers, and create delays and inefficiencies in the Company's supply chain. Should major public health issues, including pandemics, arise, the Company could be negatively affected by more stringent employee travel restrictions, additional limitations in freight services, governmental actions limiting the movement of products between regions, delays in production ramps of new products, and disruptions in the operations of the Company's manufacturing vendors and component suppliers. The majority of the Company's research and development activities, its corporate headquarters, information technology systems, and other critical business operations, including certain component suppliers and manufacturing vendors, are located near major seismic faults. Because the Company does not carry earthquake insurance for direct quake-related losses and significant recovery time could be required to resume operations, the Company's financial condition and operating results could be materially adversely affected in the event of a major earthquake.

The Company's success depends largely on its ability to attract and retain key personnel.

Much of the Company's future success depends on the continued service and availability of skilled personnel, including its CEO, its executive team and key employees in technical, marketing and staff positions. Experienced personnel in the technology industry are in high demand and competition for their talents is intense, especially in the Silicon Valley, where the majority of the Company's key employees are located. The Company has relied on equity awards as one means for recruiting and retaining this highly skilled talent. Recent accounting regulations requiring the expensing of stock options have resulted in increased stock-based compensation expense, which has caused the Company to reduce the number of stock-based awards issued to employees. There can be no assurance that the Company will continue to successfully attract and retain key personnel.

Unfavorable results of legal proceedings could materially adversely affect the Company.

The Company is subject to various legal proceedings and claims that are discussed in Part I, Item 3, "Legal Proceedings." The Company is also subject to other legal proceedings and claims that have arisen in the ordinary course of business and have not been fully adjudicated. Results of legal proceedings cannot be predicted with certainty. Regardless of its merit, litigation may be both time-consuming and disruptive to the Company's operations and cause significant expense and diversion of management attention. Should the Company fail to prevail in certain matters, or should several of these matters be resolved against the Company in the same reporting period, the Company's financial condition and operating results could be materially adversely affected.

The Company's business is subject to the risks of international operations.

The Company derives a large portion of its revenue from its international operations. As a result, its financial condition and operating results could be significantly affected by risks associated with international activities, including economic and labor conditions, political instability, tax laws (including U.S. taxes on foreign subsidiaries), and changes in the value of the U.S. dollar versus local currencies. Margins on sales of the Company's products in foreign countries, and on sales of products that include components obtained from foreign suppliers, can be materially adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including tariffs and antidumping penalties.

The Company's primary exposure to movements in foreign currency exchange rates relate to non-U.S. dollar denominated sales in Europe, Japan, Australia, Canada, and certain parts of Asia and non-dollar denominated operating expenses incurred throughout the world. Weaknesses in foreign currencies, particularly the Japanese Yen and the Euro, can adversely affect demand for the Company's products and the U.S. dollar value of the Company's foreign currency-denominated sales. Conversely, a strengthening in these and other foreign currencies can cause the Company to modify international pricing and affect the value of the Company's foreign denominated sales and may also increase the cost of product components.

The Company has used derivative instruments, such as foreign exchange forward and option positions, to hedge exposures to fluctuations in foreign currency exchange rates. The use of such hedging activities may not offset more than a portion of the adverse financial effect resulting from unfavorable movements in foreign exchange rates.

Further information related to the Company's global market risks may be found in Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk," under the subheading "Foreign Currency Risk," and in Part II, Item 8, "Financial Statements and Supplementary Data," at Note 1, "Summary of Significant Accounting Polices" and Note 2, "Financial Instruments" of Notes to Consolidated Financial Statements.

The Company's retail initiative has required and will continue to require a substantial investment and commitment of resources and is subject to numerous risks and uncertainties.

Through September 29, 2007, the Company had opened 197 retail stores. The Company's retail initiative has required substantial fixed investment in equipment and leasehold improvements, information systems, inventory, and personnel. The Company has also entered into substantial operating lease commitments for retail space with terms ranging from 5 to 20 years, the majority of which are for 10 years. Certain stores have been designed and built to serve as high-profile venues to promote brand awareness and serve as vehicles for corporate sales and marketing activities. Because of their unique design elements, locations and size, these stores require substantially more investment than the Company's more typical retail stores. A substantial decline in sales, the closure or poor performance of individual or multiple stores, or the termination of the retail initiative could result in significant lease termination costs, write-offs of equipment and leasehold improvements, and severance costs that could have a material adverse impact on the Company's financial condition and operating results.

Many factors unique to retail operations, some of which are beyond the Company's control, pose risks and uncertainties that could have a material adverse effect on the Retail segment's future results, cause its actual results to differ from anticipated results and have a material adverse effect on the Company's financial condition and operating results. These risks and uncertainties include, among other things, macro-economic factors that have a negative effect on general retail activity, inability to manage costs associated with store construction and operation, inability to sell third-party products at adequate margins, failure to manage relationships with existing retail channel partners; lack of experience in managing retail operations outside the U.S., costs associated with unanticipated fluctuations in the value of retail inventory, and inability to obtain and renew leases in quality retail locations at a reasonable cost.

The Company's future performance depends on support from third-party software developers. If third-party software applications cease to be developed and maintained for the Company's hardware products, customers may choose not to buy the Company's products.

The Company believes decisions by customers to purchase the Company's hardware products are often based on the availability of third-party application software, such as Microsoft Office. There is no assurance that third-party developers will continue to develop and maintain applications for the Company's hardware products on a timely basis or at all, and discontinuance or delay of these applications could have a material adverse effect on the Company's financial condition and operating results. The Company believes the availability of third-party applications depends in part on the developers' perception and analysis of the relative benefits of developing, maintaining, and upgrading such software for the Company's products versus Windows-based products. This analysis may be based on factors such as the perceived strength of the Company and its products, the anticipated revenue that may be generated, continued acceptance by customers of Mac OS X, and the costs of developing such applications. If the Company's minority share of the global personal computer market causes developers to question the Company's prospects, developers could be less inclined to develop or upgrade software for the Company's products and more inclined to devote their resources to developing and upgrading software for the larger Windows market. The Company's development of its own software applications may also negatively affect the decisions of third-party developers, such as Microsoft and Adobe, to develop, maintain, and upgrade similar or competitive software for the Company's products. Mac OS X Leopard, which became available in October 2007, includes a new feature that enables Intel-based Mac systems to run Windows XP and Windows Vista. This feature may deter developers from creating software applications for Mac OS X if such applications are already available for the Windows platform.

During calendar year 2006, the Company transitioned its Mac line of computers from PowerPC to Intel microprocessors. The Company depends on third-party developers to timely develop current and future Universal applications. A Universal version of Microsoft Office and certain other important applications are currently not available. The lack of Universal applications that run on Intel-based Mac systems could have a material adverse effect on the Company's financial condition and operating results.

Investment in new business strategies and initiatives could disrupt the Company's ongoing business and present risks not originally contemplated.

The Company has invested, and may in the future invest, in new business strategies or acquisitions. Such endeavors may involve significant risks and uncertainties, including distraction of management from current operations, insufficient revenue to offset liabilities assumed and expenses associated with the strategy, inadequate return of capital, and unidentified issues not discovered in the Company's due diligence. Because these new ventures are inherently risky, no assurance can be given that such strategies and initiatives will be successful and will not have a material adverse effect on the Company's financial condition and operating results.

The Company's future operating performance depends on the performance of distributors and other resellers.

The Company distributes its products through wholesalers, resellers, national and regional retailers, value-added resellers, and cataloguers, many of whom distribute products from competing manufacturers. The Company also sells many of its products and resells third-party products in most of its major markets directly to end-users, certain education customers, and certain resellers through its online and retail stores. iPhone is distributed through the Company and its exclusive cellular network carriers' distribution channels.

Many resellers operate on narrow product margins and have been negatively affected in the past by weak economic conditions. Some resellers have perceived the expansion of the Company's direct sales as conflicting with their business interests as distributors and resellers of the Company's products. Such a perception could discourage resellers from investing resources in the distribution and sale of the Company's products or lead them to limit or cease distribution of those products. The Company's financial condition and operating results could be materially adversely affected if the financial condition of these resellers weakens, if resellers stopped distributing the Company's products, or if uncertainty regarding demand for the Company's products caused resellers to reduce their ordering and marketing of the Company's products. The Company has invested and will continue to invest in programs to enhance reseller sales, including staffing selected resellers' stores with Company employees and contractors and improving product placement displays. These programs could require a substantial investment while providing no assurance of return or incremental revenue.

The Company is exposed to credit risk on its accounts receivable and prepayments related to long-term supply agreements. This risk is heightened during periods when economic conditions worsen.

A substantial majority of the Company's outstanding trade receivables are not covered by collateral or credit insurance. The Company also has unsecured non-trade receivables resulting from the sale by the Company of components to vendors who manufacture sub-assemblies or assemble final products for the Company. In addition, the Company has entered into long-term supply agreements to secure supply of NAND flash-memory and has prepaid a total of $1.25 billion under these agreements, of which $208 million had been used as of September 29, 2007. While the Company has procedures to monitor and limit exposure to credit risk on its trade and non-trade receivables as well as long-term prepayments, there can be no assurance such procedures will effectively limit its credit risk and avoid losses.

The Company is subject to risks associated with laws and regulations related to health, safety and environmental protection.

The Company's products and services, and the production and distribution of those goods and services, are subject to a variety of laws and regulations. These may require the Company to offer customers the ability to return a product at the end of its useful life and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have recently been passed in several jurisdictions in which the Company operates, including various countries within Europe and Asia, certain Canadian provinces and certain states within the U.S. Although the Company does not anticipate any material adverse effects based on the nature of its operations and the thrust of such laws, there is no assurance such existing laws or future laws will not have a material adverse effect on the Company's financial condition and operating results.

Changes in the Company's tax rates could affect its future results.

The Company's future effective tax rates could be affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, or by changes in tax laws or their interpretation. The Company is subject to the continuous examination of its income tax returns by the Internal Revenue Service and other tax authorities. The Company regularly assesses the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of its provision for taxes. There can be no assurance that the outcomes from these examinations will not have a material adverse effect on the Company's financial condition and operating results.

The Company is subject to risks associated with the availability and coverage of insurance.

For certain risks, the Company does not maintain insurance coverage because of cost and/or availability. Because the Company retains some portion of its insurable risks, and in some cases self-insures completely, unforeseen or catastrophic losses in excess of insured limits may have a material adverse effect on the Company's financial condition and operating results.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Company's headquarters are located in Cupertino, California. The Company has a manufacturing facility in Cork, Ireland. As of September 29, 2007, the Company leased approximately 3.7 million square feet of space, primarily in the U.S., and to a lesser extent, in Europe, Japan, Canada, and the Asia Pacific region. The major facility leases are generally for terms of 3 to 15 years and generally provide renewal options for terms of 3 to 7 additional years. Leased space includes approximately 1.5 million square feet of retail space, a majority of which is in the U.S. Lease terms for retail space range from 5 to 20 years, the majority of which are for 10 years, and often contain multi-year renewal options.

The Company owns a 367,000 square-foot manufacturing facility in Cork, Ireland that also houses a customer support call center. The Company also owns 805,000 square feet of facilities in Sacramento, California that include warehousing and distribution operations, as well as a customer support call center. In addition, the Company owns approximately 2.4 million square feet of facilities for research and development and corporate functions in Cupertino, California, including approximately 1.0 million square feet purchased in 2007 and 2006 for the future development of the Company's second corporate campus in Cupertino, California, and approximately 107,000 square feet for a data center in Newark, California. Outside the U.S., the Company owns additional facilities totaling approximately 129,000 square feet. The

Company believes its existing facilities and equipment are well maintained and in good operating condition.

The Company has invested in internal capacity and strategic relationships with outside manufacturing vendors, and therefore believes it has adequate manufacturing capacity for the foreseeable future. The Company continues to make investments in capital equipment as needed to meet anticipated demand for its products.

Item 3. Legal Proceedings

The Company is subject to various legal proceedings and claims as of September 29, 2007, the end of the annual period covered by this report, that are discussed below. The Company is also subject to certain other legal proceedings and claims that have arisen in the ordinary course of business and which have not been fully adjudicated. In the opinion of management, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate have a material adverse effect on its financial condition or operating results. However, the results of legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected. The Company settled certain matters during the fourth quarter of 2007 that did not individually or in the aggregate have a material impact on the Company's results of operations.

Apple Computer, Inc. v. Burst.com, Inc.

The Company filed an action for declaratory judgment against defendant Burst.com, Inc. on January 4, 2006 in the United States District Court for the Northern District of California. The Company seeks declaratory judgment that U.S. Patent Nos. 4,963,995, 5,164,839, 5,057,932 and 5,995,705 ("Burst patents") are invalid and not infringed by the Company. Burst filed an answer and counterclaim on April 17, 2006 adding infringement allegations relating to U.S. Patent No. 5,995,705. Apple counterclaimed for declaratory judgment that each of these patents is invalid, not infringed and unenforceable. Burst alleges that the following Apple products and services infringe the four patents at issue: iTunes Store, iPod devices, iTunes software, iLife software (GarageBand, iMovie, iWeb) separately and in conjunction with the .Mac service and Apple computers sold with or running iTunes or iLife. The Burst patents allegedly relate to methods and devices used for faster-than-real-time transmission of compressed audio and/or video files. The court issued its claim construction ruling on May 8, 2007. The Company filed motions for summary judgment of invalidity on January 4, 2007 and July 13, 2007. The court held a hearing on those pending motions on September 18, 2007 and has not issued a decision. The Company filed motions for summary judgment and partial summary judgment relating to enablement, indefiniteness and laches on October 29, 2007. Trial is set for February 26, 2008.

Bader v. Anderson, et al.

Plaintiff filed this purported shareholder derivative action against the Company and each of its then current executive officers and members of its Board of Directors on May 19, 2005 in Santa Clara County Superior Court asserting claims for breach of fiduciary duty, material misstatements and omissions and violations of California Business & Professions Code §17200 (unfair competition). The complaint alleged that the Company's March 14, 2005, proxy statement was false and misleading for failure to disclose certain information relating to the Apple Computer, Inc. Performance Bonus Plan, which was approved by shareholders at the annual meeting held on April 21, 2005. Plaintiff, who ostensibly brings suit on the Company's behalf, made no demand on the Board of Directors and alleged that such demand was excused. The complaint sought injunctive and other relief for purported injury to the Company. On July 27, 2005, plaintiff filed an amended complaint alleging that, in addition to the purported derivative claims, adoption of the bonus plan and distribution of the proxy statement describing that plan also inflicted injury on her directly as an individual shareholder. On January 10, 2006, the Court sustained defendants' demurrer to the amended complaint, with leave to amend. Plaintiff filed a second amended complaint on February 7, 2006, and the Company filed a demurrer. After a hearing on June 13, 2006, the Court sustained the demurrer without leave to amend as to the non-director officers and with leave to amend as to the directors. On July 24, 2006, plaintiff filed a third amended complaint, which purported to bring claims derivatively as well as directly on behalf of a class of common stockholders who have been or will be harmed by virtue of the allegedly misleading proxy statement. In addition to reasserting prior causes of action, the third amended complaint included a claim that the Company violated the terms of the plan, and a claim for waste related to restricted stock unit grants to certain officers in 2003 and 2004 and an option grant to the Company's CEO in January 2000. The Company filed a demurrer to the third amended complaint. On January 30, 2007, the Court sustained the Company's demurrer with leave to amend. On May 8, 2007, plaintiff filed a fourth amended complaint. The Company filed a demurrer to the fourth amended complaint, which the court sustained, without leave to amend, on October 12, 2007. On October 25, 2007, the Court entered a final judgment in favor of defendant and ordered the case dismissed with prejudice.

Birdsong v. Apple Computer, Inc.

This action alleges that the Company's iPod music players, and the ear bud headphones sold with them, are inherently defective in design and are sold without adequate warnings concerning the risk of noise-induced hearing loss by iPod users. The Birdsong action was initially filed on January 30, 2006 in the United States District Court for the Western District of Louisiana asserting Louisiana causes of action on behalf of a purported Louisiana class of iPod purchasers. A similar action *(Patterson v. Apple Computer, Inc.)* was filed on January 31, 2006 in the United States District Court for the Northern District of California asserting California causes of action on behalf of a purported class of all iPod purchasers within the four-year period before January 31, 2006. The Birdsong action was transferred to the Northern District of California, and the Patterson action was dismissed. An amended complaint was subsequently filed in Birdsong, dropping the Louisiana law-based claims and adding California law-based claims equivalent to those in Patterson. After the Company filed a motion to dismiss on November 3, 2006, plaintiffs agreed not to oppose the motion and filed a second amended complaint on January 16, 2007. That complaint alleges California law-based claims for breaches of implied and express warranties, violations of California Business & Professions Code §17200 (unfair competition), California Business & Professions Code §17500 (false advertising), the Consumer Legal Remedies Act and negligent misrepresentation on behalf of a putative nationwide class and a Louisiana law-based claim for redhibition for a Louisiana sub-class. On March 1, 2007, the Company filed a motion to dismiss the California law based claims. The court held a hearing on the motion to dismiss on June 4, 2007 but has not yet issued a ruling.

A similar complaint, *Royer-Brennan v. Apple Computer, Inc. and Apple Canada, Inc.*, was filed in Montreal, Quebec, Canada, on February 1, 2006, seeking authorization to institute a class action on behalf of iPod purchasers in Quebec. At the request of plaintiffs' counsel, the court has postponed class certification proceedings in this action indefinitely.

Branning et al. v. Apple Computer, Inc.

Plaintiffs originally filed this purported class action in San Francisco County Superior Court on February 17, 2005. The initial complaint alleged violations of California Business & Professions Code §17200 (unfair competition) and violation of the Consumer Legal Remedies Act ("CLRA") regarding a variety of purportedly unfair and unlawful conduct including, but not limited to, allegedly selling used computers as new and failing to honor warranties. Plaintiffs also brought causes of action for misappropriation of trade secrets, breach of contract and violation of the Song-Beverly Consumer Warranty Act. Plaintiffs requested unspecified damages and other relief. On May 9, 2005, the Court granted the Company's motion to transfer the case to Santa Clara County Superior Court. On May 2, 2005, plaintiffs filed an amended complaint adding two new named plaintiffs and three new causes of action including a claim for treble damages under the Cartwright Act (California Business & Professions Code §

16700 et seq.) and a claim for false advertising. The Company filed a demurrer to the amended complaint, which the Court sustained in its entirety on November 10, 2005. The Court granted plaintiffs leave to amend and they filed an amended complaint on December 29, 2005. Plaintiffs' amended complaint added three plaintiffs and alleged many of the same factual claims as the previous complaints, such as alleged selling of used equipment as new, alleged failure to honor warranties and service contracts for the consumer plaintiffs, and alleged fraud related to the opening of the Apple retail stores. Plaintiffs continued to assert causes of action for unfair competition (§17200), violations of the CLRA, breach of contract, misappropriation of trade secrets, violations of the Cartwright Act, and alleged new causes of action for fraud, conversion, and breach of the implied covenant of good faith and fair dealing. The Company filed a demurrer to the amended complaint on January 31, 2006, which the Court sustained on March 3, 2006 on sixteen of seventeen causes of action. Plaintiffs filed an amended complaint adding one new plaintiff. The Company filed a demurrer, which was granted in part on September 9, 2006. Plaintiffs filed a further amended complaint on September 21, 2006. On October 2, 2006, the Company filed an answer denying all allegations and asserting numerous affirmative defenses.

European Commission Investigation

The European Commission is investigating certain matters relating to the iTunes Stores in Europe. The European Commission had previously notified the Company that it was investigating claims made by Which?, a United Kingdom ("U.K.") consumer association, that the Company is violating EU competition law by charging more for online music in the U.K. than in Eurozone countries and preventing U.K. consumers from purchasing online music from the iTunes Stores for Eurozone countries. The Which? claims were originally lodged with the U.K. Office of Fair Trading, which subsequently referred them to the European Commission.

On March 30, 2007, the European Commission issued Statements of Objections to the major record labels, Apple Inc. and iTunes S.à.r.l. In the Statements of Objections, the Commission challenges provisions in the agreements pursuant to which each major record company authorizes iTunes S.à.r.l. to distribute digital music downloads through the iTunes Store. The Commission contends that, because of these provisions, residents of the European Economic Area are only permitted to buy music from the iTunes Store for the country that issued the customer's credit card. The Commission contends that these provisions are territorial sales restrictions which violate Article 81 of the European Community Treaty. The Commission seeks fines and behavioral relief. The Company filed its responses to the Statements of Objections on June 20, 2007. A hearing on the Statements of Objections took place in Brussels, Belgium on September 19, 2007.

Gordon v. Apple Computer, Inc.

Plaintiff filed this purported class action on August 31, 2006 in the United States District Court for the Northern District of California, San Jose Division, on behalf of a purported nationwide class of consumers who purchased 65W Power Adapters for iBooks and Powerbooks between November 2002 and the present. The complaint alleges various problems with the 65W Adapter, including fraying, sparking, and premature failure. Plaintiffs allege violations of California Business & Professions Code §17200 (unfair competition), the Consumer Legal Remedies Act, the Song-Beverly Consumer Warranty Act and breach of warranties. The complaint seeks damages and equitable relief. The Company filed an answer on October 20, 2006 denying the material allegations and asserting numerous affirmative defenses.

Harvey v. Apple Inc.

Plaintiff filed this action on August 6, 2007 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement by the Company of U.S. Patent No. 6,753,671 entitled "Recharger for use with a portable electronic device and which includes a proximally located light emitting device" and U.S. Patent No. 6,762,584 entitled "Recharger for use with a portable electronic device and which includes a connector terminus for communicating with rechargeable batteries contained within the device." The complaint seeks unspecified damages and other relief. The Company filed an answer on October 12, 2007 denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims for declaratory judgment of noninfringement and invalidity.

Honeywell International, Inc., et al. v. Apple Computer, Inc., et al.

Plaintiffs Honeywell International, Inc. and Honeywell Intellectual Properties, Inc. filed this action on October 6, 2004 in the United States District Court in Delaware alleging infringement by the Company and other defendants of U.S. Patent 5,280,371 entitled "Directional Diffuser for a Liquid Crystal Display." Plaintiffs seek unspecified damages and other relief. The Company filed an answer on December 21, 2004 denying all material allegations and asserting numerous affirmative defenses. The Company has tendered the case to several liquid crystal display manufacturer suppliers. On May 18, 2005 the Court stayed the case against the Company and the other non-manufacturer defendants. Plaintiffs filed an amended complaint on November 7, 2005 adding additional defendants and expanding the scope of the accused products. Given the stay, the Company's response to the amended complaint is not yet due.

In re Apple Computer, Inc. Derivative Litigation (formerly Karant v. Jobs, et al. and Related Actions) (Federal Action)

On June 30, 2006, a putative derivative action captioned *Karant v. Jobs, et. al.*, was filed in the United States District Court for the Northern District of California, San Jose Division. A number of related actions were filed in the subsequent weeks and have been consolidated into a single action captioned *In re Apple Computer, Inc. Derivative Litigation*, Master File No. C-06-04128-JF before the Hon. Jeremy Fogel. The actions were filed after the Company's announcement on June 29, 2006 that an internal investigation had discovered irregularities related to the issuance of certain stock option grants made between 1997 and 2001, that a special committee of the Company's outside directors had retained independent counsel to perform an investigation and that the Company had informed the Securities and Exchange Commission. The action purports to assert claims on behalf of the Company against several current and former executive officers and members of the Board of Directors alleging improper backdating of stock option grants to maximize certain defendants' profits, failing to properly account for and take tax deductions for those grants, insider trading, and issuing false financial statements. The Company is named as a nominal defendant. The consolidated complaint alleges various causes of action under federal and California law, including claims for unjust enrichment, breach of fiduciary duty, violation of the California Corporations Code, abuse of control, gross mismanagement, rescission, constructive fraud and waste of corporate assets, as well as claims under Sections 10(b), 14(a) and 20(a) of the Securities Exchange Act. Plaintiffs seek damages, disgorgement, restitution and imposition of a constructive trust. A Consolidated Shareholder Derivative Complaint was filed on December 18, 2006, and a First Amended Shareholder Derivative Complaint was filed on March 6, 2007. Defendants filed a motion to dismiss on April 20, 2007, which was heard on September 7, 2007.

On June 12, 2007, the Company's Board of Directors approved a resolution appointing a Special Litigation Committee to make all decisions relating to options litigation.

In re Apple Computer, Inc. Derivative Litigation (formerly Plumbers and Pipefitters v. Jobs, et al. and Related Actions) (State Action); Boston Retirement Board v. Apple Computer, Inc.

On July 5, 2006, a putative derivative action captioned *Plumbers and Pipefitters v. Jobs, et. al.*, was filed in California Superior Court for the County of Santa Clara. A number of related actions were filed in the subsequent weeks, and have been consolidated into a single action captioned *In re Apple Computer, Inc. Derivative Litigation*, No. 1:06CV066692, assigned to the Hon. Joseph Huber. These actions purport to assert claims on behalf of the Company against several current and former executive officers and members of the Board of Directors alleging improper backdating of stock option grants to maximize certain defendants' profits, failing to properly account for and take tax deductions for those grants and issuing false financial statements. The Company is named as a nominal defendant. A consolidated complaint was filed on October 5, 2006, alleging a variety of causes of action under California law, including claims for unjust enrichment, breach of fiduciary duty, violation of the California Corporations Code, abuse of control, accounting, constructive trust, rescission, deceit, gross mismanagement and waste of corporate assets. On December 7, 2006, the Court granted the Company's motion to stay these actions.

On November 3, 2006, the Boston Retirement Board, a purported shareholder, filed a petition for writ of mandate against the Company in California Superior Court for the County of Santa Clara County (*Boston Retirement Board v. Apple Computer Inc.*). The petition sought to compel the Company to allow inspection of certain corporate records relating to the Company's option practices and the Special Committee's investigation. On January 16, 2007, the Company filed a demurrer to the petition. The Court entered an order overruling the demurrer on March 13, 2007. The Company filed its answer to the petition on April 5, 2007. The trial took place on September 24, 2007. The Court granted the petition for inspection but narrowed the scope of the records to be produced.

In re Apple iPod Nano Products Liability Litigation (formerly Wimmer v. Apple Computer, Inc.; Moschella, et al., v. Apple Computer, Inc.; *Calado, et al. v. Apple Computer, Inc.*; *Kahan, et al., v. Apple Computer, Inc.*; *Jennings, et al., v. Apple Computer, Inc.*; *Rappel v. Apple Computer, Inc.*; *Mayo v. Apple Computer, Inc.*; *Valencia v. Apple Computer, Inc.*; *Williamson v. Apple Computer, Inc.*; *Sioson v. Apple Computer, Inc.*

Beginning on October 19, 2005, eight complaints were filed in various United States District Courts and two complaints were filed in California State Court alleging that the Company's iPod nano was defectively designed so that it scratches excessively during normal use, rendering the screen unreadable.

The federal actions were coordinated in the United States District Court for the Northern District of California and assigned to the Hon. Ronald Whyte pursuant to an April 17, 2006 order of the Judicial Panel on Multidistrict Litigation. Plaintiffs filed a First Consolidated and Amended Master Complaint on September 21, 2006, alleging violations of California and other states' consumer protection and warranty laws and claiming unjust enrichment. The Master Complaint alleges two putative plaintiff classes: (1) all U.S. residents (excluding California residents) who purchased an iPod nano that was not manufactured or designed using processes necessary to ensure normal resistance to scratching of the screen; and (2) all iPod nano purchasers other than U.S. residents who purchased an iPod nano that was not manufactured or designed using processes necessary to ensure normal resistance to scratching of the screen. The Company answered the Master Complaint on November 20, 2006.

The two California State Court actions were coordinated on May 4, 2006, and assigned to the Hon. Carl West in Los Angeles Superior Court. Plaintiffs filed a Consolidated Amended Class Action Complaint on June 8, 2006, alleging violations of California state consumer protection, unfair competition, false advertising and warranty laws and claiming unjust enrichment. The Consolidated Complaint alleges a putative plaintiff class of all California residents who own an iPod nano containing a manufacturing defect that results in the nano being susceptible to excessive scratching. The Company answered the Consolidated Amended Complaint on October 6, 2006.

Two similar complaints, *Carpentier v. Apple Canada, Inc.*, and *Royer-Brennan v. Apple Computer, Inc. and Apple Canada, Inc.* were filed in Montreal, Quebec, Canada on October 27, 2005 and November 9, 2005, respectively, seeking authorization to institute class actions on behalf of iPod nano purchasers in Quebec. The Royer-Brennan file was stayed in May 2006 in favor of the Carpentier file. A similar complaint, *Mund v. Apple Canada Inc. and Apple Computer, Inc.*, was filed in Ontario, Canada on January 9, 2006 seeking authorization to institute a class action on behalf of iPod nano purchasers in Canada. Apple Canada Inc. and Apple Computer, Inc. have served Notices of Intent to Defend.

Individual Networks, LLC v. Apple, Inc.

Plaintiff filed this action against the Company on April 24, 2007 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement of U.S. Patent No. 7,117,516, entitled "Method and System for Providing a Customized Media List." Plaintiff alleges certain features of the iTunes store infringe the patent. The complaint seeks unspecified damages and other relief. The Company filed an answer on July 2, 2007, denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims for declaratory judgment of noninfringement and invalidity, as well as a counterclaim against Individual Networks LLC for infringement of U.S. Patent No. 5,724,567. The Markman hearing is set for October 8, 2008, and trial is scheduled for November 9, 2009.

Intertainer, Inc. v. Apple Computer, Inc., et al.

Plaintiff filed this action on December 29, 2006 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement by the Company and others of U.S. Patent number 6,925,469 entitled "Digital Entertainment Service Platform." The complaint seeks unspecified damages and other relief. The Company filed an answer on February 21, 2007 denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims for declaratory judgment of noninfringement and invalidity.

Lenzi v. Apple Canada, Inc.; Wolfe v. Apple Computer, Inc. and Apple Canada, Inc.; Hirst v. Apple Canada, Inc.; Hamilton v. Apple Computer, Inc. and Apple Canada, Inc.

Plaintiff filed a purported class action on June 7, 2005, in Superior Court, in Montreal, Quebec, Canada allegedly on behalf of Quebec customers claiming false advertising and breach of warranty relating to iPod battery life. Plaintiff sought authorization to institute a class action on behalf of Generations 1, 2 and 3 iPod owners in Quebec. On February 2, 2006, the Court dismissed plaintiff's motion for authorization to institute a class action. Plaintiff has appealed this ruling.

Two similar complaints relative to iPod battery life, *Wolfe v. Apple* and *Hirst v. Apple*, were filed in Toronto, Ontario, Canada on August 15, 2005 and September 12, 2005, respectively. Counsel subsequently amended the complaint, now called *Waddell vs. Apple*. The Waddell lawsuit is brought on behalf of all Canadian purchasers other than Quebec purchasers. On January 17, 2006, the Company filed its statement of defence to the Waddell complaint. In addition, a similar complaint regarding iPod battery life, *Hamilton v. Apple Computer, Inc. and Apple Canada, Inc.* was filed in Calgary, Alberta, Canada on October 5, 2005, purportedly on behalf of all purchasers of iPods in Alberta, Canada. The complaint was served on September 27, 2006. The Company has reached a settlement of this matter and the parties have requested preliminary court approval for the settlement. Settlement of this matter will not have a material effect on the Company's financial condition or operating results.

Macadam v. Apple Computer, Inc.; Santos v. Apple Computer, Inc. (Santa Clara County Superior Court)

The Macadam action was filed in late 2002 asserting various causes of action including breach of contract, fraud, negligent and intentional interference with economic relationship, negligent misrepresentation, trade libel, unfair competition and false advertising. The complaint requested unspecified damages and other relief. The Company filed an answer on December 3, 2004 denying all allegations and asserting numerous defenses.

On October 1, 2003, Macadam was deauthorized as an Apple reseller. Macadam filed a motion for a temporary order to reinstate it as a reseller, which the Court denied. The Court denied Macadam's motion for a preliminary injunction on December 19, 2003. On December 6, 2004, Macadam filed for Chapter 11 bankruptcy in the Northern District of California, which placed a stay on the litigation as to Macadam. The Company filed a claim in the bankruptcy proceedings on February 16, 2005. The Macadam bankruptcy case was converted to Chapter 7 (liquidation) on April 29, 2005. The Company has reached a settlement of Macadam's claims against the Company with the Chapter 7 Bankruptcy Trustee. The Bankruptcy Court approved the settlement on July 17, 2006 over the objection of Tom Santos, Macadam's principal. Santos appealed the ruling approving the settlement, but the district court denied the appeal. Santos has appealed to the Ninth Circuit Court of Appeals.

On December 19, 2005, Tom Santos filed a Fifth Amended Complaint on his own behalf (not on behalf of Macadam) alleging fraud, violations of California Business & Professions Code §17200 (unfair competition), California Business & Professions Code §17500 (false advertising) and the Consumer Legal Remedies Act. The Company filed a demurrer to Santos' amended complaint and a special motion to strike the defamation cause of action on January 20, 2006. The Court sustained the demurrer in part but denied the special motion to strike. Santos filed a Sixth Amended Complaint on July 14, 2006. The Company filed a demurrer, which was granted on September 9, 2006. Santos filed a Seventh Amended Complaint in late September, 2006. The Company filed a motion to strike, which was granted in part and denied in part on December 15, 2006. Santos filed an Eighth Amended Complaint on January 29, 2007. The Company filed a demurrer, which was heard on May 7, 2007. The court sustained the demurrer, and Santos filed a Ninth Amended Complaint on July 11, 2007. The Company filed a demurrer, which was overruled. The Company also filed a cross complaint against Santos on January 20, 2006 alleging violations of California Business & Professions Code §17200 and California Penal Code §502, fraud and deceit and breach of contract.

Mediostream, Inc. v. Acer America Corp. et al.

Plaintiff filed this action against the Company, Acer America Corp., Dell, Inc. and Gateway, Inc. on August 28, 2007 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement of U.S. Patent No. 7,009,655, entitled "Method and System for Direct Recording of Video Information onto a Disk Medium." The complaint seeks unspecified damages and other relief. The Company's response to the complaint is not yet due.

OPTi Inc. v. Apple Inc.

Plaintiff filed this action against the Company on January 16, 2007 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement of U.S. Patent Nos. 5,710,906, 5,813,036 and 6,405,291, all entitled "Predictive Snooping of Cache Memory for Master-Initiated Accesses." The complaint seeks unspecified damages and other relief. The Company filed an answer on April 17, 2007 denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims for declaratory judgment of noninfringement and invalidity.

Premier International Associates LLC v. Apple Computer, Inc.

Plaintiff filed this action on November 3, 2005 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement by the Company of U.S. Patent Nos. 6,243,725 and 6,763,345 both entitled "List Building System." The complaint sought unspecified damages and other relief. The Company filed an answer on January 13, 2006 denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims for a declaratory judgment of noninfringement and invalidity. A Markman hearing was held on May 17, 2007 and the court issued its claim construction ruling on May 23, 2007. Trial was scheduled for December 3, 2007. The parties have reached a settlement and the matter is concluded. Settlement of this matter did not have a material effect on the Company's financial condition or operating results.

Quantum Technology Management, Ltd. v. Apple Computer, Inc.

Plaintiff filed this action on December 21, 2005 in the United States District Court for the District of Maryland against the Company and Fingerworks, Ltd., alleging infringement of U.S. Patent No. 5,730,165 entitled "Time Domain Capacitive Field Detector." The complaint seeks unspecified damages and other relief. On May 11, 2006, Quantum filed an amended complaint adding Cypress Semiconductor/MicroSystems, Inc. as a defendant. On July 31, 2006, the Company filed an answer denying all material allegations and asserting numerous affirmative defenses and also filed counterclaims for non-infringement and invalidity. On November 30, 2006, plaintiff filed a reply to the Company's counterclaims and a More Definite Statement. A Markman hearing was held on May 16, 2007. On June 7, 2007, the court issued a claim construction ruling, and also issued an order invalidating six of plaintiff's asserted patent claims in response to the Company's motion for partial summary judgment of invalidity.

Saito Shigeru Kenchiku Kenkyusho (Shigeru Saito Architecture Institute) v. iPod; Apple Japan Inc. v. Shigeru Saito Architecture Institute

Plaintiff Saito filed a petition in the Japan Customs Office in Tokyo on January 23, 2007 alleging infringement by the Company of Japanese Patent No. 3852854, entitled "Touch Operation Input Device and Electronic Parts Thereof." The petition sought an order barring the importation into Japan of fifth generation iPods and second generation iPod nanos. The Customs Office held a hearing on March 22, 2007. The Customs Office rejected the petition to bar importation and dismissed plaintiff's case.

Apple Japan, Inc. filed a Declaratory Judgment action against Saito on February 6, 2007, seeking a declaration that the '854 patent is invalid and not infringed. Saito filed a Counter Complaint for infringement seeking damages.

SP Technologies LLC v. Apple Inc.

Plaintiff filed this action against the Company on August 2, 2007 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement of U.S. Patent No. 6,784,873 entitled "Method and Medium for Computer Readable Keyboard Display Incapable of User Termination." The complaint seeks unspecified damages and other relief. The Company's response to the complaint is not yet due.

St-Germain v. Apple Canada, Inc.

Plaintiff filed this case in Montreal, Quebec, Canada, on August 5, 2005, seeking authorization to institute a class action for the refund by the Company of the Canadian Private Copying Levy that was applied to the iPod purchase price in Quebec between December 12, 2003 and December 14, 2004 but later declared invalid by the Canadian Court. The Company has completed a refund program for this levy. A class certification hearing took place January 13, 2006. On February 24, 2006, the Court granted class certification and notice was published during the last week of March 2006. The trial was conducted on October 15 and 16, 2007. The Court has not yet issued a decision.

Texas MP3 Technologies Ltd v. Apple Inc. et al.

Plaintiff filed this action against the Company and other defendants on February 16, 2007 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement of U.S. Patent No. 7,065,417 entitled "MPEG Portable Sound Reproducing System and A Reproducing Method Thereof." The complaint seeks unspecified damages and other relief. On July 12, 2007, the Company filed a petition for reexamination of the patent, which the U.S. Patent and Trademark Office granted. Plaintiff filed an amended complaint on August 1, 2007, adding the iPhone as an accused device. On August 2, 2007, the Company filed a motion to stay the litigation pending the outcome of the reexamination, which the Court denied. The Company filed an answer on August 20, 2007, denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims for declaratory judgment of noninfringement and invalidity.

The Apple iPod iTunes Antitrust Litigation (formerly Charoensak v. Apple Computer, Inc. and Tucker v. Apple Computer, Inc.); Black v. Apple Inc.

The first-listed action is a consolidated case combining two cases previously pending under the names Charoensak v. Apple Computer Inc. (formerly Slattery v. Apple Computer Inc.) and Tucker v. Apple Computer, Inc. The original plaintiff (Slattery) in the Charoensak case filed a purported class action on

January 3, 2005 in the United States District Court for the Northern District of California alleging various claims including alleged unlawful tying of music purchased on the iTunes Store with the purchase of iPods and unlawful acquisition or maintenance of monopoly market power. Plaintiff's complaint alleged violations of §§1 and 2 of the Sherman Act (15 U.S.C. §§1 and 2), California Business & Professions Code §16700 et seq. (the Cartwright Act), California Business & Professions Code §17200 (unfair competition), common law unjust enrichment and common law monopolization. Plaintiff sought unspecified damages and other relief. The Company filed a motion to dismiss on February 10, 2005. On September 9, 2005, the Court denied the motion in part and granted it in part. Plaintiff filed an amended complaint on September 23, 2005 and the Company filed an answer on October 18, 2005. In August 2006, the court dismissed Slattery without prejudice and allowed plaintiffs to file an amended complaint naming two new plaintiffs (Charoensak and Rosen). On November 2, 2006, the Company filed an answer to the amended complaint denying all material allegations and asserting numerous affirmative defenses.

The Tucker case was filed as a purported class action on July 21, 2006 in the United States District Court for the Northern District of California alleging various claims including alleged unlawful tying of music and videos purchased on the iTunes Store with the purchase of iPods and vice versa and unlawful acquisition or maintenance of monopoly market power. The complaint alleges violations of §§1 and 2 of the Sherman Act (15 U.S.C. §§1 and 2), California Business & Professions Code §16700 et seq. (the Cartwright Act), California Business & Professions Code §17200 (unfair competition) and the California Consumer Legal Remedies Act. Plaintiff sought unspecified damages and other relief. On November 3, 2006, the Company filed a motion to dismiss the complaint. On December 20, 2006, the Court denied the motion to dismiss. On January 11, 2007, The Company filed an answer denying all material allegations and asserting numerous defenses.

On March 20, 2007, the Court consolidated the two cases. Plaintiffs filed a consolidated complaint on April 19, 2007. On June 6, 2007, the Company filed an answer to the consolidated complaint denying all material allegations and asserting numerous affirmative defenses.

A related class action complaint, *Black v. Apple Inc.*, was filed on August 27, 2007 in the Circuit Court in Broward County, Florida, alleging that the Company is attempting to maintain a monopoly by precluding customers from using non-iTunes downloads on iPods and from using iTunes music on non-iPod MP3 players. Plaintiff alleges that the Company's alleged monopolization violates the Florida Antitrust Act and the Florida Deceptive and Unfair Trade Practices Act. Plaintiff seeks unspecified damages and other relief. The Company removed the case to the United States District Court for the Southern District of Florida on September 28, 2007, and filed a motion to transfer the case to the Northern District of California on October 12, 2007. The Company's motion to transfer was granted on October 17, 2007.

Tse v. Apple Computer, Inc. et al.

Plaintiff Ho Keung Tse filed this action against the Company and other defendants on August 5, 2005 in the United States District Court for the District of Maryland alleging infringement of U.S. Patent No. 6,665,797 entitled "Protection of Software Again [sic] Against Unauthorized Use." The complaint seeks unspecified damages and other relief. The Company filed an answer on October 31, 2005 denying all material allegations and asserting numerous affirmative defenses. On October 28, 2005, the Company and the other defendants filed a motion to transfer the case to the Northern District of California, which was granted on August 31, 2006. On July 24, 2007, the Company filed a petition for reexamination of the patent, which the U.S. Patent and Trademark Office granted. On July 25, 2007, the Company filed a motion to stay the litigation pending the outcome of the reexamination, which the court granted on October 4, 2007.

Union Fédérale des Consummateurs—Que Choisir v. Apple Computer France S.à.r.l. and iTunes S.à.r.l.

Plaintiff, a consumer association in France, filed this complaint on February 9, 2005 alleging that the above-listed entities are violating consumer law by (1) omitting to mention that the iPod is allegedly not compatible with music from online music services other than the iTunes Store and that the music from the iTunes Store is only compatible with the iPod and (2) allegedly tying the sales of iPods to the iTunes Store and vice versa. Plaintiff seeks damages, injunctive relief and other relief. The first hearing on the case took place on May 24, 2005. The Company's response to the complaint was served on November 8, 2005. Plaintiff's responsive pleading was filed on February 10, 2006. The Company filed a reply on June 6, 2006 and UFC filed a response on September 19, 2006.

Vitt v. Apple Computer, Inc.

Plaintiff filed this purported class action on November 7, 2006 in the United States District Court for the Central District of California on behalf of a purported nationwide class of all purchasers of the iBook G4 alleging that the computer's logic board fails at an abnormally high rate. The complaint alleges violations of California Business & Professions Code §17200 (unfair competition) and California Business & Professions Code §17500 (false advertising). Plaintiff seeks unspecified damages and other relief. The Company filed a motion to dismiss on January 19, 2007, which the court granted on March 13, 2007. Plaintiffs filed an amended complaint on March 26, 2007. The Company filed a motion to dismiss on August 16, 2007, which was heard on October 4, 2007.

Vogel v. Jobs et al.

Plaintiff filed this purported class action on August 24, 2006, in the United States District Court for the Northern District of California against the Company and certain of the Company's current and former officers and directors alleging improper backdating of stock option grants to maximize certain defendants' profits, failing to properly account for those grants and issuing false financial statements. On January 19, 2007, the Court appointed the New York City Employees' Retirement System as lead plaintiff. On March 23, 2007, plaintiffs filed a Consolidated Class Action Complaint. The Consolidated Complaint purports to be brought on behalf of several classes of holders of the Company's stock and asserts claims under Section 14(a) and 20(a) of the Securities Exchange Act as well as state law. The Consolidated Complaint seeks rescission of amendments to various stock option and other incentive compensation plans, an accounting and damages in an unspecified amount. Defendants filed a motion to dismiss on June 8, 2007, which was heard on September 7, 2007.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of the Company's fiscal year ended September 29, 2007.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's common stock is traded on the over-the-counter market and is quoted on the NASDAQ Global Select Market under the symbol AAPL and on the Frankfurt Stock Exchange under the symbol APCD.

Price Range of Common Stock

The price range per share of common stock presented below represents the highest and lowest sales prices for the Company's common stock on the NASDAQ Global Select Market during each quarter of the two most recent fiscal years.

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Fiscal 2007 price range per common share	$ 155.00 - $111.62	$ 127.61 - $89.60	$ 97.80 - $81.90	$ 93.16 - $72.60
Fiscal 2006 price range per common share	$ 77.78 - $ 50.16	$ 73.80 - $55.41	$ 86.40 - $57.67	$ 75.46 - $47.87

Holders

As of November 2, 2007, there were 30,336 shareholders of record.

Dividends

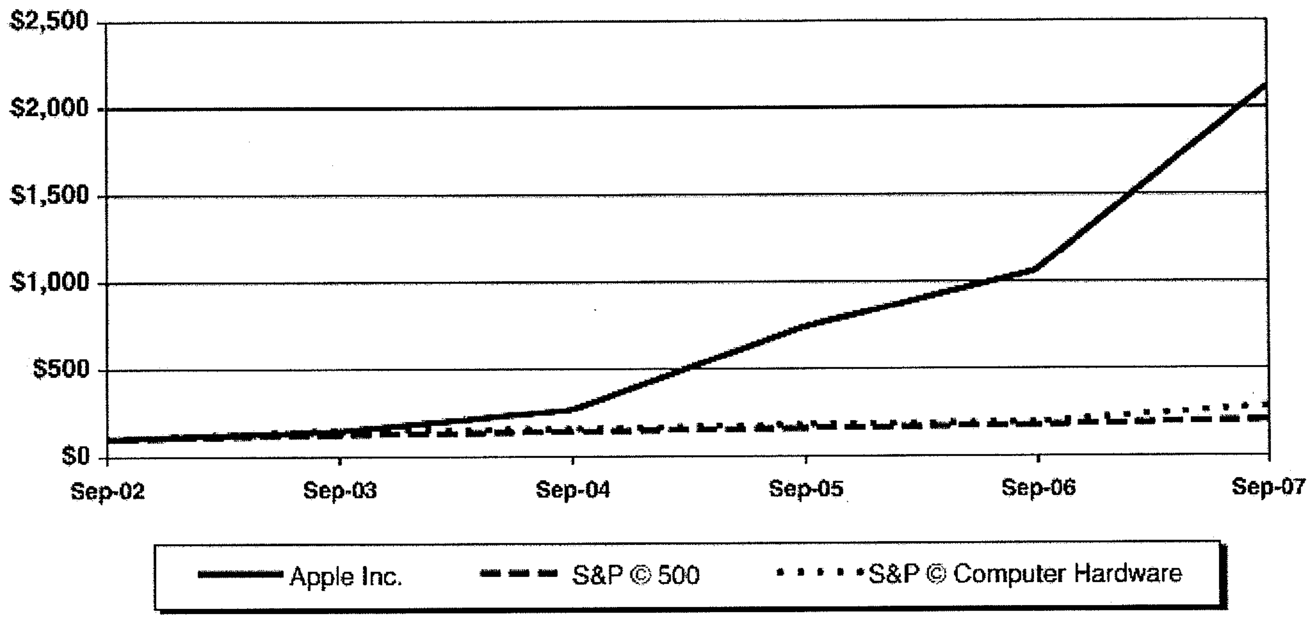
The Company did not declare or pay cash dividends in either fiscal 2007 or 2006. The Company anticipates that, for the foreseeable future, it will retain any earnings for use in the operation of its business.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

Company Stock Performance

The following graph shows a five-year comparison of cumulative total shareholder return, calculated on a dividend reinvested basis, for the Company, the S&P 500 Composite Index (the "S&P 500") and the S&P Computers (Hardware) Index (the "Industry Index"). The graph assumes $100 was invested in each of the Company's common stock, the S&P 500, and the Industry Index on September 30, 2002. Data points on the graph are annual. Note that historic stock price performance is not necessarily indicative of future stock price performance.



Item 6. Selected Financial Data

The information set forth below is not necessarily indicative of results of future operations, and should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and related notes thereto included in Item 8 of this Form 10-K to fully understand factors that may affect the comparability of the information presented below.

Five fiscal years ended September 29, 2007 (In millions, except share and per share amounts)	2007	2006	2005	2004	2003
Net sales	$ 24,006	$ 19,315	$ 13,931	$ 8,279	$ 6,207
Net income	$ 3,496	$ 1,989	$ 1,328	$ 266	$ 57
Earnings per common share:					
Basic	$ 4.04	$ 2.36	$ 1.64	$ 0.36	$ 0.08
Diluted	$ 3.93	$ 2.27	$ 1.55	$ 0.34	$ 0.08
Cash dividends declared per common share	$ —	$ —	$ —	$ —	$ —
Shares used in computing earnings per share (in thousands):					
Basic	864,595	844,058	808,439	743,180	721,262
Diluted	889,292	877,526	856,878	774,776	723,352
Cash, cash equivalents, and short-term investments	$ 15,386	$ 10,110	$ 8,261	$ 5,464	$ 4,566
Total assets	$ 25,347	$ 17,205	$ 11,516	$ 8,039	$ 6,817
Long-term debt (including current maturities)	$ —	$ —	$ —	$ —	$ 304
Total liabilities	$ 10,815	$ 7,221	$ 4,088	$ 2,976	$ 2,594
Shareholders' equity	$ 14,532	$ 9,984	$ 7,428	$ 5,063	$ 4,223

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This section and other parts of this Form 10-K contain forward-looking statements that involve risks and uncertainties. Forward-looking statements can also be identified by words such as "anticipates," "expects," "believes," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and the Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Risk Factors" above. The following discussion should be read in conjunction with the consolidated financial statements and notes thereto included in Item 8 of this Form 10-K. All information presented herein is based on the Company's fiscal calendar. Unless otherwise stated, references in this report to particular years or quarters refer to the Company's fiscal years ended in September and the associated quarters of those fiscal years. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Executive Overview

The Company designs, manufactures, and markets personal computers, portable digital music players, and mobile communication devices and sells a variety of related software, services, peripherals, and networking solutions. The Company's products and services include the Mac® line of desktop and portable computers, the iPod line of portable digital music players, iPhone, Apple TV, Xserve®, and Xserve RAID, a portfolio of consumer and professional software applications, the Mac OS® X operating system, third-party digital content through the iTunes Store™, and a variety of accessory, service and support offerings. The Company sells its products worldwide through its online stores, its retail stores, its direct sales force, and third-party wholesalers, resellers, and value-added resellers. In addition, the Company sells a variety of third-party Mac, iPod and iPhone compatible products, including application software, printers, storage devices, speakers, headphones, and various other accessories and peripherals through its online and retail stores. The Company sells to education, consumer, creative professional, business, and government customers. Further discussion of the Company's products may be found in Part I, Item 1 of this Form 10-K under the heading "Business."

The Company believes that for both professionals and consumers the personal computer has become the center of an evolving digital lifestyle by integrating with and enhancing the utility of advanced digital devices such as the Company's iPods, iPhones, digital video and still cameras, televisions, personal digital assistants, and other digital devices. The attributes of the personal computer that enable this functionality include a high-quality user interface, easy access to relatively inexpensive data storage, the ability to run complex applications, and the ability to connect easily to a wide variety of other digital devices and to the Internet. The Company is the only participant in the personal computer industry that controls the design and development of the entire personal computer—from the hardware and operating system to sophisticated applications. This, along with its products' creative industrial designs, intuitive ease-of-use, and built-in graphics, multimedia and networking capabilities, uniquely positions the Company to offer innovative integrated digital lifestyle solutions.

The Company's business strategy leverages its ability, through the design and development of its own operating system, hardware, and many software applications and technologies, to bring to its customers around the world compelling new products and solutions with superior ease-of-use, seamless integration, and innovative industrial design.

The Company participates in several highly competitive markets, including personal computers with its Mac line of computers, consumer electronics with its iPod product family of portable digital music players, and distribution of third-party digital content through its online iTunes Store. With the introduction of iPhone, the Company has also begun to compete with mobile communication device companies that have substantial experience and technological and financial resources. While the Company is widely recognized as a leading innovator in the personal computer and consumer electronics markets as well as a leader in the emerging market for distribution of digital content, these markets are highly competitive and subject to aggressive pricing. To remain competitive, the Company believes that increased investment in research and development ("R&D") and marketing and advertising is necessary to maintain or expand its position in the markets where it competes. The Company's R&D spending is focused on further developing its existing line of personal computers, operating systems, application software, and portable digital music players; developing new digital lifestyle consumer and professional software applications; and investing in new product areas such as iPhone and wireless technologies. The Company also believes increased investment in marketing and advertising programs is critical to increasing product and brand awareness.

The Company utilizes a variety of direct and indirect distribution channels. The Company believes that sales of its innovative and differentiated products are enhanced by knowledgeable salespersons who can convey the value of the hardware, software, and peripheral integration, demonstrate the unique digital lifestyle solutions that are available only on Mac computers, and demonstrate the compatibility of the Mac with the Windows platform and networks. The Company further believes providing a high-quality sales and after-sales support experience is critical to attracting and retaining customers. To ensure a high-quality buying experience for its products in which service and education are emphasized, the Company has expanded and improved its distribution capabilities by opening its own retail stores in the U.S. and internationally. The Company had 197 stores open as of September 29, 2007.

The Company also staffs selected third-party stores with the Company's own employees to improve the buying experience through reseller channels. The Company has deployed Apple employees and contractors in reseller locations around the world including the U.S., Canada, Europe, Japan, Asia, Latin America and Australia. The Company also sells to customers directly through its online stores around the world.

To improve access to the iPod product family, the Company has significantly expanded the number of distribution points where iPods are sold. iPods can be purchased in certain department stores, member-only warehouse stores, large retail chains, and specialty retail stores, as well as through the channels for Mac distribution listed above.

The Company began shipping iPhone in the U.S. on June 29, 2007, in the U.K. and Germany on November 9, 2007 and expects to begin shipping the iPhone in France on November 29, 2007. AT&T Mobility LLC ("AT&T"), O2 Limited ("O2"), T-Mobile International AG & Co. KG ("T-Mobile"), and France Telecom ("Orange") are the exclusive cellular network carriers for iPhone in the U.S., U.K., Germany, and France, respectively. iPhone is distributed through the Company and its exclusive cellular network carriers' distribution channels.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles and the Company's discussion and analysis of its financial condition and operating results require the Company's management to make judgments, assumptions, and estimates that affect the amounts reported in its consolidated financial statements and accompanying notes. Note 1 "Summary of Significant Accounting Policies" of Notes to Consolidated Financial Statements in this Form 10-K describes the significant accounting policies and methods used in the preparation of the Company's consolidated financial statements. Management bases its estimates on historical experience and on various other assumptions it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates and such differences may be material.

Management believes the Company's critical accounting policies and estimates are those related to revenue recognition, allowance for doubtful accounts, inventory valuation and inventory purchase commitments, warranty costs, stock-based compensation, income taxes, and legal and other contingencies. Management considers these critical policies because they are both important to the portrayal of the Company's financial condition and operating results, and they require management to make judgments and estimates about inherently uncertain matters. The Company's senior management has reviewed these critical accounting policies and related disclosures with the Audit and Finance Committee of the Company's Board of Directors.

Revenue Recognition

Net sales consist primarily of revenue from the sale of hardware, software, music products, digital content, peripherals, and service and support contracts. The Company recognizes revenue for software products (operating system software and applications software), or any product that is considered to be software-related in accordance with the guidance in Emerging Issues Task Force ("EITF") No. 03-5, *Applicability of AICPA Statement of Position 97-2 to Non-software Deliverables in an Arrangement Containing More-Than-Incidental Software*, (e.g., Mac computers, iPod portable digital music players and iPhone) pursuant to American Institute of Certified Public Accountants ("AICPA") Statement of Position ("SOP") No. 97-2, *Software Revenue Recognition*, as amended. For products that are not software or software-related, (e.g., digital content sold on the iTunes Store and certain Mac, iPod and iPhone supplies and accessories) the Company recognizes revenue pursuant to SEC Staff Accounting Bulletin ("SAB") No. 104, *Revenue Recognition.*

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection is probable. Product is considered delivered to the customer once it has been shipped, and title and risk of loss have been transferred. For most of the Company's product sales, these criteria are met at the time the product is shipped. For online sales to individuals, for some sales to education customers in the U.S., and for certain other sales, the Company defers revenue until the customer receives the product because the Company retains a portion of the risk of loss on these sales during transit. If at the outset of an arrangement the Company determines the arrangement fee is not, or is presumed not to be, fixed or determinable, revenue is deferred and subsequently recognized as amounts become due and payable and all other criteria for revenue recognition have been met.

During 2007, the Company began shipping Apple TV and iPhone. For both Apple TV and iPhone, the Company indicated it may provide future unspecified features and additional software products free of charge to customers. Therefore, sales of Apple TV and iPhone handsets are recognized under subscription accounting in accordance with SOP No. 97-2. The Company recognizes the associated revenue and cost of goods sold on a straight-line basis over the currently estimated 24-month economic lives of these products with any loss recognized at the time of sale. Costs incurred by the Company for engineering, sales, marketing and warranty are expensed as incurred.

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end-user rebates, and other sales programs and volume-based incentives. For transactions involving price protection, the Company recognizes revenue net of the estimated amount to be refunded, provided the refund amount can be reasonably and reliably estimated and the other conditions for revenue recognition have been met. If refunds cannot be reliably estimated, revenue is not recognized until reliable estimates can be made or the price protection lapses. For customer incentive programs, the estimated cost of these programs is recognized at the later of the date at which the Company has sold the product or the date at which the program is offered. The Company also records reductions to revenue for expected future product returns based on the Company's historical experience. Future market conditions and product transitions may require the Company to increase customer incentive programs and incur incremental price protection obligations that could result in additional reductions to revenue at the time such programs are offered. Additionally, certain customer incentive programs require management to estimate the number of customers who will actually redeem the incentive based on historical experience and the specific terms and conditions of particular incentive programs. If a greater than estimated proportion of customers redeem such incentives, the Company would be required to record additional reductions to revenue, which would have a negative impact on the Company's results of operations.

Allowance for Doubtful Accounts

The Company distributes its products through third-party distributors and resellers and directly to certain education, consumer, and commercial customers. The Company generally does not require collateral from its customers; however, the Company will require collateral in certain instances to limit credit risk. In addition, when possible the Company does attempt to limit credit risk on trade receivables with credit insurance for certain customers in Latin America, Europe, Asia, and Australia by arranging with third-party financing companies to provide flooring arrangements and other loan and lease programs to the Company's direct customers. These credit-financing arrangements are directly between the third-party financing company and the end customer. As such, the Company generally does not assume any recourse or credit risk sharing related to any of these arrangements. However, considerable trade receivables that are not covered by collateral, third-party flooring arrangements, or credit insurance are outstanding with the Company's distribution and retail channel partners.

The allowance for doubtful accounts is based on management's assessment of the collectibility of specific customer accounts and includes consideration of the credit worthiness and financial condition of those specific customers. The Company records an allowance to reduce the specific receivables to the amount that is reasonably believed to be collectible. The Company also records an allowance for all other trade receivables based on multiple factors including historical experience with bad debt, the general economic environment, the financial condition of the Company's distribution channels, and the aging of such receivables. If there is a deterioration of a major customer's financial condition, if the Company becomes aware of additional information related to the credit worthiness of a major customer, or if future actual default rates on trade receivables in general differ from those currently anticipated, the Company may have to adjust its allowance for doubtful accounts, which would affect earnings in the period the adjustments were made.

Inventory Valuation and Inventory Purchase Commitments

The Company must order components for its products and build inventory in advance of product shipments. The Company records a write-down for inventories of components and products, including third-party products held for resale, which have become obsolete or are in excess of anticipated demand or net realizable value. The Company performs a detailed review of inventory each fiscal quarter that considers multiple factors including demand forecasts, product life cycle status, product development plans, current sales levels, and component cost trends. The personal computer, consumer electronics and mobile communications industries are subject to a rapid and unpredictable pace of product and component obsolescence and demand changes. If future demand or market conditions for the Company's products are less favorable than forecasted or if unforeseen technological changes negatively impact the utility of component inventory, the Company may be required to record additional write-downs which would negatively affect gross margins in the period when the write-downs were recorded.

The Company accrues reserves for estimated cancellation fees related to component orders that have been cancelled or are expected to be cancelled. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. These commitments typically cover the Company's requirements for periods ranging from 30 to 150 days. If there is an abrupt and substantial decline in demand for one or more of the Company's products or an unanticipated change in technological requirements for any of the Company's products, the Company may be required to record additional reserves for cancellation fees that would negatively affect gross margins in the period when the cancellation fees are identified and recorded.

Warranty Costs

The Company provides for the estimated cost for hardware and software warranties at the time the related revenue is recognized based on historical and projected warranty claim rates, historical and projected cost-per-claim, and knowledge of specific product failures that are outside of the Company's typical experience. Each quarter, the Company reevaluates its estimates to assess the adequacy of its recorded warranty liabilities considering the size of the installed base of products subject to warranty protection and adjusts the amounts as necessary. For products accounted for under subscription accounting pursuant to SOP No. 97-2, the Company recognizes warranty expense as incurred. If actual product failure rates or repair costs differ from estimates, revisions to the estimated warranty liability would be required and could negatively affect the Company's results of operations.

The Company periodically provides updates to its applications and system software to maintain the software's compliance with specifications. The estimated cost to develop such updates is accounted for as warranty cost that is recognized at the time related software revenue is recognized. Factors considered in determining appropriate accruals related to such updates include the number of units delivered, the number of updates expected to occur, and the historical cost and estimated future cost of the resources necessary to develop these updates.

Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004) ("SFAS No. 123R"), *Share-Based Payment*. Under the provisions of SFAS No. 123R, stock-based compensation cost is estimated at the grant date based on the award's fair-value as calculated by the Black-Scholes-Merton ("BSM") option-pricing model and is recognized as expense ratably on a straight-line basis over the requisite service period. The BSM model requires various judgmental assumptions including expected volatility, forfeiture rates, and expected option life. If any of the assumptions used in the BSM model change significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period.

Income Taxes

The Company records a tax provision for the anticipated tax consequences of the reported results of operations. In accordance with SFAS No. 109, *Accounting for Income Taxes*, the provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. The Company records a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized.

Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets. In the event that all or part of the net deferred tax assets are determined not to be realizable in the future, an adjustment to the valuation allowance would be charged to earnings in the period such determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with management's expectations could have a material impact on the Company's financial condition and operating results.

Legal and Other Contingencies

As discussed in Part I, Item 3 of this Form 10-K under the heading "Legal Proceedings" and in Note 8 "Commitments and Contingencies" in Notes to Consolidated Financial Statements, the Company is subject to various legal proceedings and claims that arise in the ordinary course of business. The Company records a contingent liability when it is probable that a loss has been incurred and the amount is reasonably estimable in accordance with SFAS No. 5, *Accounting for Contingencies*. There is significant judgment required in both the probability determination and as to whether an exposure can be reasonably estimated. In management's opinion, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate have a material adverse effect on its financial condition or operating results. However, the outcomes of legal proceedings and claims brought against the Company are subject to significant uncertainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

Net Sales

Fiscal years 2007 and 2005 spanned 52 weeks while fiscal year 2006 spanned 53 weeks. This additional week is added to the first fiscal quarter approximately every six years to realign fiscal quarters with calendar quarters.

Net sales and Mac unit sales by operating segment and net sales and unit sales by product follow (net sales in millions and unit sales in thousands):

	September 29, 2007	Change	September 30, 2006	Change	September 24, 2005
Net Sales by Operating Segment (a):					
Americas net sales	$ 11,596	23%	$ 9,415	41%	$ 6,658
Europe net sales	5,460	33%	4,096	33%	3,073
Japan net sales	1,082	(11)%	1,211	31%	924
Retail net sales	4,115	27%	3,246	42%	2,278
Other Segments net sales (b)	1,753	30%	1,347	35%	998
Total net sales	$ 24,006	24%	$ 19,315	39%	$ 13,931
Unit Sales by Operating Segment:					
Americas Mac unit sales	3,019	24%	2,432	11%	2,184
Europe Mac unit sales	1,816	35%	1,346	18%	1,138
Japan Mac unit sales	302	(1)%	304	(3)%	313
Retail Mac unit sales	1,386	56%	886	45%	609
Other Segments Mac unit sales (b)	528	58%	335	16%	290
Total Mac unit sales	7,051	33%	5,303	17%	4,534
Net Sales by Product:					
Desktops (c)	$ 4,020	21%	$ 3,319	(3)%	$ 3,436
Portables (d)	6,294	55%	4,056	43%	2,839
Total Mac net sales	10,314	40%	7,375	18%	6,275
iPod	8,305	8%	7,676	69%	4,540
Other music related products and services (e)	2,496	32%	1,885	110%	899
iPhone and related products and services (f)	123	NM	—	NM	—
Peripherals and other hardware (g)	1,260	15%	1,100	(2)%	1,126
Software, service, and other sales (h)	1,508	18%	1,279	17%	1,091
Total net sales	$ 24,006	24%	$ 19,315	39%	$ 13,931
Unit Sales by Product:					
Desktops (c)	2,714	12%	2,434	(3)%	2,520
Portables (d)	4,337	51%	2,869	42%	2,014
Total Mac unit sales	7,051	33%	5,303	17%	4,534
Net sales per Mac unit sold (i)	$ 1,463	5%	$ 1,391	1%	$ 1,384
iPod unit sales	51,630	31%	39,409	75%	22,497
Net sales per iPod unit sold (j)	$ 161	(17)%	$ 195	(3)%	$ 202
iPhone unit sales	1,389	NM	—	NM	—

Notes:

(a) During 2007, the Company revised the way it measures the Retail Segment's operating results to a manner that is generally consistent with the Company's other operating segments. Prior period results have been reclassified to reflect this change to the Retail Segment's operating results along with the corresponding offsets to the other operating segments. Further information regarding the Company's operating segments may be found in Notes to Consolidated Financial Statements at Note 9, "Segment

Information and Geographic Data."

(b) Other Segments include Asia Pacific and FileMaker.

(c) Includes iMac, eMac, Mac mini, Mac Pro, Power Mac, and Xserve product lines.

(d) Includes MacBook, iBook, MacBook Pro, and PowerBook product lines.

(e) Consists of iTunes Store sales, iPod services, and Apple-branded and third-party iPod accessories.

(f) Derived from handset sales, carrier agreements, and Apple-branded and third-party iPhone accessories.

(g) Includes sales of Apple-branded and third-party displays, wireless connectivity and networking solutions, and other hardware accessories.

(h) Includes sales of Apple-branded operating system, application software, third-party software, AppleCare, and Internet services.

(i) Derived by dividing total Mac net sales by total Mac unit sales.

(j) Derived by dividing total iPod net sales by total iPod unit sales.

NM = Not Meaningful

Fiscal Year 2007 versus 2006

Net sales during 2007 increased 24% or $4.7 billion from 2006 even though the fiscal year of 2007 spanned 52 weeks while the fiscal year of 2006 spanned 53 weeks. Several factors contributed to these increases including the following:

- Mac net sales increased $3 billion or 40% during 2007 compared to 2006, while Mac unit sales increased by 1.75 million units or 33%. The 33% Mac unit sales growth rate is significantly greater than the estimated growth rate of the overall personal computer industry during that timeframe. Unit sales of the Company's portable products accounted for 62% of the Company's personal computer shipments in 2007, up from 54% in 2006. Net sales and unit sales of the Company's portable products increased 55% and 51%, respectively, during 2007 compared to 2006. This growth was due to strong demand for the MacBook, which increased in each of the Company's operating segments, as well as the MacBook Pro, which increased in each operating segment except Japan. Mac desktop net sales and unit sales increased by 21% and 12%, respectively, during 2007 due to stronger sales of the iMac in each of the Company's operating segments. The Mac desktop net sales growth was greater than the unit sales growth primarily due to a shift in desktop product mix away from the lower-price Mac Mini and discontinued eMac and toward the iMac.

- Net sales of iPods increased $629 million or 8% during 2007 compared to 2006. Unit sales of iPods increased 31% compared to 2006. The iPod growth was primarily driven by increased sales of the iPod shuffle and iPod nano particularly in international markets. iPod unit sales growth was significantly greater than iPod net sales due to a shift in overall iPod product mix, as well as due to lower selling prices for the iPod classic, iPod nano and iPod shuffle in 2007 compared to 2006.

- Net sales of iPhone and related products and services were $123 million in 2007. iPhone net sales include the portion of iPhone handset revenue recognized in accordance with subscription accounting over the product's 24-month estimated economic life, as well as sales of iPhone accessory products and revenue from carrier agreements. iPhone unit sales were 1.39 million in 2007.

- Net sales of other music related products and services increased $611 million or 32% during 2007 compared to 2006 due to increased net sales from the iTunes Store. The Company believes this growth was the result of heightened consumer interest in downloading digital content and the expansion of third-party audio and video content available for sale via the iTunes Store.

- Net sales of peripherals and other hardware increased $160 million or 15% compared to 2006 due to an increase in wireless networking products and other hardware accessories, including printers and scanners, which was partially offset by a decrease in net sales of displays.

- Net sales of software, service, and other sales rose $229 million or 18% during 2007 compared to 2006. This growth was primarily attributable to increased net sales of AppleCare Protection Plan ("APP") extended service and support contracts and increased sales of Apple branded and third-party developers' software products.

Fiscal Year 2006 versus 2005

Net sales during 2006 increased 39% or $5.4 billion from 2005. This increase was due in part to the fact that 2006 spanned 53 weeks while 2005 spanned 52 weeks. Several other factors contributed to these increases including the following:

- Net sales of iPods increased $3.1 billion or 69% during 2006 compared to 2005. Unit sales of iPods totaled 39.4 million in 2006, which represents an increase of 75% from the 22.5 million iPod units sold in 2005. Strong iPod sales during 2006 reflected significant sales of both the hard-drive based iPod that supports video, first introduced in October of 2005 and the iPod nano, introduced in September 2005, as well as continued expansion of iPod distribution points. During 2006, the net sales per iPod unit sold decreased by 3% compared to 2005 primarily due to an overall decrease in average selling prices for all iPods as well as a shift in product mix to the iPod nano.

- Mac net sales increased $1.1 billion or 18% during 2006 compared to 2005. Mac unit sales increased by 769,000 units or 17% during 2006 compared to 2005. These increases were mainly due to strong demand for the Intel-based MacBook and MacBook Pro systems and reflect a shift in product mix to portable products in all of the Company's operating segments. Net sales and unit sales of the Company's portable products increased 43% and 42%, respectively, during 2006 compared to 2005. Mac desktop net sales and unit sales both decreased by 3% during 2006 compared to 2005. The decrease in sales of the Company's Mac desktops was due to declines in sales of the Company's professional-oriented desktop products. The Company believes the decline in the Company's professional-oriented desktop products was due to customers delaying purchases of such products in anticipation of the release of the Intel-based Mac Pro, which did not begin shipping until August 2006, and updated software applications capable of running on Intel-based Mac computers, and the trend toward portable computers. A slight increase of 1% during 2006 in net sales per Mac unit sold was due to a shift in mix to higher-priced portable products, partially offset by price reductions on certain Mac systems.

- Other music related products and services consists of sales associated with the iTunes Store and iPod services and accessories. Net sales of other music related products and services increased $986 million or 110% during 2006 compared to 2005. The increase was primarily due to increased net sales from the iTunes Store and Apple-branded and third-party iPod accessories and services. The increase in sales from the iTunes Store stemmed from significant growth in U.S. sales and the opening of the iTunes Store in Japan during August 2005 and Australia during October 2005. The increased sales from the iTunes Store were also attributable to the availability of videos, television shows, and feature-length movie downloads.

- Net sales of software, service, and other sales increased $188 million or 17% during 2006 compared to 2005. The growth was primarily attributable to increased net sales of AppleCare Protection Plan ("APP") extended service and support contracts and application software, partially offset by a decrease in sales of Mac OS X. Mac OS X sales were particularly high in 2005 due to the release of Mac OS X Tiger in April 2005.

Offsetting the favorable factors discussed above, the Company's net sales during 2006 were negatively impacted by the following:

- Net sales of peripherals and other hardware declined $26 million or 2% compared to 2005 primarily due to price decreases and a decrease in net sales of displays relating to a shift in mix from desktop to portable systems. The decrease in net sales of displays for 2006 is consistent with the overall decrease in unit sales of Mac professional desktop systems.

Segment Operating Performance

The Company manages its business primarily on a geographic basis. The Company's reportable operating segments consist of the Americas, Europe, Japan, and Retail. The Americas, Europe, and Japan reportable segments do not include activities related to the Retail segment. The Americas segment includes both North and South America. The Europe segment includes European countries as well as the Middle East and Africa. The Retail segment operates Apple-owned retail stores in the U.S., Canada, Japan, the U.K. and Italy. Each reportable geographic operating segment and the Retail operating segment provide similar hardware and software products and similar services. During 2007, the Company revised the way it measures the Retail Segment's operating results to a manner that is generally consistent with the Company's other operating segments. Prior period results have been reclassified to reflect this change to the Retail Segment's operating results along with the corresponding offsets to the other operating segments. Further information regarding the Company's operating segments may be found in Note 9, "Segment Information and Geographic Data" in Notes to Consolidated Financial Statements of this Form 10-K.

Americas

During 2007, net sales in the Americas segment increased $2.2 billion, or 23%, compared to 2006. The main sources of this growth were Mac portable products, iMacs, iPods, and the sales of third-party content from the iTunes Store. Sales of Mac portable products increased due to the popularity of the MacBook, introduced in May 2006 and updated in May 2007, as well as the MacBook Pro, introduced in January 2006 and updated in June 2007. Sales of iMacs grew due to a shift in desktop product mix away from the Mac mini and discontinued eMac as well as the strong reception of the new iMac introduced in August 2007. Sales of iPods grew due to increased demand for the iPod nano and iPod shuffle and the introduction of the iPod touch in September 2007. The Company believes that the growth in iTunes Store sales was the result of heightened consumer interest in downloading digital content and the expansion of third-party audio and video content available for sale via the iTunes Store. During 2007, the Americas segment represented 48% of the Company's total net sales as compared to 49% in the same period of 2006. During 2007, U.S. education channel net sales and Mac unit sales increased by 14% and 18%, respectively, compared to 2006. Net sales from the higher education market grew 17% during 2007 compared to 2006, while net sales in the K-12 market grew 10% during the same period.

During 2006, net sales in the Americas segment increased $2.8 billion, or 41%, compared to 2005. The primary contributors to this increase were iPods, other music related products and services, Mac portable systems, and APP. Sales of iPods increased primarily due to the introduction of the updated iPod with video-playing capabilities in October 2005 (now referred to as iPod classic) and the iPod nano during September 2005. The increase in other music related products and services was due to increases in sales of Apple-branded and third-party iPod accessories and sales from the iTunes Store. The increase in sales of Mac portable systems in the Americas was due to strong sales of the MacBook and MacBook Pro during 2006. The overall increase in net sales was partially offset by a decline in net sales of desktops, displays, and Mac OS X. The decrease in desktop products and displays net sales reflects the overall shift in product mix toward portable Mac systems. Mac OS X sales decreased from 2005 since the Company had not released a new version of Mac OS X since Tiger began shipping in April 2005. During 2006, the Americas segment represented 49% of the Company's total net sales as compared to 48% in the same period of 2005.

Europe

Europe segment net sales increased $1.4 billion or 33% during 2007 compared to 2006. Consistent with the Americas segment, the primary drivers of this growth were Mac portable products, iMacs, iPods, and the sales of third-party content from the iTunes Store. Sales of Mac portable products increased due to the popularity of both the MacBook and MacBook Pro. Sales of iMacs grew due to a shift in desktop product mix away from the Mac mini and discontinued eMac as well as the strong reception of the new iMac introduced in August 2007. Sales of iPods grew primarily due to increased demand for the iPod nano and iPod shuffle. The Company believes that the growth in iTunes Store sales was the result of heightened consumer interest in downloading digital content and the expansion of third-party audio and video content available for sale via the iTunes Store.

Europe segment net sales increased $1.0 billion or 33% during 2006 compared to 2005. Consistent with the Americas segment, these increases were a result of strong growth in iPod sales, other music related products and services, and Mac portable systems. Sales of iPods increased primarily due to the introduction of the updated iPod with video-playing capabilities in October 2005 and the iPod nano during September 2005. The increase in other music related products and services was due to increases in sales of Apple-branded and third-party iPod accessories and sales from the iTunes Store. The increase in sales of portable systems in Europe was due to strong sales of the MacBook and MacBook Pro that were introduced during 2006. In addition, Europe also reported increased sales in APP related to the increase in Mac unit sales. These increases were partially offset by a decrease in desktop and Mac OS X net sales during 2006 compared to 2005. The decrease in desktop net sales was due to the shift in product mix toward portable Mac systems. Mac OS X sales have decreased from 2005 since the Company has not released a new version of Mac OS X since Tiger began shipping in April 2005.

Japan

Japan's net sales declined by $129 million or 11% in 2007 compared to 2006. Total Mac unit sales in Japan declined 1% during 2007. The decrease in the Japan segment's overall net sales was primarily attributable to decreases in iPod and Mac desktop sales, partially offset by an increase in revenue from MacBooks and sales of third-party content from the iTunes Store. The decline in net sales and Mac unit sales is partially attributable to Japan's declining consumer PC market, and the iPod sales decline is primarily due to lower average selling prices. The Company is continuing to evaluate ways to improve the future results of its Japan segment.

Japan's net sales increased $287 million or 31% during 2006 compared to 2005. The Japan segment experienced increased net sales in iPods, Mac portable products, and other music related products and services. Consistent with the Company's other segments, Japan experienced increases in sales of iPods due to the introduction of the iPod with video-playing capabilities (now referred to as the iPod classic) and the iPod nano in October and September of 2005, respectively. Japan also experienced strong sales of the Intel-based MacBook and increased sales from the iTunes Store. These increases were partially offset by decreases in net sales of Mac desktop products, displays, and Mac OS X. The decreases in desktop products and displays reflect the overall shift in product mix toward portable Mac systems. Mac OS X sales have decreased from 2005 since the Company had not released a new version of Mac OS X since Tiger began shipping in April 2005. Total Mac unit sales during 2006 remained relatively flat compared to 2005.

Retail

The Company opened 32 new retail stores during 2007, including a total of 5 international stores in the U.K. and Italy, bringing the total number of open stores to 197 as of September 29, 2007. This compares to 165 open stores as of September 30, 2006 and 124 open stores as of September 24, 2005.

The Retail segment's net sales increased by 27% to $4.1 billion during 2007 compared to 2006. Retail segment Mac unit sales increased 56% during 2007 as compared to 2006. With an average of 178 stores open during 2007, average revenue per store was $23.1 million, compared to $22.9 million in 2006 and $21.7 million in 2005. The current year increase in Retail segment net sales was primarily due to stronger sales of Mac portable products, iMacs, accessories and services. The increase was partially offset primarily by lower net sales of iPods and other music related products due to the expanded availability of those products through third-party resellers.

The Retail segment's net sales increased by 42% to $3.3 billion during 2006 compared to 2005. Retail segment Mac unit sales increased 45% during 2006 compared to 2005. The current year increase was primarily due to strong sales of Mac portable and desktop products, iPods, and other music related products and services. Sales of iPods increased primarily due to the introduction of the updated iPod with video-playing capabilities in October 2005 and the iPod nano during September 2005. The increase in other music related products and services was due to increased sales of Apple-branded and third-party iPod accessories. Mac portable and desktop sales increased due to strong sales of the Intel-based MacBook, MacBook Pro, and iMac.

As measured by the Company's operating segment reporting, the Retail segment reported operating income of $875 million during 2007 as compared to operating income of $600 million and $396 million during 2006 and 2005, respectively. This improvement in 2007 was primarily attributable to an increase in the Company's overall gross margin percentage.

Expansion of the Retail segment has required and will continue to require a substantial investment in fixed assets and related infrastructure, operating lease commitments, personnel, and other operating expenses.

Capital asset purchases associated with the Retail segment were $294 million in 2007, bringing the total capital asset purchases since inception of the Retail segment to $1.0 billion. As of September 29, 2007, the Retail segment had approximately 7,900 employees and had outstanding operating lease commitments associated with retail store space and related facilities of $1.1 billion. The Company would incur substantial costs if it were to close multiple retail stores. Such costs could adversely affect the Company's financial condition and operating results.

Other Segments

The Company's Other Segments, which consists of its Asia Pacific and FileMaker operations, experienced an increase in net sales of $406 million, or 30% during 2007 compared to 2006. This increase related primarily to a 58% increase in sales of Mac portable products and strong iPod sales in the Company's Asia Pacific region.

During 2006, net sales in Other Segments increased 35% compared to 2005 primarily due to an increase in sales of iPod and Mac portable products. Strong sales growth was a result of the introduction of the updated iPods featuring video-playing capabilities and the new Intel-based Mac portable products that translated to a 16% increase in Mac unit sales during 2006 compared to 2005.

Gross Margin

Gross margin for each of the last three fiscal years are as follows (in millions, except gross margin percentages):

	September 29, 2007	September 30, 2006	September 24, 2005
Net sales	$ 24,006	$ 19,315	$ 13,931
Cost of sales	15,852	13,717	9,889
Gross margin	$ 8,154	$ 5,598	$ 4,042
Gross margin percentage	34.0%	29.0%	29.0%

Gross margin percentage of 34.0% in 2007 increased significantly from 29.0% in 2006. The primary drivers of this increase were more favorable costs on certain commodity components, including NAND flash memory and DRAM memory, higher overall revenue that provided for more leverage on fixed production costs and a higher percentage of revenue from the Company's direct sales channels.

The Company anticipates that its gross margin and the gross margins of the personal computer, consumer electronics and mobile communication industries will be subject to pressure due to price competition. The Company expects gross margin percentage to decline sequentially in the first quarter of 2008 primarily as a result of the full-quarter impact of product transitions and reduced pricing that were effected in the fourth quarter of 2007, lower sales of iLife and iWork in their second quarter of availability, seasonally higher component costs, and a higher mix of indirect sales. These factors are expected to be partially offset by higher sales of the Company's Mac OS X operating system due to the introduction of Mac OS X Version 10.5 Leopard ("Mac OS X Leopard") that became available in October 2007.

The foregoing statements regarding the Company's expected gross margin percentage are forward-looking. There can be no assurance that current gross margin percentage will be maintained or targeted gross margin percentage levels will be achieved. In general, gross margins and margins on individual products will remain under downward pressure due to a variety of factors, including continued industry wide global pricing pressures, increased competition, compressed product life cycles, potential increases in the cost and availability of raw material and outside manufacturing services, and a potential shift in the Company's sales mix towards products with lower gross margins. In response to these competitive pressures, the Company expects it will continue to take pricing actions with respect to its products. Gross margins could also be affected by the Company's ability to effectively manage product quality and warranty costs and to stimulate demand for certain of its products. Due to the Company's significant international operations, financial results can be significantly affected in the short-term by fluctuations in exchange rates.

The Company orders components for its products and builds inventory in advance of product shipments. Because the Company's markets are volatile and subject to rapid technology and price changes, there is a risk the Company will forecast incorrectly and produce or order from third-parties excess or insufficient inventories of particular products or components. The Company's financial condition and operating results in the past have been and may in the future be materially adversely affected by the Company's ability to manage its inventory levels and outstanding purchase commitments and to respond to short-term shifts in customer demand patterns.

Gross margin percentage of 29.0% in 2006 remained flat compared to 2005. The Company experienced more favorable pricing on certain commodity components including LCD flat-panel displays and DRAM memory and higher overall revenue that provided for more leverage on fixed production costs, offset by an increase in lower margin iPod sales and other music-related services.

Operating Expenses

Operating expenses for each of the last three fiscal years are as follows (in millions, except for percentages):

	September 29, 2007	September 30, 2006	September 24, 2005
Research and development	$ 782	$ 712	$ 535
Percentage of net sales	3%	4%	4%
Selling, general, and administrative expenses	$ 2,963	$ 2,433	$ 1,864
Percentage of net sales	12%	13%	13%

Research and Development ("R&D")

Expenditures for R&D increased 10% or $70 million to $782 million in 2007 compared to 2006. R&D expense does not include capitalized software development costs of $75 million related to the development of Mac OS X Leopard and iPhone. The increases in R&D expense were primarily due to an increase in R&D headcount in the current year to support expanded R&D activities, partially offset by one less week of expenses in the first quarter of 2007 and the capitalized software development costs mentioned above. The Company continues to believe that focused investments in R&D are critical to its future growth and competitive position in the marketplace and are directly related to timely development of new and enhanced products that are central to the Company's core business strategy. As such, the Company expects to increase spending in R&D to remain competitive.

Selling, General, and Administrative Expense ("SG&A")

Expenditures for SG&A increased $530 million or 22% during 2007 compared to 2006. The increase was primarily due to higher direct and indirect channel variable selling expenses resulting from the significant year-over-year increase in total net sales in 2007, the Company's continued expansion of its Retail segment in both domestic and international markets, and a current year increase in spending on marketing and advertising, partially offset by one less week of expenses in the first quarter of 2007.

Other Income and Expense

Other income and expense for each of the last three fiscal years are as follows (in millions):

	September 29, 2007	September 30, 2006	September 24, 2005
Interest income	$ 647	$ 394	$ 183
Other income (expense), net	(48)	(29)	(18)
Total other income and expense	$ 599	$ 365	$ 165

Total other income and expense increased $234 million or 64% to $599 million during 2007 as compared to $365 million and $165 million in 2006 and 2005, respectively. The increase in 2007 is attributable primarily to increased interest received from higher cash and short-term investment balances and stronger investment yields resulting from higher average market interest rates partially offset by one less week of interest income earned in 2007. The weighted average interest rate earned by the Company on its cash, cash equivalents, and short-term investments increased to 5.27% in 2007 as compared to the 4.58% and 2.70% rates earned during 2006 and 2005, respectively. The current year increase in interest income was partially offset by higher other expense, which was primarily associated with higher foreign currency hedging expenses. During 2007, 2006 and 2005, the Company had no debt outstanding and accordingly did not incur any interest expense.

Provision for Income Taxes

The Company's effective tax rate for the year ended September 29, 2007 was 30%. The Company's effective rate differs from the statutory federal income tax rate of 35% due primarily to certain undistributed foreign earnings for which no U.S. taxes are provided because such earnings are intended to be indefinitely reinvested outside the U.S. In addition, the Company recorded a tax benefit of $63 million due to the settlement of prior year audits in the U.S.

As of September 29, 2007, the Company had deferred tax assets arising from deductible temporary differences, tax losses, and tax credits of $1.1 billion before being offset against certain deferred liabilities and a valuation allowance for presentation on the Company's balance sheet. Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets. As of September 29, 2007 and September 30, 2006 a valuation allowance of $5 million was recorded against the deferred tax asset for the benefits of state operating losses that may not be realized. The Company will continue to evaluate the realizability of the deferred tax assets quarterly by assessing the need for and amount of the valuation allowance.

The Internal Revenue Service ("IRS") has completed its field audit of the Company's federal income tax returns for the years 2002 through 2003 and proposed certain adjustments. The Company intends to contest certain of these adjustments through the IRS Appeals Office. All IRS audit issues for years prior to 2002 have been resolved. In addition, the Company is subject to audits by state, local, and foreign tax authorities. Management believes that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. Should any issues addressed in the Company's tax audits be resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs.

Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board ("FASB") issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115* ("SFAS No. 159"). SFAS No. 159 allows companies to choose to elect measuring eligible financial instruments and certain other items at fair value that are not required to be measured at fair value. SFAS

No. 159 requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings at each reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 and is required to be adopted by the Company beginning in the first quarter of fiscal 2009. Although the Company will continue to evaluate the application of SFAS No. 159, management does not currently believe adoption will have a material impact on the Company's financial condition or operating results.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements,* which defines fair value, provides a framework for measuring fair value, and expands the disclosures required for fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require fair value measurements; it does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and is required to be adopted by the Company beginning in the first quarter of fiscal 2009. Although the Company will continue to evaluate the application of SFAS No. 157, management does not currently believe adoption will have a material impact on the Company's financial condition or operating results.

In June 2006, the FASB issued FASB Interpretation No. ("FIN") 48, *Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for uncertainty in income taxes by creating a framework for how companies should recognize, measure, present, and disclose in their financial statements uncertain tax positions that they have taken or expect to take in a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006 and is required to be adopted by the Company beginning in the first quarter of fiscal 2008. Although the Company will continue to evaluate the application of FIN 48, management does not currently believe adoption will have a material impact on the Company's financial condition or operating results.

Liquidity and Capital Resources

The following table presents selected financial information and statistics for each of the last three fiscal years (dollars in millions):

	September 29, 2007	September 30, 2006	September 24, 2005
Cash, cash equivalents, and short-term investments	$ 15,386	$ 10,110	$ 8,261
Accounts receivable, net	$ 1,637	$ 1,252	$ 895
Inventory	$ 346	$ 270	$ 165
Working capital	$ 12,657	$ 8,066	$ 6,813
Annual operating cash flow	$ 5,470	$ 2,220	$ 2,535

As of September 29, 2007, the Company had $15.4 billion in cash, cash equivalents, and short-term investments, an increase of $5.3 billion over the same balance at the end of September 30, 2006. The principal components of this net increase were cash generated by operating activities of $5.5 billion, proceeds from the issuance of common stock under stock plans of $365 million and excess tax benefits from stock-based compensation of $377 million. These increases were partially offset by payments for acquisitions of property, plant, and equipment of $735 million and payments for acquisitions of intangible assets of $251 million. The Company's short-term investment portfolio is primarily invested in highly rated, liquid investments. As of September 29, 2007 and September 30, 2006, $6.5 billion and $4.1 billion, respectively, of the Company's cash, cash equivalents, and short-term investments were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings.

The Company believes its existing balances of cash, cash equivalents, and short-term investments will be sufficient to satisfy its working capital needs, capital expenditures, outstanding commitments, and other liquidity requirements associated with its existing operations over the next 12 months.

Capital Assets

The Company's total capital asset purchases were $822 million during 2007, consisting of $294 million for retail store facilities and $528 million for real estate acquisitions and corporate infrastructure including information systems enhancements. Of the $822 million in total capital asset purchases during 2007, $87 million were not yet paid for as of September 29, 2007. The Company currently anticipates it will utilize approximately $1.1 billion for capital asset purchases during 2008, including approximately $400 million for expansion of the Company's Retail segment, and approximately $700 million to support normal replacement of existing capital assets, including manufacturing related equipment, enhancements to general information technology infrastructure, and real estate acquisitions.

Off-Balance Sheet Arrangements and Contractual Obligations

The Company has not entered into any transactions with unconsolidated entities whereby the Company has financial guarantees, subordinated retained interests, derivative instruments, or other contingent arrangements that expose the Company to material continuing risks, contingent liabilities, or any other obligation under a variable interest in an unconsolidated entity that provides financing, liquidity, market risk, or credit risk support to the Company.

The following table presents certain payments due by the Company under contractual obligations with minimum firm commitments as of September 29, 2007 and excludes amounts already recorded on the Company's balance sheet as current liabilities (in millions):

	Total	Payments Due in Less Than 1 Year	Payments Due in 1-3 Years	Payments Due in 4-5 Years	Payments Due in More Than 5 Years
Operating leases	$ 1,425	$ 155	$ 345	$ 308	$ 617
Purchase obligations	3,179	3,179	—	—	—
Asset retirement obligations	24	3	3	7	11
Other obligations	50	50	—	—	—
Total	$ 4,678	$ 3,387	$ 348	$ 315	$ 628

Lease Commitments

As of September 29, 2007, the Company had total outstanding commitments on noncancelable operating leases of $1.4 billion, $1.1 billion of which related to the lease of retail space and related facilities. Lease terms on the Company's existing major facility operating leases generally range from 3 to 15 years.

Purchase Commitments with Contract Manufacturers and Component Suppliers

The Company utilizes several contract manufacturers to manufacture sub-assemblies for the Company's products and to perform final assembly and test of finished products. These contract manufacturers acquire components and build product based on demand information supplied by the Company, which typically covers periods ranging from 30 to 150 days. The Company also obtains individual components for its products from a wide variety of individual suppliers. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. Such purchase commitments typically cover the Company's forecasted component and manufacturing requirements for periods ranging from 30 to 150 days. In addition, the Company has an off-balance sheet warranty obligation for products accounted for under subscription accounting pursuant to SOP No. 97-2 whereby the Company recognizes warranty expense as incurred. As of September 29, 2007, the Company had outstanding off-balance sheet third-party manufacturing commitments, component purchase commitments, and warranty commitments of $3.2 billion.

During the first quarter of 2006, the Company entered into long-term supply agreements with Hynix Semiconductor, Inc., Intel Corporation, Micron Technology, Inc., Samsung Electronics Co., Ltd., and Toshiba Corporation to secure supply of NAND flash memory through calendar year 2010. As part of these agreements, the Company prepaid $1.25 billion for flash memory components during 2006, which will be applied to certain inventory purchases made over the life of each respective agreement. The Company utilized $208 million of the prepayment as of September 29, 2007.

Asset Retirement Obligations

The Company's asset retirement obligations are associated with commitments to return property subject to operating leases to original condition upon lease termination. As of September 29, 2007, the Company estimated that gross expected future cash flows of $24 million would be required to fulfill these obligations.

Other Obligations

Other outstanding obligations were $50 million as of September 29, 2007, primarily related to Internet and telecommunications services and the estimated cost related to the $100 store credit the Company offered to customers who purchased an iPhone prior to the Company's September 2007 price reduction.

Indemnifications

The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against itself or an indemnified third-party and, in the opinion of management, does not have a liability related to unresolved infringement claims subject to indemnification that would have a material adverse effect on its financial condition or operating results.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate and Foreign Currency Risk Management

The Company regularly reviews its foreign exchange forward and option positions, both on a stand-alone basis and in conjunction with its underlying foreign currency and interest rate related exposures. However, given the effective horizons of the Company's risk management activities and the anticipatory nature of the exposures, there can be no assurance the hedges will offset more than a portion of the financial impact resulting from movements in either foreign exchange or interest rates. In addition, the timing of the accounting for recognition of gains and losses related to mark-to-market instruments for any given period may not coincide with the timing of gains and losses related to the underlying economic exposures and, therefore, may adversely affect the Company's financial condition and operating results.

Interest Rate Risk

While the Company is exposed to interest rate fluctuations in many of the world's leading industrialized countries, the Company's interest income and expense is most sensitive to fluctuations in the general level of U.S. interest rates. As such, changes in U.S. interest rates affect the interest earned on the Company's cash, cash equivalents, and short-term investments, the value of those investments, as well as costs associated with foreign currency hedges.

The Company's short-term investment policy and strategy is to ensure the preservation of capital, meet liquidity requirements, and optimize return in light of the current credit and interest rate environment. A portion of the Company's cash is managed by external managers within the guidelines of the Company's investment policy and to an objective market benchmark. The Company's internal portfolio is benchmarked against external manager performance, allowing for differences in liquidity needs.

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's investment portfolio. The Company places its short-term investments in highly liquid securities issued by highly rated issuers and, by policy, limits the amount of credit exposure to any one issuer. The Company's general policy is to limit the risk of principal loss and ensure the safety of invested funds by limiting market and credit risk. All highly liquid investments with initial maturities of three months or less at the date of purchase are classified as cash equivalents; highly liquid investments with initial maturities greater than three months at the date of purchase are classified as short-term investments. As of September 29, 2007, $1.9 billion of the Company's short-term investments had underlying maturities ranging from 1 to 5 years. The remainder all had underlying maturities of less than 12 months. The Company may sell its investments prior to their stated maturities for strategic purposes, in anticipation of credit deterioration, or for duration management. The Company recognized net gains before taxes on short-term investments of approximately $474,000 in 2007 and net losses before taxes of approximately $434,000 and $137,000 in 2006 and 2005, respectively.

To provide a meaningful assessment of the interest rate risk associated with the Company's investment portfolio, the Company performed a sensitivity analysis to determine the impact a change in interest rates would have on the value of the investment portfolio assuming a 100 basis point parallel shift in the yield curve. Based on investment positions as of September 29, 2007, a hypothetical 100 basis point increase in interest rates across all maturities would result in $16 million incremental decline in the fair market value of the portfolio. As of September 30, 2006, a similar 100 basis point shift in the yield curve would have resulted in a $15 million incremental decline in the fair market value of the portfolio. Such losses would only be realized if the Company sold the investments prior to maturity.

Foreign Currency Risk

In general, the Company is a net receiver of currencies other than the U.S. dollar. Accordingly, changes in exchange rates, and in particular a strengthening of the U.S. dollar, may negatively affect the Company's net sales and gross margins as expressed in U.S. dollars. There is also a risk that the Company will have to adjust local currency product pricing due to competitive pressures when there has been significant volatility in foreign currency exchange rates.

The Company may enter into foreign currency forward and option contracts with financial institutions to protect against foreign exchange risks associated with existing assets and liabilities, certain firmly committed transactions, forecasted future cash flows, and net investments in foreign subsidiaries. Generally, the Company's practice is to hedge a majority of its material foreign exchange exposures. However, the Company may choose not to hedge certain foreign exchange exposures due to immateriality, prohibitive economic cost of hedging particular exposures, and/or limited availability of appropriate hedging instruments.

To provide a meaningful assessment of the foreign currency risk associated with certain of the Company's foreign currency derivative positions, the Company performed a sensitivity analysis using a value-at-risk ("VAR") model to assess the potential impact of fluctuations in exchange rates. The VAR model consisted of using a Monte Carlo simulation to generate 3,000 random market price paths. The VAR is the maximum expected loss in fair value, for a given confidence interval, to the Company's foreign exchange portfolio due to adverse movements in rates. The VAR model is not intended to represent actual losses but is used as a risk estimation and management tool. The model assumes normal market conditions. Forecasted transactions, firm commitments, and assets and liabilities denominated in foreign currencies were excluded from the model. Based on the results of the model, the Company estimates with 95% confidence a maximum one-day loss in fair value of $12.8 million as of September 29, 2007 compared to a maximum one-day loss of $9.2 million as of September 30, 2006. Because the Company uses foreign currency instruments for hedging purposes, losses incurred on those instruments are generally offset by increases in the fair value of the underlying exposures.

Actual future gains and losses associated with the Company's investment portfolio and derivative positions may differ materially from the sensitivity analyses performed as of September 29, 2007 due to the inherent limitations associated with predicting the changes in the timing and amount of interest rates, foreign currency exchanges rates, and the Company's actual exposures and positions.

Item 8. Financial Statements and Supplementary Data

All financial statement schedules have been omitted, since the required information is not applicable or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Consolidated Financial Statements and Notes thereto.

CONSOLIDATED BALANCE SHEETS

(In millions, except share amounts)

	September 29, 2007	September 30, 2006
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 9,352	$ 6,392
Short-term investments	6,034	3,718
Accounts receivable, less allowances of $47 and $52, respectively	1,637	1,252
Inventories	346	270
Deferred tax assets	782	607
Other current assets	3,805	2,270
Total current assets	21,956	14,509
Property, plant, and equipment, net	1,832	1,281
Goodwill	38	38
Acquired intangible assets, net	299	139
Other assets	1,222	1,238
Total assets	$ 25,347	$ 17,205
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	$ 4,970	$ 3,390
Accrued expenses	4,329	3,053
Total current liabilities	9,299	6,443
Non-current liabilities	1,516	778
Total liabilities	10,815	7,221
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value; 1,800,000,000 shares authorized; 872,328,972 and 855,262,568 shares issued and outstanding, respectively	5,368	4,355
Retained earnings	9,101	5,607
Accumulated other comprehensive income	63	22
Total shareholders' equity	14,532	9,984
Total liabilities and shareholders' equity	$ 25,347	$ 17,205

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except share and per share amounts)

Three fiscal years ended September 29, 2007	2007	2006	2005
Net sales	$ 24,006	$ 19,315	$ 13,931
Cost of sales (1)	15,852	13,717	9,889
Gross margin	8,154	5,598	4,042
Operating expenses:			
Research and development (1)	782	712	535
Selling, general, and administrative (1)	2,963	2,433	1,864
Total operating expenses	3,745	3,145	2,399
Operating income	4,409	2,453	1,643
Other income and expense	599	365	165
Income before provision for income taxes	5,008	2,818	1,808
Provision for income taxes	1,512	829	480
Net income	$ 3,496	$ 1,989	$ 1,328
Earnings per common share:			
Basic	$ 4.04	$ 2.36	$ 1.64
Diluted	$ 3.93	$ 2.27	$ 1.55
Shares used in computing earnings per share (in thousands):			
Basic	864,595	844,058	808,439
Diluted	889,292	877,526	856,878

(1) Includes stock-based compensation expense, which was allocated as follows:

Cost of sales	$ 35	$ 21	$ 3
Research and development	$ 77	$ 53	$ 7
Selling, general, and administrative	$ 130	$ 89	$ 39

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In millions, except share amounts which are in thousands)

	Common Stock Shares	Common Stock Amount	Deferred Stock Compensation	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances as of September 25, 2004	782,887	$ 2,582	$ (101)	$ 2,597	$ (15)	$ 5,063
Components of comprehensive income:						
Net income	—	—	—	1,328	—	1,328
Change in foreign currency translation	—	—	—	—	7	7
Change in unrealized gain on derivative instruments, net of tax	—	—	—	—	8	8
Total comprehensive income						1,343
Issuance of stock-based compensation awards	—	7	(7)	—	—	—
Stock-based compensation	—	—	47	—	—	47
Common stock issued under stock plans	52,132	547	—	—	—	547
Tax benefit from employee stock plan awards	—	428	—	—	—	428
Balances as of September 24, 2005	835,019	3,564	(61)	3,925	—	7,428
Components of comprehensive income:						
Net income	—	—	—	1,989	—	1,989
Change in foreign currency translation	—	—	—	—	19	19
Change in unrealized gain on available-for-sale securities, net of tax	—	—	—	—	4	4
Change in unrealized gain on derivative instruments, net of tax	—	—	—	—	(1)	(1)
Total comprehensive income						2,011
Common stock repurchased	(4,574)	(48)	—	(307)	—	(355)
Stock-based compensation	—	163	—	—	—	163
Deferred compensation	—	(61)	61	—	—	—
Common stock issued under stock plans	24,818	318	—	—	—	318
Tax benefit from employee stock plan awards	—	419	—	—	—	419
Balances as of September 30, 2006	855,263	4,355	—	5,607	22	9,984
Components of comprehensive income:						
Net income	—	—	—	3,496	—	3,496
Change in foreign currency translation	—	—	—	—	51	51
Change in unrealized loss on available-for-sale securities, net of tax	—	—	—	—	(7)	(7)
Change in unrealized loss on derivative instruments, net of tax	—	—	—	—	(3)	(3)
Total comprehensive income						3,537
Stock-based compensation	—	251	—	—	—	251
Common stock issued under stock plans, net of shares withheld for employee taxes	17,066	364	—	(2)	—	362
Tax benefit from employee stock plan awards	—	398	—	—	—	398
Balances as of September 29, 2007	872,329	$ 5,368	$ —	$ 9,101	$ 63	$ 14,532

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

Three fiscal years ended September 29, 2007	2007	2006	2005
Cash and cash equivalents, beginning of the year	$ 6,392	$ 3,491	$ 2,969
Operating Activities:			
Net income	3,496	1,989	1,328
Adjustments to reconcile net income to cash generated by operating activities:			
Depreciation, amortization and accretion	317	225	179
Stock-based compensation expense	242	163	49
Provision for deferred income taxes	78	53	50
Excess tax benefits from stock options	—	—	428
Gain on sale of PowerSchool net assets	—	(4)	—
Loss on disposition of property, plant, and equipment	12	15	9
Changes in operating assets and liabilities:			
Accounts receivable, net	(385)	(357)	(121)
Inventories	(76)	(105)	(64)
Other current assets	(1,540)	(1,626)	(150)
Other assets	81	(1,040)	(35)
Accounts payable	1,494	1,611	328
Other liabilities	1,751	1,296	534
Cash generated by operating activities	5,470	2,220	2,535
Investing Activities:			
Purchases of short-term investments	(11,719)	(7,255)	(11,470)
Proceeds from maturities of short-term investments	6,483	7,226	8,609
Proceeds from sales of investments	2,941	1,086	586
Purchases of long-term investments	(17)	(25)	—
Proceeds from sale of PowerSchool net assets	—	40	—
Payment for acquisition of property, plant, and equipment	(735)	(657)	(260)
Payment for acquisition of intangible assets	(251)	—	—
Other	49	(58)	(21)
Cash (used for) generated by investing activities	(3,249)	357	(2,556)
Financing Activities:			
Proceeds from issuance of common stock	365	318	543
Excess tax benefits from stock-based compensation	377	361	—
Repurchases of common stock	(3)	(355)	—
Cash generated by financing activities	739	324	543
Increase in cash and cash equivalents	2,960	2,901	522
Cash and cash equivalents, end of the year	$ 9,352	$ 6,392	$ 3,491
Supplemental cash flow disclosures:			
Cash paid for income taxes, net	$ 863	$ 194	$ 17

See accompanying Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1—Summary of Significant Accounting Policies

Apple Inc. and its wholly-owned subsidiaries (collectively "Apple" or the "Company") design, manufacture, and market personal computers, portable digital music players, and mobile communication devices and sells a variety of related software, services, peripherals, and networking solutions. The Company sells its products worldwide through its online stores, its retail stores, its direct sales force, and third-party wholesalers, resellers, and value-added resellers. In addition, the Company sells a variety of third-party Mac, iPod and iPhone compatible products including application software, printers, storage devices, speakers, headphones, and various other accessories and supplies through its online and retail stores. The Company sells to education, consumer, creative professional, business, and government customers.

Basis of Presentation and Preparation

The accompanying consolidated financial statements include the accounts of the Company. Intercompany accounts and transactions have been eliminated. The preparation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in these consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates. Certain prior year amounts in the consolidated financial statements and notes thereto have been reclassified to conform to the current year presentation.

The Company's fiscal year is the 52 or 53-week period that ends on the last Saturday of September. The Company's first quarter of fiscal year 2007 contained 13 weeks and the first quarter of fiscal year 2006 contained 14 weeks. The Company's fiscal year 2007 ended on September 29, 2007 and included 52 weeks, while fiscal year 2006 included 53 weeks and fiscal year 2005 included 52 weeks. Unless otherwise stated, references to particular years or quarters refer to the Company's fiscal years ended in September and the associated quarters of those fiscal years.

Financial Instruments

Cash Equivalents and Short-term Investments

All highly liquid investments with maturities of three months or less at the date of purchase are classified as cash equivalents. Highly liquid investments with maturities greater than three months at the date of purchase are classified as short-term investments. The Company's debt and marketable equity securities have been classified and accounted for as available-for-sale. Management determines the appropriate classification of its investments in debt and marketable equity securities at the time of purchase and reevaluates the available-for-sale designations as of each balance sheet date. These securities are carried at fair value, with the unrealized gains and losses, net of taxes, reported as a component of shareholders' equity. The cost of securities sold is based upon the specific identification method.

Derivative Financial Instruments

The Company accounts for its derivative instruments as either assets or liabilities and carries them at fair value. Derivatives that are not defined as hedges in Statement of Financial Accounting Standards ("SFAS") No. 133, *Accounting for Derivative Instruments and Hedging Activities,* as amended, must be adjusted to fair value through earnings.

For derivative instruments that hedge the exposure to variability in expected future cash flows that are designated as cash flow hedges, the effective portion of the gain or loss on the derivative instrument is reported as a component of accumulated other comprehensive income in shareholders' equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of the gain or loss on the derivative instrument is recognized in current earnings. To receive hedge accounting treatment, cash flow hedges must be highly effective in offsetting changes to expected future cash flows on hedged transactions. For derivative instruments that hedge the exposure to changes in the fair value of an asset or a liability and that are designated as fair value hedges, the net gain or loss on the derivative instrument as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in earnings in the current period. The net gain or loss on the effective portion of a derivative instrument that is designated as an economic hedge of the foreign currency translation exposure of the net investment in a foreign operation is reported in the same manner as a foreign currency translation adjustment. For forward contracts designated as net investment hedges, the Company excludes changes in fair value relating to changes in the forward carry component from its definition of effectiveness. Accordingly, any gains or losses related to this component are recognized in current earnings.

Inventories

Inventories are stated at the lower of cost, computed using the first-in, first-out method, or market. If the cost of the inventories exceeds their market value, provisions are made currently for the difference between the cost and the market value. The Company's inventories consist primarily of finished goods for all periods presented.

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. Depreciation is computed by use of the straight-line method over the estimated useful lives of the assets, which for buildings is the lesser of 30 years or the remaining life of the underlying building, up to 5 years for equipment, and the shorter of lease terms or 10 years for leasehold improvements. The Company capitalizes eligible costs to acquire or develop internal-use software that are incurred subsequent to the preliminary project stage. Capitalized costs related to internal-use software are amortized using the straight-line method over the estimated useful lives of the assets, which range from 3 to 5 years. Depreciation and amortization expense on property and equipment was $249 million, $180 million, and $141 million during 2007, 2006, and 2005, respectively.

Asset Retirement Obligations

The Company records obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs in accordance with SFAS No. 143, *Accounting for Asset Retirement Obligations*. The Company reviews legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the assets. If it is determined that a legal obligation exists, the fair value of the liability for an asset retirement obligation is recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset and this additional carrying amount is depreciated over the life of the asset. The difference between the gross expected future cash flow and its present value is accreted over the life of the related lease as an operating expense. All of the Company's existing asset retirement obligations are associated with commitments to return property subject to operating leases to original condition upon lease termination. The Company's asset retirement liability was $18 million and $15 million as of September 29, 2007 and September 30, 2006, respectively.

Long-Lived Assets Including Goodwill and Other Acquired Intangible Assets

The Company reviews property, plant, and equipment and certain identifiable intangibles, excluding goodwill, for impairment in accordance with SFAS No. 144, *Accounting for the Impairment of Long-Lived*

Assets and for Long-Lived Assets to Be Disposed Of. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of these assets is measured by comparison of its carrying amount to future undiscounted cash flows the assets are expected to generate. If property, plant, and equipment and certain identifiable intangibles are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the assets exceeds its fair market value. The Company did not record any material impairments during 2007, 2006, and 2005.

SFAS No. 142, *Goodwill and Other Intangible Assets* requires that goodwill and intangible assets with indefinite useful lives should not be amortized but rather be tested for impairment at least annually or sooner whenever events or changes in circumstances indicate that they may be impaired. The Company performs its goodwill impairment tests on or about August 31 of each year. The Company did not recognize any goodwill or intangible asset impairment charges in 2007, 2006, or 2005. The Company established reporting units based on its current reporting structure. For purposes of testing goodwill for impairment, goodwill has been allocated to these reporting units to the extent it relates to each reporting unit.

SFAS No. 142 also requires that intangible assets with definite lives be amortized over their estimated useful lives and reviewed for impairment in accordance with SFAS No. 144. The Company is currently amortizing its acquired intangible assets with definite lives over periods ranging from 2 to 10 years.

Foreign Currency Translation

The Company translates the assets and liabilities of its international non-U.S. dollar functional currency subsidiaries into U.S. dollars using exchange rates in effect at the end of each period. Revenue and expenses for these subsidiaries are translated using rates that approximate those in effect during the period. Gains and losses from these translations are credited or charged to foreign currency translation included in "accumulated other comprehensive income" in shareholders' equity. The Company's foreign manufacturing subsidiaries and certain other international subsidiaries that use the U.S. dollar as their functional currency remeasure monetary assets and liabilities at exchange rates in effect at the end of each period, and inventories, property, and nonmonetary assets and liabilities at historical rates. Gains and losses from these translations were insignificant and have been included in the Company's results of operations.

Revenue Recognition

Net sales consist primarily of revenue from the sale of hardware, software, music products, digital content, peripherals, and service and support contracts. For any product within these groups that either is software, or is considered software-related in accordance with the guidance in Emerging Issues Task Force ("EITF") No. 03-5, *Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software* (e.g., Macintosh computers and iPod portable digital music players), the Company accounts for such products in accordance with the revenue recognition provisions of American Institute of Certified Public Accountants ("AICPA") Statement of Position ("SOP") No. 97-2, *Software Revenue Recognition.* The Company applies Staff Accounting Bulletin ("SAB") No. 104, *Revenue Recognition,* for products that are not software or software-related, such as digital content sold on the iTunes Store and certain Mac, iPod and iPhone supplies and accessories.

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection is probable. Product is considered delivered to the customer once it has been shipped and title and risk of loss have been transferred. For most of the Company's product sales, these criteria are met at the time the product is shipped. For online sales to individuals, for some sales to education customers in the U.S., and for certain other sales, the Company defers revenue until the customer receives the product because the Company legally retains a portion of the risk of loss on these sales during transit. If at the outset of an arrangement the Company determines the arrangement fee is not, or is presumed not to be, fixed or determinable, revenue is deferred and subsequently recognized as amounts become due and payable.

Revenue from service and support contracts is deferred and recognized ratably over the service coverage periods. These contracts typically include extended phone support, repair services, web-based support resources, diagnostic tools, and extend the service coverage offered under the Company's one-year limited warranty.

The Company sells software and peripheral products obtained from other companies. The Company establishes its own pricing and retains related inventory risk, is the primary obligor in sales transactions with its customers, and assumes the credit risk for amounts billed to its customers. Accordingly, the Company recognizes revenue for the sale of products obtained from other companies based on the gross amount billed.

The Company accounts for multiple element arrangements that consist only of software or software-related products in accordance with SOP No. 97-2. If a multiple-element arrangement includes deliverables that are neither software nor software-related, the Company applies EITF No. 00-21, *Revenue Arrangements with Multiple Deliverables,* to determine if those deliverables constitute separate units of accounting from the SOP No. 97-2 deliverables. If the Company can separate the deliverables, the Company applies SOP No. 97-2 to the software and software-related deliverables and applies other appropriate guidance (e.g., SAB No. 104) to the deliverables outside the scope of SOP No. 97-2. Revenue on arrangements that include multiple elements such as hardware, software, and services is allocated to each element based on the relative fair value of each element. Each element's allocated revenue is recognized when the revenue recognition criteria for that element have been met. Fair value is generally determined by vendor specific objective evidence ("VSOE"), which is based on the price charged when each element is sold separately. If the Company cannot objectively determine the fair value of any undelivered element included in a multiple-element arrangement, the Company defers revenue until all elements are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered elements. When the fair value of a delivered element has not been established, the Company uses the residual method to recognize revenue if the fair value of all undelivered elements is determinable. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is allocated to the delivered elements and is recognized as revenue.

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end-user rebates, and other sales programs and volume-based incentives. The estimated cost of these programs is accrued as a reduction to revenue in the period the Company has sold the product and committed to a plan. The Company also records reductions to revenue for expected future product returns based on the Company's historical experience. Revenue is recorded net of taxes collected from customers that are remitted to governmental authorities, with the collected taxes recorded as current liabilities until remitted to the relevant government authority.

Generally, the Company does not offer specified or unspecified upgrade rights to its customers in connection with software sales or the sale of extended warranty and support contracts. When the Company does offer specified upgrade rights, the Company defers revenue for the fair value of the specified upgrade right until the future obligation is fulfilled or when the right to the specified upgrade expires. Additionally, a limited number of the Company's software products are available with maintenance agreements that grant customers rights to unspecified future upgrades over the maintenance term on a when and if available basis. Revenue associated with such maintenance is recognized ratably over the maintenance term.

In March 2007, the Company began shipping Apple TV and in June 2007 began shipping iPhone. For Apple TV and iPhone, the Company indicated it may provide future unspecified features and additional software products free of charge to customers. Accordingly, Apple TV and iPhone handsets sales are accounted for under subscription accounting in accordance with SOP No. 97-2. As such, the Company's policy is to defer the associated revenue and cost of goods sold at the time of sale, and recognize both on a straight-line basis over the currently estimated 24-month economic life of these products, with any loss recognized at the time of sale. Costs incurred by the Company for engineering, sales, marketing and warranty are expensed as incurred.

Allowance for Doubtful Accounts

The Company records its allowance for doubtful accounts based upon its assessment of various factors. The Company considers historical experience, the age of the accounts receivable balances, credit quality of the Company's customers, current economic conditions, and other factors that may affect customers' ability to pay.

Shipping Costs

For all periods presented, amounts billed to customers related to shipping and handling are classified as revenue, and the Company's shipping and handling costs are included in cost of sales.

Warranty Expense

The Company generally provides for the estimated cost of hardware and software warranties at the time the related revenue is recognized. The Company assesses the adequacy of its preexisting warranty liabilities and adjusts the amounts as necessary based on actual experience and changes in future estimates. For products accounted for under subscription accounting pursuant to SOP No. 97-2, the Company recognizes warranty expense as incurred.

Software Development Costs

Research and development costs are expensed as incurred. Development costs of computer software to be sold, leased, or otherwise marketed are subject to capitalization beginning when a product's technological feasibility has been established and ending when a product is available for general release to customers pursuant to SFAS No. 86, *Computer Software to be Sold, Leased, or Otherwise Marketed*. In most instances, the Company's products are released soon after technological feasibility has been established. Therefore, costs incurred subsequent to achievement of technological feasibility are usually not significant, and generally most software development costs have been expensed.

In 2007, the Company determined that both Mac OS X Version 10.5 Leopard ("Mac OS X Leopard") and iPhone achieved technological feasibility. During 2007, the Company capitalized $75 million of costs associated with the development of Leopard and iPhone. In accordance with SFAS No. 86, the capitalized costs related to Mac OS X Leopard and iPhone are amortized to cost of sales commencing when each respective product begins shipping and are recognized on a straight-line basis over a 3 year estimated useful life of the underlying technology.

Total amortization related to capitalized software development costs was $13 million, $18 million, and $16 million in 2007, 2006, and 2005, respectively.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expense was $467 million, $338 million, and $287 million for 2007, 2006, and 2005, respectively.

Stock-Based Compensation

On September 25, 2005, the Company adopted SFAS No. 123 (revised 2004) ("SFAS No. 123R"), *Share-Based Payment*, which addresses the accounting for stock-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. In January 2005, the Securities and Exchange Commission ("SEC") issued SAB No. 107, which provides supplemental implementation guidance for SFAS No. 123R. SFAS No. 123R eliminates the ability to account for stock-based compensation transactions using the intrinsic value method under Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees*, and instead generally requires that such transactions be accounted for using a fair-value-based method. The Company uses the Black-Scholes-Merton ("BSM") option-pricing model to determine the fair-value of stock-based awards under SFAS No. 123R, consistent with that used for pro forma disclosures under SFAS No. 123, *Accounting for Stock-Based Compensation*.

SFAS No. 123R prohibits recognition of a deferred tax asset for an excess tax benefit that has not been realized. The Company will recognize a benefit from stock-based compensation in equity if an incremental tax benefit is realized by following the ordering provisions of the tax law. In addition, the Company accounts for the indirect effects of stock-based compensation on the research tax credit, the foreign tax credit, and the domestic manufacturing deduction through the income statement.

Prior to the adoption of SFAS No. 123R, the Company measured compensation expense for its employee stock-based compensation plans using the intrinsic value method prescribed by APB Opinion No. 25. The Company applied the disclosure provisions of SFAS No. 123 as amended by SFAS No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure,* as if the fair-value-based method had been applied in measuring compensation expense. Under APB Opinion No. 25, when the exercise price of the Company's employee stock options was equal to the market price of the underlying stock on the date of the grant, no compensation expense was recognized.

The following table illustrates the effect on net income after taxes and net income per common share as if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation during 2005 (in millions, except per share amounts):

	2005
Net income	$ 1,328
Add: Stock-based employee compensation expense included in reported net income, net of tax	45
Deduct: Stock-based employee compensation expense determined under the fair value based method for all awards, net of tax	(118)
Net income—pro forma	$ 1,255
Net income per common share	
Basic	$ 1.64
Diluted	$ 1.55
Net income per common share—pro forma	
Basic	$ 1.55
Diluted	$ 1.47

Further information regarding stock-based compensation can be found in Notes 6 and 7.

Earnings Per Common Share

Basic earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the dilutive potential shares of common stock had been issued. The dilutive effect of outstanding options, shares to be purchased under the employee stock purchase plan, unvested restricted stock and restricted stock units ("RSUs") is reflected in diluted earnings per share by application of the treasury stock method. Under the treasury stock method, an increase in the fair market value of the Company's common stock can result in a greater dilutive effect from outstanding options, restricted stock, and RSUs. Additionally, the exercise of employee stock options and the vesting of restricted stock and RSUs can result in a greater dilutive effect on earnings per share.

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except net income and per share amounts):

Three fiscal years ended September 29, 2007	2007	2006	2005
Numerator (in millions):			
Net income	$ 3,496	$ 1,989	$ 1,328
Denominator (in thousands):			
Weighted-average shares outstanding, excluding unvested restricted stock	864,595	844,058	808,439
Effect of dilutive securities	24,697	33,468	48,439
Denominator for diluted earnings per share	889,292	877,526	856,878
Basic earnings per share	$ 4.04	$ 2.36	$ 1.64
Diluted earnings per share	$ 3.93	$ 2.27	$ 1.55

Potentially dilutive securities representing 13.7 million, 3.9 million, and 12.7 million shares of common stock for the years ended September 29, 2007, September 30, 2006, and September 24, 2005, respectively, were excluded from the computation of diluted earnings per share for these periods because their effect would have been antidilutive. These potentially dilutive securities include stock options, unvested restricted stock, and RSUs.

Comprehensive Income

Comprehensive income consists of two components, net income and other comprehensive income. Other comprehensive income refers to revenue, expenses, gains, and losses that under U.S. generally accepted accounting principles are recorded as an element of shareholders' equity but are excluded from net income. The Company's other comprehensive income consists of foreign currency translation adjustments from those subsidiaries not using the U.S. dollar as their functional currency, unrealized gains and losses on marketable securities categorized as available-for-sale, and net deferred gains and losses on certain derivative instruments accounted for as cash flow hedges.

Segment Information

The Company reports segment information based on the "management" approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of the Company's reportable segments. Information about the Company's products, major customers, and geographic areas on a company-wide basis is also disclosed.

Note 2—Financial Instruments

Cash, Cash Equivalents and Short-Term Investments

The following table summarizes the fair value of the Company's cash and available-for-sale securities held in its short-term investment portfolio, recorded as cash and cash equivalents or short-term investments (in millions):

	September 29, 2007	September 30, 2006
Cash	$ 256	$ 200
U.S. Treasury and Agency securities	670	52
U.S. Corporate securities	5,597	4,309
Foreign securities	2,829	1,831
Total cash equivalents	9,096	6,192
U.S. Treasury and Agency securities	358	447
U.S. Corporate securities	4,718	2,701
Foreign securities	958	570
Total short-term investments	6,034	3,718
Total cash, cash equivalents, and short-term investments	$ 15,386	$ 10,110

The Company's U.S. Corporate securities consist primarily of commercial paper, certificates of deposit, time deposits, and corporate debt securities. Foreign securities consist primarily of foreign commercial paper issued by foreign companies, and certificates of deposit and time deposits with foreign institutions, most of which are denominated in U.S. dollars. The Company had $11 million in net unrealized losses on its investment portfolio, primarily related to investments with stated maturities ranging from 1 to 5 years, as of September 29, 2007, and net unrealized losses of approximately $687,000 on its investment portfolio, primarily related to investments with stated maturities less than 1 year, as of September 30, 2006. The Company may sell its investments prior to their stated maturities for strategic purposes, in anticipation of credit deterioration, or for duration management. The Company recognized net gains before taxes of approximately $474,000 in 2007 and net losses before taxes of approximately $434,000 and $137,000 in 2006 and 2005, respectively.

As of September 29, 2007 and September 30, 2006, $1.9 billion and $921 million, respectively, of the Company's short-term investments had underlying maturities ranging from 1 to 5 years. The remaining short-term investments as of September 29, 2007 and September 30, 2006 had maturities less than 12 months.

In accordance with FASB Staff Position ("FSP") FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments,* the following table shows the gross unrealized losses and fair value for those investments that were in an unrealized loss position as of

September 29, 2007 and September 30, 2006, aggregated by investment category and the length of time that individual securities have been in a continuous loss position (in millions):

	2007											
	Less than 12 Months				12 Months or Greater				Total			
Security Description	Fair Value		Unrealized Loss		Fair Value		Unrealized Loss		Fair Value		Unrealized Loss	
U.S. Treasury and Agency securities	$	338	$	—	$	—	$	—	$	338	$	—
U.S. Corporate securities		2,521		(12)		32		—		2,553		(12)
Foreign securities		474		(1)		8		—		482		(1)
Total	$	3,333	$	(13)	$	40	$	—	$	3,373	$	(13)

	2006											
	Less than 12 Months				12 Months or Greater				Total			
Security Description	Fair Value		Unrealized Loss		Fair Value		Unrealized Loss		Fair Value		Unrealized Loss	
U.S. Treasury and Agency securities	$	234	$	—	$	26	$	—	$	260	$	—
U.S. Corporate securities		943		—		102		(1)		1,045		(1)
Foreign securities		164		—		34		—		198		—
Total	$	1,341	$	—	$	162	$	(1)	$	1,503	$	(1)

The unrealized losses on the Company's investments during 2007 in U.S. Corporate securities and foreign securities and during 2006 in U.S. Corporate securities were caused primarily by changes in interest rates. The Company typically invests in highly-rated securities with strong liquidity and with low probabilities of default. The Company's investment policy requires investments to be rated single-A or better. Therefore, the Company considers the declines to be temporary in nature. During 2007, the Company did not record any material impairment on outstanding securities. As of September 29, 2007, the Company does not consider the investments to be other-than-temporarily impaired.

Market values were determined for each individual security in the investment portfolio. When evaluating the investments for other-than-temporary impairment, the Company reviews factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer, and the Company's ability and intent to hold the investment for a period of time, which may be sufficient for anticipated recovery in market value.

Accounts Receivable

Trade Receivables

The Company distributes its products through third-party distributors and resellers and directly to certain education, consumer, and commercial customers. The Company generally does not require collateral from its customers; however, the Company requires collateral in certain instances to limit credit risk. In addition, when possible, the Company attempts to limit credit risk on trade receivables with credit insurance for certain customers in Latin America, Europe, Asia, and Australia by arranging with third-party financing companies to provide flooring arrangements and other loan and lease programs to the Company's direct customers. These credit-financing arrangements are directly between the third-party financing company and the end customer. As such, the Company generally does not assume any recourse or credit risk sharing related to any of these arrangements. However, considerable trade receivables not covered by collateral, third-party flooring arrangements, or credit insurance are outstanding with the Company's distribution and retail channel partners. One customer accounted for approximately 11% of trade receivables as of September 29, 2007, while no customers accounted for more than 10% of trade receivables as of September 30, 2006.

The following table summarizes the activity in the allowance for doubtful accounts (in millions):

	September 29, 2007	September 30, 2006	September 24, 2005
Beginning allowance balance	$ 52	$ 46	$ 47
Charged to costs and expenses	12	17	8
Deductions	(17)	(11)	(9)
Ending allowance balance	$ 47	$ 52	$ 46

Vendor Non-Trade Receivables

The Company has non-trade receivables from certain of its manufacturing vendors resulting from the sale of raw material components to these manufacturing vendors who manufacture sub-assemblies or assemble final products for the Company. The Company purchases these raw material components directly from suppliers. These non-trade receivables, which are included in the Consolidated Balance Sheets in other current assets, totaled $2.4 billion and $1.6 billion as of September 29, 2007 and September 30, 2006, respectively. The Company does not reflect the sale of these components in net sales and does not recognize any profits on these sales until the products are sold through to the end customer at which time the profit is recognized as a reduction of cost of sales.

Derivative Financial Instruments

The Company uses derivatives to partially offset its business exposure to foreign exchange risk. Foreign currency forward and option contracts are used to offset the foreign exchange risk on certain existing assets and liabilities and to hedge the foreign exchange risk on expected future cash flows on certain forecasted revenue and cost of sales. The Company's accounting policies for these instruments are based on whether the instruments are designated as hedge or non-hedge instruments. The Company records all derivatives on the balance sheet at fair value.

The following table shows the notional principal, net fair value, and credit risk amounts of the Company's foreign currency instruments as of September 29, 2007 and September 30, 2006 (in millions):

	September 29, 2007			September 30, 2006		
	Notional Principal	Fair Value	Credit Risk Amounts	Notional Principal	Fair Value	Credit Risk Amounts
Foreign exchange instruments qualifying as accounting hedges:						
Spot/Forward contracts	$ 570	$ (8)	$ —	$ 351	$ 6	$
Purchased options	$ 2,564	$ 10	$ 10	$ 1,256	$ 9	$
Sold options	$ 1,498	$ (2)	$ —	$ 80	$ (1)	$ –
Foreign exchange instruments other than accounting hedges:						
Spot/Forward contracts	$ 1,768	$ (2)	$ —	$ 1,103	$ 2	$
Purchased options	$ 161	$ 1	$ 1	$ 167	$ 1	$ –

The notional principal amounts for derivative instruments provide one measure of the transaction volume outstanding as of year-end, and do not represent the amount of the Company's exposure to credit or market loss. The credit risk amounts shown in the table above represents the Company's gross exposure to potential accounting loss on these transactions if all counterparties failed to perform according to the terms of the contract, based on then-current currency exchange rates at each respective date. The Company's exposure to credit loss and market risk will vary over time as a function of currency exchange rates.

The estimates of fair value are based on applicable and commonly used pricing models and prevailing financial market information as of September 29, 2007 and September 30, 2006. Although the table above reflects the notional principal, fair value, and credit risk amounts of the Company's foreign exchange instruments, it does not reflect the gains or losses associated with the exposures and transactions that the foreign exchange instruments are intended to hedge. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

Foreign Exchange Risk Management

The Company may enter into foreign currency forward and option contracts with financial institutions to protect against foreign exchange risk associated with existing assets and liabilities, certain firmly committed transactions, forecasted future cash flows, and net investments in foreign subsidiaries. Generally, the Company's practice is to hedge a majority of its material foreign exchange exposures. However, the Company may choose not to hedge certain foreign exchange exposures due to immateriality, prohibitive economic cost of hedging particular exposures, or limited availability of appropriate hedging instruments.

To help protect gross margins from fluctuations in foreign currency exchange rates, the Company's U.S. dollar functional subsidiaries hedge a portion of forecasted foreign currency revenue, and the Company's non-U.S. dollar functional subsidiaries selling in local currencies hedge a portion of forecasted inventory purchases not denominated in the subsidiaries' functional currency. Other comprehensive income associated with hedges of foreign currency revenue is recognized as a component of net sales in the same period as the related sales are recognized, and other comprehensive income related to inventory purchases is recognized as a component of cost of sales in the same period as the related costs are recognized.

Typically, the Company hedges portions of its forecasted foreign currency exposure associated with revenue and inventory purchases over a time horizon of up to 6 months.

Derivative instruments designated as cash flow hedges must be de-designated as hedges when it is probable the forecasted hedged transaction will not occur in the initially identified time period or within a subsequent 2 month time period. Deferred gains and losses in other comprehensive income associated with such derivative instruments are immediately reclassified into earnings in other income and expense. Any subsequent changes in fair value of such derivative instruments are also reflected in current earnings unless they are re-designated as hedges of other transactions. The Company recognized net gains of approximately $672,000 and $421,000 in 2007 and 2006, respectively, and a net loss of $1.6 million in 2005 in other income and expense related to the loss of hedge designation on discontinued cash flow hedges due to changes in the Company's forecast of future net sales and cost of sales and due to prevailing market conditions. As of September 29, 2007, the Company had a net deferred gain associated with cash flow hedges of approximately $468,000, net of taxes, substantially all of which is expected to be reclassified to earnings by the end of the second quarter of fiscal 2008.

The net gain or loss on the effective portion of a derivative instrument designated as a net investment hedge is included in the cumulative translation adjustment account of accumulated other comprehensive income within shareholders' equity. For the years ended September 29, 2007 and September 30, 2006, the Company had a net loss of $2.6 million and a net gain of $7.4 million, respectively, included in the cumulative translation adjustment.

The Company may also enter into foreign currency forward and option contracts to offset the foreign exchange gains and losses generated by the re-measurement of certain assets and liabilities recorded in non-functional currencies. Changes in the fair value of these derivatives are recognized in current earnings in other income and expense as offsets to the changes in the fair value of the related assets or liabilities. Due to currency market movements, changes in option time value can lead to increased volatility in other income and expense.

Note 3—Consolidated Financial Statement Details (in millions)

Other Current Assets

	2007	2006
Vendor non-trade receivables	$ 2,392	$ 1,593
NAND flash memory prepayments	417	208
Other current assets	996	469
Total other current assets	$ 3,805	$ 2,270

Property, Plant, and Equipment

	2007	2006
Land and buildings	$ 762	$ 626
Machinery, equipment, and internal-use software	954	595
Office furniture and equipment	106	94
Leasehold improvements	1,019	760
	2,841	2,075
Accumulated depreciation and amortization	(1,009)	(794)
Net property, plant, and equipment	$ 1,832	$ 1,281

Other Assets

	2007	2006
Long-term NAND flash memory prepayments	$ 625	$ 1,042
Non-current deferred tax assets	88	—
Capitalized software development costs, net	83	21
Other assets	426	175
Total other assets	$ 1,222	$ 1,238

Accrued Expenses

	2007	2006
Deferred revenue—current	$ 1,410	$ 718
Deferred margin on component sales	545	324
Other accrued tax liabilities	488	388
Accrued marketing and distribution	288	298
Accrued compensation and employee benefits	254	221
Accrued warranty and related costs	230	284
Other current liabilities	1,114	820
Total accrued expenses	$ 4,329	$ 3,053

Non-Current Liabilities

	2007	2006
Deferred revenue—non-current	$ 830	$ 383
Deferred tax liabilities	619	381
Other non-current liabilities	67	14
Total non-current liabilities	$ 1,516	$ 778

Other Income and Expense

	2007	2006	2005
Interest income	$ 647	$ 394	$ 183
Other income (expense), net	(48)	(29)	(18)
Total other income and expense	$ 599	$ 365	$ 165

Note 4—Goodwill and Other Intangible Assets

The Company is currently amortizing its acquired intangible assets with definite lives over periods ranging from 2 to 10 years. The following table summarizes the components of gross and net intangible asset balances (in millions):

	September 29, 2007			September 30, 2006		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Definite lived and amortizable acquired technology	$ 276	$ (77)	$ 199	$ 181	$ (42)	$ 139
Indefinite lived and unamortizable trademarks	100	—	100	—	—	—
Total acquired intangible assets	$ 376	$ (77)	$ 299	$ 181	$ (42)	$ 139
Goodwill	$ 38	$ —	$ 38	$ 38	$ —	$ 38

As of September 29, 2007, and September 30, 2006, the weighted-average amortization period for acquired technology was 7.1 years and 8.5 years, respectively.

During 2006, the Company sold certain assets related to its PowerSchool web-based student information system operations. In connection with this sale, the Company reduced goodwill by $31 million for the outstanding balance from the acquisition of PowerSchool, Inc. in 2001 and recognized a $4 million pre-tax gain, which is reflected in other income and expense in the Consolidated Statement of Operations.

Expected annual amortization expense related to acquired technology is as follows (in millions):

Fiscal Years:	
2008	$ 52
2009	37
2010	28
2011	25
2012	19
Thereafter	38
Total	$ 199

Amortization expense related to acquired intangible assets was $35 million, $12 million, and $9 million in 2007, 2006, and 2005, respectively.

Note 5—Income Taxes

The provision for income taxes consisted of the following (in millions):

	2007	2006	2005
Federal:			
Current	$ 1,219	$ 619	$ 305
Deferred	85	56	144
	1,304	675	449
State:			
Current	112	56	66
Deferred	9	14	(91)
	121	70	(25)
Foreign:			
Current	103	101	59
Deferred	(16)	(17)	(3)
	87	84	56
Provision for income taxes	$ 1,512	$ 829	$ 480

The foreign provision for income taxes is based on foreign pretax earnings of $2.2 billion, $1.5 billion, and $922 million in 2007, 2006, and 2005, respectively. As of September 29, 2007, $6.5 billion of the Company's cash, cash equivalents, and short-term investments were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S. The Company's consolidated financial statements provide for any related tax liability on amounts that may be repatriated, aside from undistributed earnings of certain of the Company's foreign subsidiaries that are intended to be indefinitely reinvested in operations outside the U.S. U.S. income taxes have not been provided on a cumulative total of $2.4 billion of such earnings. It is not practicable to determine the income tax liability that might be incurred if these earnings were to be distributed.

Deferred tax assets and liabilities reflect the effects of tax losses, credits, and the future income tax effects of temporary differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases and are measured using enacted tax rates that apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

As of September 29, 2007 and September 30, 2006, the significant components of the Company's deferred tax assets and liabilities were (in millions):

	2007	2006
Deferred tax assets:		
Accrued liabilities and other reserves	$ 679	$ 485
Tax losses and credits	8	55
Basis of capital assets and investments	146	124
Accounts receivable and inventory reserves	64	45
Other	161	30
Total deferred tax assets	1,058	739
Less valuation allowance	5	5
Net deferred tax assets	1,053	734
Deferred tax liabilities:		
Unremitted earnings of subsidiaries	803	514
Total deferred tax liabilities	803	514
Net deferred tax asset	$ 250	$ 220

As of September 29, 2007, the Company has tax loss and credit carryforwards in the tax effected amount of $8 million. As of September 29, 2007 and September 30, 2006, a valuation allowance of $5 million was recorded against the deferred tax asset for the benefits of state operating losses that may not be realized. Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets.

A reconciliation of the provision for income taxes, with the amount computed by applying the statutory federal income tax rate (35% in 2007, 2006, and 2005) to income before provision for income taxes, is as follows (in millions):

	2007	2006	2005
Computed expected tax	$ 1,753	$ 987	$ 633
State taxes, net of federal effect	140	86	(19)
Indefinitely invested earnings of foreign subsidiaries	(297)	(224)	(98)
Nondeductible executive compensation	6	11	14
Research and development credit, net	(54)	(12)	(26)
Other items	(36)	(19)	(24)
Provision for income taxes	$ 1,512	$ 829	$ 480
Effective tax rate	30%	29%	27%

The Company's income taxes payable have been reduced by the tax benefits from employee stock options. The Company receives an income tax benefit calculated as the difference between the fair market value of the stock issued at the time of the exercise and the option price, tax effected. The net tax benefits from employee stock option transactions were $398 million, $419 million, and $428 million in 2007, 2006, and 2005, respectively, and were reflected as an increase to common stock in the Consolidated Statements of Shareholders' Equity.

The Internal Revenue Service ("IRS") has completed its field audit of the Company's federal income tax returns for the years 2002 through 2003 and proposed certain adjustments. The Company intends to contest certain of these adjustments through the IRS Appeals Office. All IRS audit issues for years prior to 2002 have been resolved. In addition, the Company is also subject to audits by state, local, and foreign tax authorities. Management believes that adequate provisions have been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. Should any issues addressed in the Company's tax audits be resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs. In 2007 and 2006, the Company recorded tax benefits of $63 million and $20 million, respectively, due to the settlement of prior year tax audits in the U.S.

Note 6—Shareholders' Equity

Preferred Stock

The Company has five million shares of authorized preferred stock, none of which is issued or outstanding. Under the terms of the Company's Restated Articles of Incorporation, the Board of Directors is authorized to determine or alter the rights, preferences, privileges and restrictions of the Company's authorized but unissued shares of preferred stock.

Restricted Stock Units

The Company's Board of Directors has granted RSUs to members of the Company's management team, excluding its CEO. These RSUs generally vest over four years either at the end of the four-year service period, in two equal installments on the second and fourth anniversaries of the date of grant, or in equal installments on each of the first through fourth anniversaries of the grant date. Upon vesting, the RSUs will convert into an equivalent number of shares of common stock. The compensation expense incurred by the Company for RSUs is based on the closing market price of the Company's common stock on the date of grant and is amortized ratably on a straight-line basis over the requisite service period. The RSUs have been reflected in the calculation of diluted earnings per share utilizing the treasury stock method.

During 2007 and 2006, 45,000 and 2.47 million, respectively, previously granted RSUs vested. A majority of these vested RSUs were net-share settled such that the Company withheld shares with value equivalent to the employees' minimum statutory obligation for the applicable income and other employment taxes, and remitted the cash to the appropriate taxing authorities. The total shares withheld of approximately 20,000 and 990,000 for 2007 and 2006, respectively, was based on the value of the RSUs on their vesting date as determined by the Company's closing stock price. Total payments for the employees' tax obligations to the taxing authorities were $3 million and $59 million in 2007 and 2006, respectively, and are reflected as a financing activity within the Consolidated Statements of Cash Flows. These net-share settlements had the effect of share repurchases by the Company as they reduced and retired the number of shares that would have otherwise been issued as a result of the vesting and did not represent an expense to the Company.

CEO Restricted Stock Award

On March 19, 2003, the Company's Board of Directors granted 10 million shares of restricted stock to the Company's CEO that vested on March 19, 2006. The amount of the restricted stock award expensed by the Company was based on the closing market price of the Company's common stock on the date of grant and was amortized ratably on a straight-line basis over the three-year requisite service period. Upon vesting during 2006, the 10 million shares of restricted stock had a fair value of $646.6 million and had grant-date fair value of $7.48 per share. The restricted stock award was net-share settled such that the Company withheld shares with value equivalent to the CEO's minimum statutory obligation for the applicable income and other employment taxes, and remitted the cash to the appropriate taxing authorities. The total shares withheld of 4.6 million were based on the value of the restricted stock award on the vesting date as determined by the Company's closing stock price of $64.66. The remaining shares net of those withheld were delivered to the Company's CEO. Total payments for the CEO's tax obligations to the taxing authorities was $296 million in 2006 and are reflected as a financing activity within the Consolidated Statements of Cash Flows. The net-share settlement had the effect of share repurchases by the Company as it reduced and retired the number of shares outstanding and did not represent an expense to the Company. The Company's CEO has no remaining shares of restricted stock. For the years ended September 30, 2006 and September 24, 2005, compensation expense related to restricted stock was $4.6 million and $24.9 million, respectively.

Stock Repurchase Plan

In July 1999, the Company's Board of Directors authorized a plan for the Company to repurchase up to $500 million of its common stock. This repurchase plan does not obligate the Company to acquire any specific number of shares or acquire shares over any specified period of time. The Company has repurchased a total of 13.1 million shares at a cost of $217 million under this plan and was authorized to repurchase up to an additional $283 million of its common stock as of September 29, 2007.

Comprehensive Income

Comprehensive income consists of two components, net income and other comprehensive income. Other comprehensive income refers to revenue, expenses, gains, and losses that under U.S. generally accepted accounting principles are recorded as an element of shareholders' equity but are excluded from net income. The Company's other comprehensive income consists of foreign currency translation adjustments from those subsidiaries not using the U.S. dollar as their functional currency, unrealized gains and losses on marketable securities categorized as available-for-sale, and net deferred gains and losses on certain derivative instruments accounted for as cash flow hedges.

The following table summarizes the components of accumulated other comprehensive income, net of taxes (in millions):

	2007	2006	2005
Unrealized losses on available-for-sale securities	$ (7)	$ —	$ (4)
Unrealized gains on derivative instruments	—	3	4
Cumulative foreign currency translation	70	19	—
Accumulated other comprehensive income	$ 63	$ 22	$ —

The change in fair value of available-for-sale securities included in other comprehensive income was $(7) million, $4 million, and zero, net of taxes in 2007, 2006, and 2005, respectively. The tax effect related to the change in unrealized gain/loss on available-for-sale securities was $4 million, $(2) million, and zero for 2007, 2006, and 2005, respectively.

The following table summarizes activity in other comprehensive income related to derivatives, net of taxes, held by the Company (in millions):

	2007	2006	2005
Changes in fair value of derivatives	$ (1)	$ 11	$ 7
Adjustment for net (losses)/gains realized and included in net income	(2)	(12)	1
Change in unrealized gains on derivative instruments	$ (3)	$ (1)	$ 8

The tax effect related to the changes in fair value of derivatives was $1 million, $(8) million, and $(3) million for 2007, 2006, and 2005, respectively. The tax effect related to derivative gains/losses reclassified from other comprehensive income to net income was $2 million, $8 million, and $(2) million for 2007, 2006, and 2005, respectively.

Employee Benefit Plans

2003 Employee Stock Plan

The 2003 Employee Stock Plan (the "2003 Plan") is a shareholder approved plan that provides for broad-based grants to employees, including executive officers. Based on the terms of individual option grants, options granted under the 2003 Plan generally expire 7 to 10 years after the grant date and generally become exercisable over a period of four years, based on continued employment, with either annual or quarterly vesting. The 2003 Plan permits the granting of incentive stock options, nonstatutory stock options, RSUs, stock appreciation rights, stock purchase rights and performance-based awards. During 2007, the Company's shareholders approved an amendment to the 2003 Plan to increase the number of shares authorized for issuance by 28 million shares.

1997 Employee Stock Option Plan

In August 1997, the Company's Board of Directors approved the 1997 Employee Stock Option Plan (the "1997 Plan"), a non-shareholder approved plan for grants of stock options to employees who are not officers of the Company. Based on the terms of individual option grants, options granted under the 1997 Plan generally expire 7 to 10 years after the grant date and generally become exercisable over a period of four years, based on continued employment, with either annual or quarterly vesting. In October 2003, the Company terminated the 1997 Plan and no new options can be granted from this plan.

1997 Director Stock Option Plan

In August 1997, the Company's Board of Directors adopted a Director Stock Option Plan (the "Director Plan") for non-employee directors of the Company, which was approved by shareholders in 1998. Pursuant to the Director Plan, the Company's non-employee directors are granted an option to acquire 30,000 shares of common stock upon their initial election to the Board ("Initial Options"). The Initial Options vest and become exercisable in three equal annual installments on each of the first through third anniversaries of the grant date. On the fourth anniversary of a non-employee director's initial election to the Board and on each subsequent anniversary thereafter, the director will be entitled to receive an option to acquire 10,000 shares of common stock ("Annual Options"). Annual Options are fully vested and immediately exercisable on their date of grant.

Rule 10b5-1 Trading Plans

Certain of the Company's executive officers, including Mr. Timothy D. Cook, Mr. Peter Oppenheimer, Mr. Philip W. Schiller, and Dr. Bertrand Serlet, have entered into trading plans pursuant to

Rule 10b5-1(c)(1) of the Securities Exchange Act of 1934, as amended. A trading plan is a written document that pre-establishes the amounts, prices and dates (or formula for determining the amounts, prices and dates) of future purchases or sales of the Company's stock including the exercise and sale of employee stock options and shares acquired pursuant to the Company's employee stock purchase plan and upon vesting of RSUs.

Employee Stock Purchase Plan

The Company has a shareholder approved employee stock purchase plan (the "Purchase Plan"), under which substantially all employees may purchase common stock through payroll deductions at a price equal to 85% of the lower of the fair market values as of the beginning and end of six-month offering periods. Stock purchases under the Purchase Plan are limited to 10% of an employee's compensation, up to a maximum of $25,000 in any calendar year. During 2007, the Company's shareholders approved an amendment to the Purchase Plan to increase the number of shares authorized for issuance by 6 million shares and limit the number of shares that may be purchased in any calendar year to 3 million shares. As of September 29, 2007, approximately 7 million shares were reserved for future issuance under the Purchase Plan.

Employee Savings Plan

The Company has an employee savings plan (the "Savings Plan") qualifying as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code. Under the Savings Plan, participating U.S. employees may defer a portion of their pre-tax earnings, up to the Internal Revenue Service annual contribution limit ($15,500 for calendar year 2007). The Company matches 50% to 100% of each employee's contributions, depending on length of service, up to a maximum 6% of the employee's eligible earnings. The Company's matching contributions to the Savings Plan were $39 million, $33 million, and $28 million in 2007, 2006, and 2005, respectively.

Stock Option Activity

A summary of the Company's stock option activity and related information for the last three fiscal years follows (stock award amounts and aggregate intrinsic value are presented in thousands):

	Shares Available for Grant	Outstanding Options					
		Number of Shares		Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term		Aggregate Intrinsic Value
Balance at September 25, 2004	24,050	110,722	$	10.52			
Additional options authorized	49,000	—		—			
Restricted stock units granted	(460)	—		—			
Options granted	(16,214)	16,214	$	42.52			
Options cancelled	3,844	(3,844)	$	13.28			
Options exercised	—	(49,871)	$	10.05			
Restricted stock units cancelled	230	—		—			
Plan shares expired	(1,493)	—		—			
Balance at September 24, 2005	58,957	73,221	$	17.79			
Restricted stock units granted	(2,950)	—		—			
Options granted	(3,881)	3,881	$	65.28			
Options cancelled	2,325	(2,325)	$	29.32			
Restricted stock units cancelled	625	—		—			
Options exercised	—	(21,795)	$	11.78			
Plan shares expired	(82)	—		—			
Balance at September 30, 2006	54,994	52,982	$	23.23			
Additional shares authorized	28,000	—		—			
Restricted stock units granted	(2,640)	—		—			
Options granted	(14,010)	14,010	$	94.52			
Options cancelled	1,471	(1,471)	$	55.38			
Restricted stock units cancelled	20	—		—			
Options exercised	—	(15,770)	$	18.32			
Plan shares expired	(8)	—		—			
Balance at September 29, 2007	67,827	49,751	$	43.91	4.57	$	5,450,528
Exercisable at September 29, 2007		27,319	$	23.13	3.80	$	3,560,682
Expected to Vest after September 29, 2007		21,260	$	72.69	5.51	$	1,717,383

Aggregate intrinsic value represents the value of the Company's closing stock price on the last trading day of the fiscal period in excess of the exercise price multiplied by the number of options outstanding or exercisable. Total intrinsic value of options at time of exercise was $1.3 billion, $1.2 billion, and $1.1 billion for 2007, 2006, and 2005, respectively.

The Company recognized $242 million, $163 million and $49 million of stock-based compensation expense in 2007, 2006 and 2005, respectively. Capitalized stock-based compensation costs were $9 million as of September 29, 2007. There were no stock-based compensation costs capitalized as of September 30, 2006. The income tax benefit related to stock-based compensation expense was $81 million and $39 million for the years ended September 29, 2007 and September 30, 2006, respectively. The total unrecognized compensation cost related to stock options and RSUs expected to vest was $631 million and $375 million as of September 29, 2007 and September 30, 2006, respectively. The total unrecognized compensation cost as of September 29, 2007, is expected to be recognized over a weighted-average period of 2.92 years.

Note 6—Shareholders' Equity (Continued)

As of September 29, 2007, the Company had 4.7 million RSUs outstanding with a total grant-date fair value of $249 million that were excluded from the options outstanding balances in the preceding table. The weighted-average grant date fair value of RSUs granted during 2007, 2006, and 2005 was $88.51 per share, $70.92 per share, and $45.04 per share, respectively. Aggregate intrinsic value of RSUs was $701.3 million and $262.5 million at September 29, 2007 and September 30, 2006, respectively. RSUs that vested during 2007 and 2006 totaled 45,000 and 2.47 million, respectively, and had a fair value of $6.1 million and $148.5 million, respectively, as of the vesting date. Shares of RSUs granted after April 2005 have been deducted from the shares available for grant under the Company's stock option plans utilizing a factor of two times the number of RSUs granted.

Note 7—Stock-Based Compensation

The Company has provided pro forma disclosures in Note 1 of the effect on net income and earnings per share for the year ended September 24, 2005 as if the fair value method of accounting for stock-based compensation had been used for its employee stock option grants and employee stock purchase plan purchases. These pro forma effects have been estimated at the date of grant and beginning of the period, respectively, using the BSM option-pricing model.

The Company uses the BSM option-pricing model to calculate the fair value of stock-based awards. The BSM option-pricing model incorporates various assumptions including expected volatility, expected life, and interest rates. The expected volatility is based on the historical volatility of the Company's common stock over the most recent period commensurate with the estimated expected life of the Company's stock options and other relevant factors including implied volatility in market traded options on the Company's common stock. The Company bases its expected life assumption on its historical experience and on the terms and conditions of the stock awards it grants to employees. Stock-based compensation cost is estimated at the grant date based on the award's fair-value as calculated by the BSM option-pricing model and is recognized as expense ratably on a straight-line basis over the requisite service period.

The weighted average assumptions used for 2007, 2006, and 2005 and the resulting estimates of weighted-average fair value per share of options granted and for stock purchases during those periods are as follows:

	2007	2006	2005
Expected life of stock options	3.46 years	3.56 years	3.57 years
Expected life of stock purchases	6 months	6 months	6 months
Interest rate—stock options	4.61%	4.60%	3.73%
Interest rate—stock purchases	5.13%	4.29%	2.54%
Volatility—stock options	38.13%	40.34%	39.52%
Volatility—stock purchases	39.22%	39.56%	40.88%
Dividend yields	—	—	—
Weighted-average fair value of options granted during the year	$ 31.86	$ 23.16	$ 14.41
Weighted-average fair value of stock purchases during the year	$ 20.90	$ 14.06	$ 7.55

Note 8—Commitments and Contingencies

Lease Commitments

The Company leases various equipment and facilities, including retail space, under noncancelable operating lease arrangements. The Company does not currently utilize any other off-balance sheet financing arrangements. The major facility leases are generally for terms of 3 to 15 years and generally provide renewal options for terms of 3 to 7 additional years. Leases for retail space are for terms of 5 to 20 years, the majority of which are for 10 years, and often contain multi-year renewal options. As of September 29, 2007, the Company's total future minimum lease payments under noncancelable operating leases were $1.4 billion, of which $1.1 billion related to leases for retail space.

Rent expense under all operating leases, including both cancelable and noncancelable leases, was $151 million, $138 million, and $140 million in 2007, 2006, and 2005, respectively. Future minimum lease payments under noncancelable operating leases having remaining terms in excess of one year as of September 29, 2007, are as follows (in millions):

Fiscal Years		
2008	$	155
2009		172
2010		173
2011		160
2012		148
Thereafter		617
Total minimum lease payments	$	1,425

Accrued Warranty and Indemnifications

The Company offers a basic limited parts and labor warranty on its hardware products. The basic warranty period for hardware products is typically one year from the date of purchase by the end-user. The Company also offers a 90-day basic warranty for its service parts used to repair the Company's hardware products. The Company provides currently for the estimated cost that may be incurred under its basic limited product warranties at the time related revenue is recognized. Factors considered in determining appropriate accruals for product warranty obligations include the size of the installed base of products subject to warranty protection, historical and projected warranty claim rates, historical and projected cost-per-claim, and knowledge of specific product failures that are outside of the Company's typical experience. The Company assesses the adequacy of its preexisting warranty liabilities and adjusts the amounts as necessary based on actual experience and changes in future estimates. For products accounted for under subscription accounting pursuant to SOP No. 97-2, the Company recognizes warranty expense as incurred.

The Company periodically provides updates to its applications and system software to maintain the software's compliance with specifications. The estimated cost to develop such updates is accounted for as warranty costs that are recognized at the time related software revenue is recognized. Factors considered in determining appropriate accruals related to such updates include the number of units delivered, the number of updates expected to occur, and the historical cost and estimated future cost of the resources necessary to develop these updates.

The following table reconciles changes in the Company's accrued warranties and related costs (in millions):

	2007	2006	2005
Beginning accrued warranty and related costs	$ 284	$ 188	$ 105
Cost of warranty claims	(281)	(267)	(188)
Accruals for product warranties	227	363	271
Ending accrued warranty and related costs	$ 230	$ 284	$ 188

The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against itself or an indemnified third-party and, in the opinion of management, does not have a potential liability related to unresolved infringement claims subject to indemnification that would have a material adverse effect on its financial condition or operating results. Therefore, the Company did not record a liability for infringement costs as of either September 29, 2007 or September 30, 2006.

Concentrations in the Available Sources of Supply of Materials and Product

Certain key components including, but not limited to, microprocessors, enclosures, certain LCDs, certain optical drives, and application-specific integrated circuits ("ASICs") are currently obtained by the Company from single or limited sources which subjects the Company to supply and pricing risks. Many of these and other key components that are available from multiple sources including, but not limited to, NAND flash memory, DRAM memory, and certain LCDs, are at times subject to industry-wide shortages and significant commodity pricing fluctuations. In addition, the Company has entered into certain agreements for the supply of critical components at favorable pricing, and there is no guarantee that the Company will be able to extend or renew these agreements when they expire. Therefore, the Company remains subject to significant risks of supply shortages and/or price increases that can adversely affect gross margins and operating margins. In addition, the Company uses some components that are not common to the rest of the global personal computer, consumer electronics and mobile communication industries, and new products introduced by the Company often utilize custom components obtained from only one source until the Company has evaluated whether there is a need for and subsequently qualifies additional suppliers. If the supply of a key single-sourced component to the Company were to be delayed or curtailed, or in the event a key manufacturing vendor delays shipments of completed products to the Company, the Company's ability to ship related products in desired quantities and in a timely manner could be adversely affected. The Company's business and financial performance could also be adversely affected depending on the time required to obtain sufficient quantities from the original source, or to identify and obtain sufficient quantities from an alternative source. Continued availability of these components may be affected if producers were to decide to concentrate on the production of common components instead of components customized to meet the Company's requirements. Finally, significant portions of the Company's CPUs, iPods, iPhones, logic boards, and other assembled products are now manufactured by outsourcing partners, primarily in various parts of Asia. A significant concentration of this outsourced manufacturing is currently performed by only a few of the Company's outsourcing partners, often in single locations. Certain of these outsourcing partners are the sole-sourced supplier of components and manufacturing outsourcing for many of the Company's key products, including but not limited to, assembly of most of the Company's portable Mac computers, iPods, and iPhones. Although the Company works closely with its outsourcing partners on manufacturing schedules, the Company's operating results could be adversely affected if its outsourcing partners were unable to meet their production commitments.

Long-Term Supply Agreements

During the first quarter of 2006, the Company entered into long-term supply agreements with Hynix Semiconductor, Inc., Intel Corporation, Micron Technology, Inc., Samsung Electronics Co., Ltd., and Toshiba Corporation to secure supply of NAND flash memory through calendar year 2010. As part of these agreements, the Company prepaid $1.25 billion for flash memory components during 2006, which will be applied to certain inventory purchases made over the life of each respective agreement. The Company utilized $208 million of the prepayment as of September 29, 2007.

Contingencies

The Company is subject to certain other legal proceedings and claims that have arisen in the ordinary course of business and have not been fully adjudicated. In the opinion of management, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate have a material adverse effect on its financial condition or operating results. However, the results of legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations including, in some instances, the requirement to provide customers the ability to return product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have recently been passed in several jurisdictions in which the Company operates including various countries within Europe and Asia, certain Canadian provinces and certain states within the U.S. Although the Company does not anticipate any material adverse effects in the future based on the nature of its operations and the thrust of such laws, there is no assurance that such existing laws or future laws will not have a material adverse effect on the Company's financial condition or operating results.

Note 9—Segment Information and Geographic Data

In accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, the Company reports segment information based on the "management" approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of the Company's reportable segments.

The Company manages its business primarily on a geographic basis. Accordingly, the Company determined its operating segments, which are generally based on the nature and location of its customers, to be the Americas, Europe, Japan, Asia-Pacific, Retail, and FileMaker operations. The Company's four geographical segments, together with the Retail segment, all sell the same products to the same types of customers. The Company's reportable operating segments are comprised of the Americas, Europe, Japan, and Retail operations. The Americas, Europe, and Japan reportable segments exclude activities related to the Retail segment. The Americas segment includes both North and South America. The Europe segment includes European countries as well as the Middle East and Africa. The Retail segment operates Apple-owned retail stores in the U.S., Canada, Japan, the U.K. and Italy. Other operating segments include

Asia-Pacific, which includes Australia and Asia except for Japan, and the Company's subsidiary, FileMaker, Inc. Each reportable geographic operating segment provides similar hardware and software products, similar services and the accounting policies of the various segments are the same as those described in Note 1.

The Company evaluates the performance of its operating segments based on net sales and operating income. Net sales for geographic segments are generally based on the location of the customers, and net sales for the Retail segment are based on sales from the Company's retail stores. Operating income for each segment includes net sales to third parties, related cost of sales, and operating expenses directly attributable to the segment. Advertising expenses are generally included in the geographic segment in which the expenditures are incurred. Operating income for each segment excludes other income and expense and certain expenses managed outside the operating segments. Costs excluded from segment operating income include various corporate expenses such as manufacturing costs and variances not included in standard costs, research and development, corporate marketing expenses, stock-based compensation expense, income taxes, various nonrecurring charges, and other separately managed general and administrative costs. The Company does not include intercompany transfers between segments for management reporting purposes. Segment assets exclude corporate assets such as cash, short-term and long-term investments, manufacturing facilities, miscellaneous corporate infrastructure, goodwill and other acquired intangible assets, and retail store construction-in-progress not subject to depreciation. Except for the Retail segment, capital asset purchases for long-lived assets are not reported to management by segment. Capital asset purchases by the Retail segment were $294 million, $200 million, and $132 million for 2007, 2006, and 2005 respectively.

From the establishment of the Retail segment in fiscal 2001 through the quarter ended March 31, 2007, Company management assessed the segment's operating performance differently from the Company's other operating segments. Because the Company's Retail initiative was an unproven concept at inception, management chose to measure the Retail segment's performance in a manner that would allow comparability to the Company's major channel partners operating retail stores in the U.S. There were three significant differences in the measurement of the Retail segment's results relative to the Company's other operating segments. First, the Retail segment's operating income reflected cost of sales for Apple products at amounts normally charged to Apple's major U.S. channel partners for the same products, less the cost of the Company's sales programs and other costs to support those partners. Second, the cost of sales of the Company's service and support contracts, including the AppleCare Protection Plan ("APP") and .Mac, were reflected in the Retail segment's results at the costs charged to major channel partners for such contracts, and all associated revenue was reflected in the Retail segment's results at the time of sale rather than being amortized over the lives of the respective agreements. Because the Company had not yet earned the revenue or incurred the cost associated with the sale of such contracts, an offset to these amounts was recognized in other segments' net sales and cost of sales. Third, the Company allocated certain expenses related to the operation of its high-profile stores to corporate marketing expense.

Having operated the Company's Retail stores successfully for more than six years, management believes its Retail initiative is a proven concept that will continue to be an integral element of the Company's distribution and marketing strategies. Additionally, the Company expects sales of iPhone by the Company's geographic and Retail operating segments to generate significant levels of deferred revenue and deferred cost of sales over time. In consideration of these factors, management has determined that beginning with the quarter ended June 30, 2007, aligning measurements for the performance of the Retail segment with those used for the Company's other operating segments provides the most meaningful information. Accordingly, management has begun to measure the Retail segment's operating performance in a manner generally consistent with the Company's other operating segments. The cost of sales of the Company's products sold through the Retail segment is now reflected at amounts similar to the cost of sales of the same products reflected in the Company's other operating segments. Revenue from APP and .Mac contracts sold through the Retail segment is now being recognized over the lives of the respective service agreements. Additionally, the Retail segment is applying the same subscription accounting to iPhone net sales and cost of sales that the Company's other operating segments apply. Management believes aligning measurements for the performance of the Retail segment with those used for the Company's other operating segments will provide greater comparability with the rest of the Company's segments and allow for more meaningful assessment of the Retail segment's operating results. The Company has reclassified prior period operating segment results to reflect these changes in the measurement of the operating results for the Retail segment, along with the corresponding offsetting impact to the Company's other operating segments.

The Company will continue to allocate certain operating expenses associated with its high-profile stores to corporate marketing expense to reflect the estimated Company-wide benefit. These high-profile stores are larger than the Company's typical retail stores and were designed to further promote brand awareness and provide a venue for certain corporate sales and marketing activities, including corporate briefings. The allocation of these operating costs to corporate expense is based on the amount incurred for a high-profile store in excess of that incurred by a more typical Company retail location. The Company had opened a total of eight high-profile stores as of September 29, 2007. Expenses allocated to corporate marketing resulting from the operations of high-profile stores were $39 million, $33 million, and $31 million for the years ended September 29, 2007, September 30, 2006, and September 24, 2005 respectively.

Summary information by operating segment follows (in millions):

	2007	2006	2005
Americas:			
Net sales	$ 11,596	$ 9,415	$ 6,658
Operating income	$ 2,949	$ 1,899	$ 970
Depreciation, amortization, and accretion	$ 9	$ 6	$ 6
Segment assets (a)	$ 1,497	$ 896	$ 705
Europe:			
Net sales	$ 5,460	$ 4,096	$ 3,073
Operating income	$ 1,348	$ 627	$ 465
Depreciation, amortization, and accretion	$ 6	$ 4	$ 4
Segment assets	$ 595	$ 471	$ 289
Japan:			
Net sales	$ 1,082	$ 1,211	$ 924
Operating income	$ 232	$ 208	$ 147
Depreciation, amortization, and accretion	$ 3	$ 3	$ 3
Segment assets	$ 159	$ 181	$ 165
Retail:			
Net sales	$ 4,115	$ 3,246	$ 2,278
Operating income	$ 875	$ 600	$ 396
Depreciation, amortization, and accretion (b)	$ 88	$ 59	$ 43
Segment assets (b)	$ 1,085	$ 651	$ 589
Other Segments (c):			
Net sales	$ 1,753	$ 1,347	$ 998
Operating income	$ 388	$ 235	$ 118
Depreciation, amortization, and accretion	$ 3	$ 3	$ 2
Segment assets	$ 252	$ 180	$ 133

(a) The Americas asset figures do not include fixed assets held in the U.S. Such fixed assets are not allocated specifically to the Americas segment and are included in the corporate assets figures below.

(b) Retail segment depreciation and asset figures reflect the cost and related depreciation of its retail stores and related infrastructure. Retail store construction-in-progress, which is not subject to depreciation, is reflected in corporate assets.

(c) Other Segments include Asia-Pacific and FileMaker.

A reconciliation of the Company's segment operating income and assets to the consolidated financial statements follows (in millions):

	2007	2006	2005
Segment operating income	$ 5,792	$ 3,569	$ 2,096
Other corporate expenses, net (a)	(1,141)	(953)	(404)
Stock-based compensation expense	(242)	(163)	(49)
Total operating income	$ 4,409	$ 2,453	$ 1,643
Segment assets	$ 3,588	$ 2,379	$ 1,881
Corporate assets	21,759	14,826	9,635
Consolidated assets	$ 25,347	$ 17,205	$ 11,516
Segment depreciation, amortization, and accretion	$ 109	$ 75	$ 58
Corporate depreciation, amortization, and accretion	208	150	121
Consolidated depreciation, amortization, and accretion	$ 317	$ 225	$ 179

(a) Corporate expenses include research and development, corporate marketing expenses, manufacturing costs and variances not included in standard costs, and other separately managed general and administrative expenses including certain corporate expenses associated with support of the Retail segment.

No single customer or single country outside of the U.S. accounted for more than 10% of net sales in 2007, 2006, or 2005. Net sales and long-lived assets related to the U.S. and international operations are as follows (in millions):

	2007	2006	2005
Net sales:			
U.S.	$ 14,128	$ 11,486	$ 8,194
International	9,878	7,829	5,737
Total net sales	$ 24,006	$ 19,315	$ 13,931
Long-lived assets:			
U.S.	$ 1,752	$ 1,150	$ 738
International	260	218	175
Total long-lived assets	$ 2,012	$ 1,368	$ 913

Information regarding net sales by product is as follows (in millions):

	2007	2006	2005
Net sales:			
Desktops (a)	$ 4,020	$ 3,319	$ 3,436
Portables (b)	6,294	4,056	2,839
Total Mac net sales	10,314	7,375	6,275
iPod	8,305	7,676	4,540
Other music related products and services (c)	2,496	1,885	899
iPhone and related products and services (d)	123	—	—
Peripherals and other hardware (e)	1,260	1,100	1,126
Software, service, and other net sales (f)	1,508	1,279	1,091
Total net sales	$ 24,006	$ 19,315	$ 13,931

(a) Includes iMac, eMac, Mac mini, Power Mac, Mac Pro, and Xserve product lines.

(b) Includes MacBook, iBook, MacBook Pro, and PowerBook product lines.

(c) Consists of iTunes Store sales and iPod services, and Apple-branded and third-party iPod accessories.

(d) Derived from handset sales, carrier agreements, and Apple-branded and third-party iPhone accessories.

(e) Includes sales of Apple-branded and third-party displays, wireless connectivity and networking solutions, and other hardware accessories.

(f) Includes sales of Apple-branded operating system and application software, third-party software, AppleCare, and Internet services.

Note 10—Related Party Transactions and Certain Other Transactions

The Company entered into a Reimbursement Agreement with its CEO, Steve Jobs, for the reimbursement of expenses incurred by Mr. Jobs in the operation of his private plane when used for Apple business. The Company recognized a total of approximately $776,000, $202,000, and $1,100,000 in expenses pursuant to the Reimbursement Agreement during 2007, 2006, and 2005, respectively.

In 2006, the Company entered into an agreement with Pixar to sell certain of Pixar's short films on the iTunes Store. Mr. Jobs was the CEO, Chairman, and a large shareholder of Pixar. On May 5, 2006, The Walt Disney Company ("Disney") acquired Pixar, which resulted in Pixar becoming a wholly-owned subsidiary of Disney. Upon Disney's acquisition of Pixar, Mr. Jobs' shares of Pixar common stock were exchanged for Disney's common stock and he was elected to the Disney Board of Directors. Royalty expense recognized by the Company under the arrangement with Pixar from September 25, 2005 through May 5, 2006 was less than $1 million.

Note 11—Selected Quarterly Financial Information (Unaudited)

The following tables set forth a summary of the Company's quarterly financial information for each of the four quarters ended September 29, 2007 and September 30, 2006 (in millions, except share and per share amounts):

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
2007				
Net sales	$ 6,217	$ 5,410	$ 5,264	$ 7,115
Gross margin	$ 2,090	$ 1,995	$ 1,849	$ 2,220
Net income	$ 904	$ 818	$ 770	$ 1,004
Earnings per common share:				
Basic	$ 1.04	$ 0.94	$ 0.89	$ 1.17
Diluted	$ 1.01	$ 0.92	$ 0.87	$ 1.14
2006				
Net sales	$ 4,837	$ 4,370	$ 4,359	$ 5,749
Gross margin	$ 1,412	$ 1,325	$ 1,297	$ 1,564
Net income	$ 542	$ 472	$ 410	$ 565
Earnings per common share:				
Basic	$ 0.63	$ 0.55	$ 0.49	$ 0.68
Diluted	$ 0.62	$ 0.54	$ 0.47	$ 0.65

Basic and diluted earnings per share are computed independently for each of the quarters presented. Therefore, the sum of quarterly basic and diluted per share information may not equal annual basic and diluted earnings per share.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Apple Inc.:

We have audited the accompanying consolidated balance sheets of Apple Inc. and subsidiaries (the Company) as of September 29, 2007 and September 30, 2006, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended September 29, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Apple Inc. and subsidiaries as of September 29, 2007 and September 30, 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended September 29, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the Consolidated Financial Statements, effective September 25, 2005, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123R, *Share-Based Payment*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Apple Inc.'s internal control over financial reporting as of September 29, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated November 15, 2007 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Mountain View, California
November 15, 2007

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Apple Inc.:

We have audited Apple Inc.'s internal control over financial reporting as of September 29, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Apple's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Apple Inc. maintained, in all material respects, effective internal control over financial reporting as of September 29, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Apple Inc. as of September 29, 2007 and September 30, 2006, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended September 29, 2007, and our report dated November 15, 2007 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Mountain View, California
November 15, 2007

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on an evaluation under the supervision and with the participation of the Company's management, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ("Exchange Act") were effective as of September 29, 2007 to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Inherent Limitations Over Internal Controls

The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the Company's assets;

(ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that the Company's receipts and expenditures are being made only in accordance with authorizations of the Company's management and directors; and

(iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Management, including the Company's Chief Executive Officer and Chief Financial Officer, does not expect that the Company's internal controls will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of internal controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Also, any evaluation of the effectiveness of controls in future periods are subject to the risk that those internal controls may become inadequate because of changes in business conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management's Annual Report on Internal Control Over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). Management conducted an evaluation of the effectiveness of the Company's internal control over financial reporting based on the criteria set forth in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on this evaluation, management has concluded that the Company's internal control over financial reporting was effective as of September 29, 2007. The Company's independent registered public accounting firm, KPMG

LLP, has issued an attestation report on the Company's internal control over financial reporting. The report on the audit of internal control over financial reporting appears on page 92 of this Form 10-K.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the fourth quarter of fiscal 2007, which were identified in connection with management's evaluation required by paragraph (d) of rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information

On November 13, 2007, the Board of Directors of the Company amended and restated the Company's Amended Bylaws to permit the issuance of uncertificated shares of stock and to make related conforming and mechanical changes. The foregoing description of the amendments to the Company's Amended and Restated Bylaws is qualified in its entirety by the text of the Amended and Restated Bylaws, which is attached hereto as Exhibit 3.5 and is incorporated herein by reference.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Directors

Listed below are the Company's seven directors whose terms expire at the next annual meeting of shareholders.

Name	Position With the Company	Age	Director Since
William V. Campbell	Co-lead Director	67	1997
Millard S. Drexler	Director	63	1999
Albert A. Gore, Jr.	Director	59	2003
Steven P. Jobs	Director and Chief Executive Officer	52	1997
Arthur D. Levinson, Ph.D.	Co-lead Director	57	2000
Eric E. Schmidt, Ph.D.	Director	52	2006
Jerome B. York	Director	69	1997

William V. Campbell has been Chairman of the Board of Directors of Intuit, Inc. ("Intuit") since August 1998. From September 1999 to January 2000, Mr. Campbell acted as Chief Executive Officer of Intuit. From January 1994 to August 1998, Mr. Campbell was President and Chief Executive Officer and a director of Intuit. From January 1991 to December 1993, Mr. Campbell was President and Chief Executive Officer of GO Corporation.

Millard S. Drexler has been Chairman and Chief Executive Officer of J. Crew Group, Inc. since January 2003. Previously, Mr. Drexler was Chief Executive Officer of Gap Inc. ("Gap") from 1995 and President from 1987 until 1995. Mr. Drexler was also a member of the Board of Directors of Gap from November 1983 until October 2002.

Albert A. Gore, Jr. has served as a Senior Advisor to Google, Inc. ("Google") since 2001. He has also served as Executive Chairman of Current TV since 2002 and as Chairman of Generation Investment Management since 2004. He is a visiting professor at Middle Tennessee State University. Mr. Gore was inaugurated as the 45th Vice President of the United States in 1993. He was re-elected in 1996 and served for a total of eight years as President of the Senate, a member of the Cabinet and the National Security Council. Prior to 1993, he served eight years in the U.S. Senate and eight years in the U.S. House of Representatives.

Steven P. Jobs is one of the Company's co-founders and currently serves as its Chief Executive Officer. Mr. Jobs is also a director of The Walt Disney Company.

Arthur D. Levinson, Ph.D. has been Chief Executive Officer and a Director of Genentech Inc. ("Genentech") since July 1995. Dr. Levinson has been Chairman of the Board of Directors of Genentech since September 1999. He joined Genentech in 1980 and served in a number of executive positions, including Senior Vice President of R&D from 1993 to 1995. Dr. Levinson also serves on the Board of Directors of Google.

Eric E. Schmidt, Ph.D. has served as the Chief Executive Officer of Google since July 2001 and as a member of Google's Board of Directors since March 2001, where he served as Chairman of the Board from March 2001 to April 2004. In April 2004, Dr. Schmidt was named Chairman of the Executive Committee of Google's Board of Directors. From April 1997 to November 2001, Dr. Schmidt served as Chairman of the Board of Directors of Novell, Inc. ("Novell"), a computer networking company, and, from April 1997 to July 2001, as the Chief Executive Officer of Novell.

Jerome B. York has been Chief Executive Officer of Harwinton Capital LLC (formerly Harwinton Capital Corporation), a private investment company that he controls, since September 2003. From January 2000 until September 2003, Mr. York was Chairman and Chief Executive Officer of MicroWarehouse, Inc., a reseller of computer hardware, software and peripheral products. From September 1995 to October 1999, he was Vice Chairman of Tracinda Corporation. From May 1993 to September 1995 he was Senior Vice President and Chief Financial Officer of IBM Corporation ("IBM"), and served as a member of IBM's Board of Directors from January 1995 to August 1995. Mr. York is also a director of Tyco International Ltd.

Role of the Board; Corporate Governance Matters

It is the paramount duty of the Company's Board of Directors (the "Board of Directors") to oversee the Chief Executive Officer and other senior management in the competent and ethical operation of the Company on a day-to-day basis and to assure that the long-term interests of the shareholders are being served. To satisfy this duty, the directors take a proactive, focused approach to their position, and set standards to ensure that the Company is committed to business success through maintenance of high standards of responsibility and ethics.

Members of the Board of Directors bring a wide range of experience, knowledge and judgment to the Company. These varied skills mean that governance is far more than a "check the box" approach to standards or procedures. The governance structure in the Company is designed to be a working structure for principled actions, effective decision-making and appropriate monitoring of both compliance and performance. The key practices and procedures of the Board of Directors are outlined in the Corporate Governance Guidelines available on the Company's website at www.apple.com/investor.

Board Committees

The Board of Directors has a standing Compensation Committee, a Nominating and Corporate Governance Committee ("Nominating Committee") and an Audit and Finance Committee ("Audit Committee"). All committee members are independent under the listing standards of the NASDAQ Global Select Market. The members of the committees are identified in the table below.

Director	Audit and Finance Committee	Compensation Committee	Nominating and Corporate Governance Committee
William V. Campbell	X	Chair	—
Millard S. Drexler	—	X	X
Albert A. Gore, Jr.	—	X	X
Steven P. Jobs	—	—	—
Arthur D. Levinson, Ph.D.	X	—	Chair
Eric E. Schmidt, Ph.D.	—	—	—
Jerome B. York	Chair	—	—

The Audit Committee is primarily responsible for overseeing the services performed by the Company's independent registered public accounting firm and internal audit department, evaluating the Company's accounting policies and its system of internal controls and reviewing significant financial transactions. Members of the Audit Committee are Messrs. Campbell and York and Dr. Levinson. The Audit Committee met a total of 14 times during fiscal year 2007.

The Compensation Committee is primarily responsible for reviewing the compensation arrangements for the Company's executive officers, including the Chief Executive Officer, and for administering the Company's equity compensation plans. Members of the Compensation Committee are Messrs. Campbell, Drexler, and Gore. The Compensation Committee met a total of five (5) times during fiscal year 2007.

The Nominating Committee assists the Board of Directors in identifying qualified individuals to become directors, determines the composition of the Board of Directors and its committees, monitors the process to assess the Board of Directors' effectiveness and helps develop and implement the Company's corporate governance guidelines. The Nominating Committee also considers nominees proposed by shareholders.

Members of the Nominating Committee are Messrs. Drexler and Gore and Dr. Levinson. The Nominating Committee met a total of three (3) times during fiscal year 2007.

The Audit, Compensation and Nominating Committees operate under written charters adopted by the Board of Directors. These charters are available on the Company's website at www.apple.com/investor.

Audit Committee Financial Expert

The Board of Directors has determined that all members of the Company's Audit Committee, Messrs. Campbell and York and Dr. Levinson, qualify as "audit committee financial experts" as defined by the Securities and Exchange Commission (the "SEC") and also meet the additional criteria for independence of Audit Committee members set forth in Rule 10A-3(b)(l) under the Securities Exchange Act of 1934, as amended (the "Exchange Act").

Code of Ethics

The Company has a code of ethics that applies to all of the Company's employees, including its principal executive officer, principal financial officer and principal accounting officer, and the Board of Directors. A copy of this code, "Ethics: The Way We Do Business Worldwide," is available on the Company's website at www.apple.com/investor. The Company intends to disclose any changes in or waivers from its code of ethics by posting such information on its website or by filing a Form 8-K.

Executive Officers of the Registrant

The following sets forth certain information regarding executive officers of the Company. Information pertaining to Mr. Jobs, who is both a director and an executive officer of the Company, may be found in the section entitled "**Directors**."

Name	Position With the Company	Age
Timothy D. Cook	Chief Operating Officer	46
Daniel Cooperman	Senior Vice President, General Counsel and Secretary	56
Tony Fadell	Senior Vice President, iPod Division	38
Ronald B. Johnson	Senior Vice President, Retail	49
Peter Oppenheimer	Senior Vice President and Chief Financial Officer	44
Philip W. Schiller	Senior Vice President, Worldwide Product Marketing	47
Bertrand Serlet, Ph.D.	Senior Vice President, Software Engineering	46
Sina Tamaddon	Senior Vice President, Applications	50

Timothy D. Cook, Chief Operating Officer, joined the Company in March 1998. Mr. Cook also served in the position of Executive Vice President, Worldwide Sales and Operations from 2002 to 2005. In 2004, his responsibilities were expanded to include the Company's Macintosh hardware engineering. From 2000 to 2002, Mr. Cook served in the role of Senior Vice President, Worldwide Operations, Sales, Service and Support. From 1998 to 2000, Mr. Cook served in the position of Senior Vice President, Worldwide Operations. Prior to joining the Company, Mr. Cook held the position of Vice President, Corporate Materials for Compaq Computer Corporation ("Compaq"). Previous to his work at Compaq, Mr. Cook was the Chief Operating Officer of the Reseller Division at Intelligent Electronics. Mr. Cook also spent 12 years with IBM, most recently as Director of North American Fulfillment. Mr. Cook also serves as a member of the Board of Directors of Nike, Inc.

Daniel Cooperman, Senior Vice President, General Counsel and Secretary, joined the Company in November 2007. Prior to joining the Company, he served as Senior Vice President, General Counsel and Secretary of Oracle Corporation since February 1997. Prior to that, he had been associated with the law firm of McCutchen, Doyle, Brown & Enersen (which is now Bingham McCutchen LLP) since October 1977, and had served as a partner since June 1983. From September 1995 until February 1997, Mr. Cooperman was Chair of the law firm's Business and Transactions Group and from April 1989 through September 1995, he served as the Managing Partner of the law firm's San Jose office.

Tony Fadell, Senior Vice President, iPod Division, joined the Company in 2001. From 2004 to April 2006, Mr. Fadell was Vice President of iPod Engineering. From 2001 to 2004, Mr. Fadell was the Senior Director of the Company's iPod Engineering Team. Prior to joining Apple, Mr. Fadell was a co-founder, CTO, and director of engineering of the Mobile Computing Group at Philips Electronics where he was responsible for all aspects of business and product development for a variety of products. Mr. Fadell later became VP of Business Development for Philips U.S. Strategy & Ventures, focusing on building the company's digital media strategy and investment portfolio.

Ronald B. Johnson, Senior Vice President, Retail, joined the Company in January 2000. Prior to joining the Company, Mr. Johnson spent 16 years with Target Stores, most recently as Senior Merchandising Executive.

Peter Oppenheimer, Senior Vice President and Chief Financial Officer, joined the Company in July 1996. Mr. Oppenheimer also served the Company in the position of Vice President and Corporate Controller, and as Senior Director of Finance for the Americas. Prior to joining the Company, Mr. Oppenheimer was CFO of one of the four business units for Automatic Data Processing, Inc. ("ADP"). Prior to joining ADP, Mr. Oppenheimer spent six years in the Information Technology Consulting Practice with Coopers and Lybrand.

Philip W. Schiller, Senior Vice President, Worldwide Product Marketing, rejoined the Company in 1997. Prior to rejoining the Company, Mr. Schiller was Vice President of Product Marketing at Macromedia, Inc. from December 1995 to March 1997, and was Director of Product Marketing at FirePower Systems, Inc. from 1993 to December 1995. Prior to that, Mr. Schiller spent six years at the Company in various marketing positions.

Bertrand Serlet, Ph.D., Senior Vice President, Software Engineering, joined the Company in February 1997 upon the Company's acquisition of NeXT and also served the Company in the position of Vice President of Platform Technology. At NeXT, Dr. Serlet held several engineering and managerial positions, including Director of Web Engineering. Prior to NeXT, from 1985 to 1989, Dr. Serlet worked as a research engineer at Xerox PARC.

Sina Tamaddon, Senior Vice President, Applications, joined the Company in September 1997. Mr. Tamaddon has also served with the Company in the position of Senior Vice President, Worldwide Service and Support, and Vice President and General Manager, Newton Group. Before joining the Company, Mr. Tamaddon held the position of Vice President, Europe with NeXT from September 1996 through March 1997. From August 1994 to August 1996, Mr. Tamaddon held the position of Vice President, Professional Services with NeXT.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires the Company's executive officers and directors, and persons who own more than ten percent of a registered class of the Company's equity securities, to file reports of securities ownership and changes in such ownership with the SEC. Executive officers, directors and greater than ten percent shareholders also are required by rules promulgated by the SEC to furnish the Company with copies of all Section 16(a) forms they file.

Based solely upon a review of the copies of such forms furnished to the Company or written representations that no Forms 5 were required, the Company believes that all Section 16(a) filing requirements were met during fiscal year 2007, except that (i) one Form 4 was filed for William Campbell on October 26, 2007 with respect to the purchase by Mr. Campbell's independent money manager of 3,600, 2,600 and 2,900 shares of the Company's common stock, in February 2006, September 2006 and January 2007, respectively, and the sale by Mr. Campbell's independent money manager of 2,200, 1,400 and 2,600 shares of the Company's common stock in April 2006, June 2006 and July 2007, respectively, and (ii) one Form 4 was filed for Tony Fadell on November 15, 2007 with respect to the acquisition by Mr. Fadell's spouse of 40,000 restricted stock units in December 2006 and 25,000 restricted stock units in October 2007.

Item 11. Executive Compensation

COMPENSATION DISCUSSION AND ANALYSIS

A. EXECUTIVE SUMMARY

This section explains Apple's executive compensation program as it relates to the following "named executive officers:"

Steve Jobs	Chief Executive Officer
Tim Cook	Chief Operating Officer
Peter Oppenheimer	Senior Vice President and Chief Financial Officer
Ron Johnson	Senior Vice President, Retail Sales
Tony Fadell	Senior Vice President, iPod Division

Apple's executive compensation program for the named executive officers consists of long-term equity awards in the form of restricted stock units ("RSUs") and cash compensation in the form of performance-based cash incentives and base salaries. Each year, the Compensation Committee, which is made up entirely of independent directors, determines the compensation for the named executive officers.

Apple relies heavily on long-term equity awards to attract and retain an outstanding executive team and to ensure a strong connection between executive compensation and financial performance. An RSU award gives the named executive officer the right to receive, at no cost, a specified number of shares of Apple common stock when the award vests, typically at intervals of two to four years. Because the value of the RSUs depends on Apple's future share price, the award links compensation to future financial performance. The officer is generally not eligible to receive the shares if employment is terminated before the RSUs vest. The Compensation Committee reviews annually the outstanding, unvested equity awards of each named executive officer to determine, in the Committee's discretion, whether additional awards are warranted in light of the officer's performance, the competitive environment and the other factors discussed in Section D3 below.

The performance-based cash incentives compensate the named executive officers for achieving specific financial goals established annually by the Compensation Committee, as described in Section D4. The Committee sets aggressive performance goals each year based on the revenue and operating income objectives in Apple's internal business plan. Payments are not automatic, however, because the Committee may exercise its discretion to reduce (but not increase) the amount of any incentive payment based on an officer's overall performance.

Based on the factors discussed in Section D3 below and the Committee's belief that the outstanding, unvested equity awards still had significant retention value, the Committee made no new equity awards to the named executive officers in fiscal 2007. The officers earned cash incentives in fiscal 2007 at the maximum amount allowed by the plan—100% of base salary—because Apple's financial performance significantly exceeded the annual performance goals set by the Committee. The Committee assessed both the amount and allocation of the compensation components for each officer based on Apple's overall annual financial performance and each officer's individual performance. The Committee did not increase base salaries for the named executive officers because it concluded that the total compensation for each officer was appropriate.

Apple's shareholders have been generously rewarded for Apple's success, with a three-year annualized shareholder return of 101% through the end of fiscal 2007. The Committee believes the compensation of the named executive officers has been appropriate and fair in light of Apple's performance.

B. EXECUTIVE COMPENSATION OBJECTIVES

Apple's goal for executive compensation is simple: attract and retain an exceptionally talented, entrepreneurial and creative team of executives who will provide the leadership for Apple's success in dynamic, highly-competitive markets.

C. EXECUTIVE COMPENSATION OVERVIEW

1. Three Components

The compensation program for the named executive officers consists of the following three components, in order of their importance:

- Long-term equity awards in the form of RSUs under the shareholder-approved Employee Stock Plan
- Annual performance-based cash incentives under the shareholder-approved Performance Bonus Plan (the CEO, however, does not participate in this plan and is not eligible for performance-based cash incentives)
- Base salary

The named executive officers are also eligible to participate in Apple's health and welfare programs, Employee Stock Purchase Plan, 401(k) Plan, patent bonus program and other minor employee recognition programs on the same basis as other employees.

2. Mix of Equity, Cash Incentives and Salary

Apple relies heavily on long-term equity awards because the Compensation Committee believes they are the most effective compensation element for attracting entrepreneurial, creative executives and promoting their long-term commitment to Apple. An RSU award generally vests only if the named executive officer continues employment until the specified vesting date, typically two to four years after the date of grant. Equity awards also help to ensure a strong connection between executive compensation and Apple's financial performance because the value of RSUs depends on Apple's future share price.

Although the Compensation Committee reviews the compensation practices of its peer companies as described in Section D6 below, the Committee does not adhere to strict formulas or survey data to determine the mix of compensation elements. Instead, as described in Section D, the Committee considers various factors in exercising its discretion to determine compensation, including the experience, responsibilities and performance of each named executive officer as well as Apple's overall financial performance. This flexibility is particularly important in designing compensation arrangements to attract new executives in highly-competitive, rapidly changing markets.

3. Elements of Compensation Not Included In The Compensation Program

The current compensation program for the named executive officers, including the CEO, does not include the following:

- Employment contracts

- Cash bonuses other than the performance-based cash incentives under the Performance Bonus Plan and payments under the patent bonus program
- Severance and change of control arrangements beyond what is available to all U.S. employees (with the exception of rights to accelerated vesting previously granted as part of equity awards that will fully vest in March 2008)
- Perquisites or personal benefits that are not available to employees generally
- Guarantees of the value of equity awards

4. CEO Compensation

Apple's CEO, Steve Jobs, currently holds approximately 5.5 million shares of Apple common stock. Since rejoining Apple in 1997, Mr. Jobs has never sold a share of Apple stock. His last equity grant was awarded in 2003, and vested in full in 2006. Mr. Jobs currently holds no unvested equity awards. In fiscal 2007, Mr. Jobs's entire compensation consisted of his $1 annual salary. Because Mr. Jobs's continued leadership is critical to Apple, the Compensation Committee is considering additional compensation arrangements for him.

Mr. Jobs has received a $1 annual salary since he rejoined Apple in 1997 and began serving as interim CEO. In 1999, Apple awarded Mr. Jobs an aircraft as an executive bonus in recognition of his outstanding performance during the previous two years. Mr. Jobs also received two stock option grants, one in 2000 and another in 2001. Mr. Jobs never exercised these grants, and they were both cancelled in March 2003, when Apple awarded Mr. Jobs a grant of 5 million shares of restricted stock.

The 2003 restricted stock grant required Mr. Jobs to remain employed by Apple for three more years before it vested. This grant, which increased to 10 million shares when Apple's common stock split in 2005, vested in full in March 2006. After a portion of these shares was withheld for the payment of taxes, Mr. Jobs received the remaining 5,426,447 shares. Due in large part to Mr. Jobs's leadership, Apple's stock price (after accounting for a stock split) increased from $7.47 on the March 2003 grant date to $64.66 on the March 2006 vesting date—more than an eight-fold increase in three years. Under Mr. Jobs's continued leadership, Apple's stock price increased from $64.66 per share in March 2006 to $189.95 per share as of October 31, 2007—a three-fold increase in approximately 18 months.

When he was elected to Apple's Board of Directors in 1997, Mr. Jobs received the standard director's stock option grant for 30,000 shares. Because Mr. Jobs became employed later that year as Apple's interim CEO, he was no longer eligible for such director grants. When the 1997 director grant (which increased to 120,000 shares after two stock splits) was due to expire in August 2007, Mr. Jobs exercised the option and he currently holds these 120,000 shares.

D. EXECUTIVE COMPENSATION PROGRAM DESIGN AND IMPLEMENTATION

1. Team-Based Compensation

The compensation program for the named executive officers rests on two assumptions. First, each officer must demonstrate exceptional personal performance in order to remain part of the executive team. Second, each officer must contribute as a member of the team to Apple's overall success rather than merely achieve specific objectives within that officer's area of responsibility.

2. Independent Compensation Committee Determines All Executive Compensation

The Compensation Committee determines all compensation for the named executive officers. All three Committee members are independent of Apple's management.

During the first quarter of each fiscal year, the Compensation Committee conducts an evaluation of each named executive officer to determine if any changes in the officer's compensation are appropriate based on the considerations described below. The CEO does not participate in the Committee's deliberations or decision with regard to his compensation. At the Committee's request, the CEO reviews with the Committee the performance of the other four named executive officers, but no other named executive officer has any input into executive compensation decisions. The Committee gives considerable weight to the CEO's evaluation of the other named executive officers because of his direct knowledge of each officer's performance and contributions. For each officer, the Committee members independently determine each component of compensation based on their collective assessment of the officer's performance as well as Apple's overall financial performance.

3. The Crucial Role of Long-Term Equity Awards

Overview. The Committee believes that long-term equity awards are the most effective way to attract and retain a superlative executive team. Accordingly, executive compensation is heavily weighted toward long-term equity awards rather than cash compensation, and the awards have long vesting intervals to maximize their retention value. This approach is reflected in the following:

- The CEO's compensation has been generally tied to long-term equity; for example, his last equity award did not vest for three years.
- For the other four named executive officers, equity awards represented approximately 85% of their target total compensation in fiscal 2007. This compares to approximately 70% at Apple's peer companies.
- Fiscal 2004 equity awards vested 50% on the second anniversary of the grant date; the remaining 50% will vest on the fourth anniversary of the grant date.
- Fiscal 2006 equity awards do not vest at all until 2010, when they vest in full.

In designing long-term equity awards, the Committee seeks to maximize their effectiveness in accomplishing Apple's compensation objectives while recognizing the Board's duty to Apple's shareholders to limit equity dilution. The Committee believes this balance has been achieved as follows:

Restricted Stock Units Minimize Dilution and Support Long-Term Focus. Since fiscal 2004, all equity awards to the named executive officers have been RSUs rather than stock options. A grant of RSUs gives an officer the right to receive a specified number of shares of Apple common stock, at no cost to the officer, if the officer remains employed at Apple until the RSUs vest. RSUs granted in 2004 also provide for accelerated vesting if the named executive officer is terminated without cause or on a change of control, RSUs granted before 2007 provide for accelerated vesting on a change of control, and all RSUs provide for accelerated vesting upon the death of the officer. The compensation value of an RSU does not depend solely on future stock price increases; at grant, its value is equal to Apple's stock price. Although its value may increase or decrease with changes in the stock price during the period before vesting, an RSU will have value in the long term, encouraging retention. By contrast, the entire compensation value of a stock option depends on future stock price appreciation. Accordingly, RSUs can deliver significantly greater share-for-share compensation value at grant than stock options, and Apple can offer comparable grant date compensation value with fewer shares and less dilution for its shareholders.

Long Vesting Intervals to Maximize Retention. All vesting of RSUs is generally subject to continued employment. Except for occasional new hire grants, vesting occurs at intervals of no less than two years after the grant date. This ensures that a meaningful portion of a named executive officer's awards will vest every two years—a strong incentive to continue employment with Apple. The following table shows the grant and vesting patterns for ongoing RSU grants for the named executive officers since fiscal 2004 (excluding those who were not named executive officers at the time of grant).

Equity Awards	FY05 vesting	FY06 vesting	FY07 vesting	FY08 vesting	FY09 vesting	FY10 vesting
Fiscal 2004 RSU (excluding CEO)	—	50%	—	50%		
Fiscal 2006 RSU (excluding CEO)	—	—	—	—	—	100%

Vesting Conditions. As noted above, the vesting of all RSUs is generally contingent on the named executive officer's continued employment with Apple, rather than on performance with regard to specific business objectives. From time to time, the Compensation Committee has considered various forms of performance-based vesting. After careful evaluation, the Committee has concluded that performance-based vesting would not serve Apple's current objectives as effectively as the program described above. The Committee generally grants RSUs with two to four year vesting periods to maximize the award's retention value. This retention value would be undermined if a named executive officer's equity awards (which represent approximately 85% of the officer's compensation) were at risk based on performance measures that were determined two or even four years prior to the vesting date. Given the intensely dynamic business environment in which Apple operates, it would be extremely difficult to craft meaningful objectives with such a long horizon. Apple imposes no requirement that the named executive officers hold their common stock for any period after vesting.

Annual Burn Rate Averages Less Than 2.5%. In fiscal 2005, Apple committed to an annual "burn rate" (the total number of all equity award shares granted during the fiscal year divided by the total shares outstanding at the end of the fiscal year) of 2.5% from fiscal 2005 through fiscal 2007. This commitment represented a significant reduction from an average burn rate of 4.8% from fiscal 2002 through fiscal 2004. In fact, Apple's average annual burn rate from fiscal 2005 through fiscal 2007 was approximately 1.6%.

Overhang from Equity Plans at 12.9%. Overhang (granted and outstanding equity awards plus shares reserved for future awards, divided by the sum of total shares outstanding, granted and outstanding equity awards, and shares reserved for future awards) is another measure of equity dilution. The efficient use of equity awards, combined with the substantial exercise of employee stock options due to the significant increase in Apple's stock price over the past few years, has caused Apple's overhang to decline from approximately 14.5% at the end of fiscal 2005 to approximately 12.9% at the end of fiscal 2007.

Frequency and Size of Equity Awards. The named executive officers typically receive equity awards every two years, rather than every year. This practice is consistent with the long time horizon and lengthy vesting periods of the awards. By making awards less frequently, the Committee can provide larger grants, which in turn promotes greater retention.

To determine the size of RSU grants, the Compensation Committee first establishes a target compensation value that it wants to deliver to the named executive officers through long-term equity awards. In doing so, the Committee considers various factors, including the following:

- The practice of granting equity only every two years
- The heavy weight placed on equity in the mix of total compensation

- The officer's experience and performance
- The scope, responsibility and business impact of the officer's position
- The perceived retention value of the total compensation package in light of the competitive environment

Once the target value has been established, the Committee determines the number of shares by reference to the current value of Apple's common stock.

4. *The Minor Role of Cash Compensation*

Base Salaries. The Committee believes that base salaries are significantly less important than performance-based bonuses and long-term equity awards in meeting Apple's compensation objectives. The minor role of salaries as part of total compensation is reflected in the following:

- The CEO has received an annual base salary of $1 since rejoining Apple in 1997.
- The fiscal 2007 average base salary for the other named executive officers was below median among the peer companies shown in Section D6, despite Apple's significantly greater financial and business success.
- Base salaries for the named executive officers have not increased since October 2005, except for a promotion-related increase for one officer.

Performance-Based Cash Incentives. The Performance Bonus Plan, which has been approved by Apple's shareholders, authorizes the Committee to issue plan-based cash incentive awards to compensate officers for achieving specific financial objectives that are established annually. The Committee believes that performance-based cash compensation is an important component of executive compensation; however, it represents a small percentage of total compensation because its effectiveness in meeting Apple's compensation objectives is limited. It is a less significant factor in attracting new executive talent than equity compensation, and it promotes retention only in the short-term—over the performance period. Accordingly, the plan is modestly funded, as reflected by the following:

- The CEO does not participate in the Performance Bonus Plan.
- Apple's target payout of 50% of base salary is significantly lower than peer companies as a group, where median target bonus payouts range from 100% to 160% of base salary.
- The maximum payout of 100% for exceptional performance is also lower than peer companies, where 3 times the target range (i.e., 300% to 480% of base salary) is becoming increasingly common.

The Compensation Committee establishes performance goals each year based on revenue and operating income objectives in Apple's internal business plan. The Committee has selected these performance goals because they are important indicators of increased shareholder value. These performance goals generally exclude the effects of extraordinary, unusual or infrequently occurring events or changes in accounting principles. Apple does not publicly disclose specific annual internal revenue or operating income objectives, as its business plan is highly confidential. Disclosing specific objectives would provide competitors and other third parties with insights into the planning process and would therefore cause competitive harm.

The Committee next determines the maximum amount of any cash incentive payment denominated as a percentage of base salary. The current payment structure is shown in the payout matrix below. Once the performance goals and payment structure are established, no one has the authority to modify or waive them.

Percentage of Salary Payable As Performance-Based Cash Incentives

Operating Income	Revenue: Below Objective	Revenue: Meet Objective	Revenue: Above Objective
Below Objective	0%	25%	up to 50%
Meet Objective	25%	50%	up to 75%
Above Objective	up to 50%	up to 75%	up to 100%

The performance goals are aggressive. Thus, there is considerable risk that payments will not be made at all or will be made at less than 100%. For the past three years, the performance goals have reflected double-digit growth in both revenue and operating income. In four of the past eight years, Apple did not meet one or both performance goals. This uncertainty ensures that any payments under the plan are truly performance-based, consistent with the plan's objectives.

At the end of the year, the Committee determines the amount of the award to be paid to each officer by comparing actual results to the performance goals. The Committee may, in its discretion, reduce (but not increase) the amount of any individual award based on the officer's overall performance. The plan does not provide for the adjustment or recovery of an award paid to a named executive officer if the results in a previous year are subsequently restated or adjusted in a manner that would have originally resulted in a smaller award.

5. *The Role of Consultants*

The Compensation Committee has selected and directly retained the services of Frederic W. Cook & Co., Inc., an executive compensation consulting firm. No member of the Compensation Committee or any named executive officer has any affiliation with F.W. Cook. The Committee periodically seeks input from F.W. Cook on a range of external market factors, including evolving compensation trends, appropriate comparison companies and market survey data. F.W. Cook also provides general observations on Apple's compensation programs, but it does not determine or recommend the amount or form of compensation for any executives.

6. *The Role of Peer Groups, Surveys and Benchmarking*

With the assistance of F.W. Cook, the Committee identified peer companies for fiscal 2007 that compete with Apple in the labor and capital markets and that follow similar pay models. The Committee established the two peer groups listed below, one consisting of large technology companies and another consisting of large retailers. The retail peer group is a relevant comparison group for the Senior Vice President, Retail Sales; the technology peer group is relevant for the other four named executive officers.

Technology Companies		Retail Companies
Adobe Systems	IBM	The Gymboree Corporation
Amazon.com	Intel	Limited Brands
Applied Materials	Microsoft	Nike
Cisco Systems	Motorola	Polo Ralph Lauren
Comcast	Oracle	Restoration Hardware
Dell	Qualcomm	Sharper Image
eBay	Sprint Nextel	Target
EMC	Sun Microsystems	Tiffany & Co.
Google	Texas Instruments	Tween Brands
Hewlett-Packard	Xerox	Wal-Mart

The Committee reviews compensation practices at peer companies (gathered from SEC filings and the Radford High Technology compensation survey) at a high level to ensure that Apple's total compensation is within a reasonably competitive range. The Committee, however, does not attempt to set compensation components to meet specific benchmarks, such as salaries "above the median" or equity compensation "at the 75th percentile." Furthermore, the Committee believes that excessive reliance on benchmarking is detrimental to shareholder interests because it can result in compensation that is unrelated to the value delivered by the named executive officers.

7. *Tax and Accounting Considerations*

Tax Deductibility of Compensation Expense. Section 162(m) of the Internal Revenue Code places a limit of $1,000,000 on the amount of compensation to certain officers that may be deducted by Apple as a business expense in any tax year unless, among other things, the compensation is performance-based and has been approved by the shareholders. To qualify as performance-based compensation, the amount of compensation must depend on the officer's performance against pre-determined performance goals established by a committee that consists solely of at least two "outside" directors who have never been employed by Apple or its subsidiaries. Two Compensation Committee members, Mr. Gore and Mr. Drexler, qualify as outside directors under the IRS definition. Although Mr. Campbell is an independent director under SEC and NASDAQ governance standards, he does not qualify as an outside director because he was an officer of Apple from 1983 to 1987 and an Apple subsidiary from 1987 to 1991. For this reason, he does not discuss or vote on any Section 162(m)-related matters.

Salaries for the named executive officers do not qualify as performance-based compensation. Apple's performance-based cash incentives, however, are exempt from the Section 162(m) limit because they are paid based on predetermined goals established by the Compensation Committee pursuant to the shareholder-approved Performance Bonus Plan. The RSUs do not qualify as performance-based compensation for purposes of Section 162(m) because vesting is based on continued employment rather than specific performance goals. See page 103 for an explanation of Apple's decision not to implement performance-based vesting.

Tax Implications for Officers. Section 409A of the Internal Revenue Code imposes additional income taxes on executive officers for certain types of deferred compensation that do not comply with Section 409A. Because Apple does not generally provide deferred compensation to the named executive officers, this limitation has no impact on the structure of the compensation program for the officers. Section 280G of the Internal Revenue Code imposes an excise tax on payments to executives of severance or change of control compensation that exceed the levels specified in Section 280G. The named executive officers could receive the amounts shown on the table on page 113 as severance or change of control payments, but the Committee does not consider their potential impact in compensation program design.

Accounting Considerations. The Committee also considers the accounting and cash flow implications of various forms of executive compensation. In its financial statements, Apple records salaries and performance-based compensation incentives as expenses in the amount paid, or to be paid, to the named executive officers. Accounting rules also require Apple to record an expense in its financial statements for equity awards, even though equity awards are not paid as cash to employees. The accounting expense of equity awards to employees is calculated in accordance with SFAS 123R. The Committee believes, however, that the many advantages of equity compensation, as discussed above, more than compensate for the non-cash accounting expense associated with them.

E. Fiscal 2007 Compensation Decisions

1. No Equity Grants or Salary Changes

In fiscal 2007, the Committee did not grant new equity awards or increase base salaries for the named executive officers. Based on its assessment of the factors discussed above and the Committee's belief that the outstanding, unvested equity grants at the beginning of fiscal 2007 had significant retention value, the Committee concluded that the compensation packages for the named executive officers were reasonable without additional equity awards. The outstanding equity grants at the end of fiscal 2007 are shown on the Outstanding Equity Awards table on pages 110 and 111. Based on a review of competitive practices and the Committee's approach to place less emphasis on cash compensation, the Committee concluded that the total compensation for the officers were appropriate for fiscal 2007 without a salary increase.

2. 2007 Performance-Based Cash Incentive Plan Payments

Apple's fiscal 2007 performance significantly exceeded the revenue and operating income goals established under the cash incentive plan, so the Committee, in the exercise of its discretion, approved payouts to the named executive officers at the maximum of 100% of base salary, pursuant to the payout matrix on page 105. The specific payment amounts are shown in the Summary Compensation Table at page 108.

Compensation Committee Report(1)

The Compensation Committee has certain duties and powers as described in its charter. The Compensation Committee is currently composed of the three non-employee directors named at the end of this report, each of whom is independent as defined by the NASDAQ listing standards.

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(1) SEC filings sometimes "incorporate information by reference." This means the Company is referring to information that has previously been filed with the SEC, and that this information should be considered as part of this filing. Unless the Company specifically states otherwise, this report shall not be deemed to be incorporated by reference and shall not constitute soliciting material or otherwise be considered filed under the Securities Act or the Securities Exchange Act.

The Compensation Committee has reviewed and discussed with management the disclosures contained in the Compensation Discussion and Analysis section of this Form 10-K. Based upon this review and discussion, the Compensation Committee recommended to the Board of Directors that the Compensation Discussion and Analysis section be included in this Form 10-K and the Company's Proxy Statement for its 2008 Annual Meeting of Shareholders, to be filed with the SEC.

Compensation Committee of the Board of Directors
William V. Campbell (Chairman)
Millard S. Drexler
Albert A. Gore, Jr.

Summary Compensation Table

The following table presents information regarding compensation of each of the Company's Named Executive Officers for services rendered during fiscal year 2007.

Name and Principal Position (a)	Year (b)	Salary ($) (c)	Bonus ($) (d)	Stock Awards ($)(1) (e)	Option Awards ($)(1) (f)	Non-Equity Incentive Plan Compensation ($)(2) (g)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($) (h)	All Other Compensation ($) (i)	Total ($) (j)
Steven P. Jobs Chief Executive Officer	2007	1	—	—	—	—	—	—	1
Timothy D. Cook Chief Operating Officer	2007	700,014	—	6,943,426	—	700,000	—	13,750(3)	8,357,190
Peter Oppenheimer Senior Vice President and Chief Financial Officer	2007	600,012	—	4,946,610	—	600,000	—	598,723(4)	6,745,345
Ronald B. Johnson Senior Vice President, Retail	2007	600,012	—	4,946,610	—	600,000	—	379(5)	6,147,001
Tony Fadell Senior Vice President, iPod Division	2007	500,009	6,750(6)	3,705,832	628,628	500,000	—	13,952(7)	5,355,171

(1) The amounts reported in Columns (e) and (f) of the table above reflect the aggregate dollar amounts recognized for stock awards and option awards, respectively, for financial statement reporting purposes with respect to fiscal year 2007 (disregarding any estimate of forfeitures related to service-based vesting conditions). No stock awards or option awards granted to Named Executive Officers were forfeited during fiscal year 2007. Detailed information about the amount recognized for specific awards is reported in the table under "Outstanding Equity Awards at Fiscal Year-End" below. For a discussion of the assumptions and methodologies used to value the awards reported in Column (e) and Column (f), please see the discussion of stock awards and option awards contained in Part II, Item 8, "Financial Statements and Supplementary Data" of this Form 10-K in Notes to Consolidated Financial Statements at Note 7, "Stock-Based Compensation."

(2) As described in the "Compensation Discussion and Analysis" above, the Named Executive Officers' annual bonuses are derived based on the performance of the Company and the individual executive relative to pre-established objectives for the fiscal year. The target and maximum amounts for each Named Executive Officer's fiscal year 2007 bonus opportunity are reported in the "Grants of Plan-Based Awards" table below.

(3) This amount represents the Company's contributions to Mr. Cook's account under its 401(k) plan in the amount of $13,500 and a tax gross-up in the amount of $250 for an iPhone given by the Company to each of its employees, including the Named Executive Officers, other than Mr. Jobs.

(4) This amount represents (i) the Company's contributions to Mr. Oppenheimer's account under its 401(k) plan in the amount of $13,500; (ii) a tax gross-up in the amount of $250 for an iPhone given by the Company to each of its employees, including the Named Executive Officers, other than Mr. Jobs; and (iii) reimbursement by the Company of $584,973 for payment of a tax liability under Internal Revenue Code Section 409A.

(5) This amount represents a tax gross-up in the amount of $379 for an iPhone given by the Company to each of its employees, including the Named Executive Officers, other than Mr. Jobs.

(6) This amount represents a patent award paid by the Company to Mr. Fadell.

(7) This amount represents (i) the Company's contributions to Mr. Fadell's account under its 401(k) plan in the amount of $13,500; and (ii) a tax gross-up in the amount of $379 for an iPhone given by the Company to each of its employees, including the Named Executive Officers, other than Mr. Jobs; and (iii) a tax gross-up in the amount of $73 for an iPod given to him by the Company.

Compensation of Named Executive Officers

The Summary Compensation Table above quantifies the value of the different forms of compensation earned by or awarded to the Named Executive Officers in fiscal year 2007. The primary elements of each

Named Executive Officer's total compensation reported in the table are base salary, an annual bonus, and long-term equity incentives consisting of restricted stock units and, in the case of Mr. Fadell, a patent award and stock options received prior to his appointment as an executive of the Company. Named Executive Officers also earned the other benefits listed in Column (i) of the Summary Compensation Table, as further described in footnotes 3, 4, 5 and 7 to the table. As noted above, the Company does not have employment agreements with any of the Named Executive Officers.

The Summary Compensation Table should be read in conjunction with the tables and narrative descriptions that follow. The Grants of Plan-Based Awards table, and the accompanying description of the material terms of the stock options and restricted stock unit awards granted in fiscal year 2007, provides information regarding the long-term equity incentives awarded to Named Executive Officers in fiscal year 2007. The Outstanding Equity Awards at Fiscal Year End and Option Exercises and Stock Vested tables provide further information on the Named Executive Officers' potential realizable value and actual value realized with respect to their equity awards.

Grants of Plan-Based Awards

The following table presents information regarding the incentive awards granted to the Named Executive Officers for fiscal year 2007.

		Estimated Future Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards						
Name (a)	Grant Date (b)	Threshold ($) (c)	Target ($) (d)	Maximum ($) (e)	Threshold (#) (f)	Target (#) (g)	Maximum (#) (h)	All Other Stock Awards: Number of Shares of Stock or Units (#) (i)	All Other Option Awards: Number of Securities Underlying Options (#) (j)	Exercise or Base Price of Option Awards ($/Sh) (k)	Grant Date Fair Value of Stock and Option Awards ($) (l)
Steven P. Jobs	—	—	—	—	—	—	—	—	—	—	—
Timothy D. Cook	—	0	350,000	700,000	—	—	—	—	—	—	—
Peter Oppenheimer	—	0	300,000	600,000	—	—	—	—	—	—	—
Ronald B. Johnson	—	0	300,000	600,000	—	—	—	—	—	—	—
Tony Fadell	—	0	250,000	500,000	—	—	—	—	—	—	—

Description of Plan-Based Awards

Each of the "Non-Equity Incentive Plan Awards" reported in the Grants of Plan-Based Awards Table was granted under the Company's Performance Bonus Plan. The material terms of these incentive awards are described in the "Compensation Discussion and Analysis" above. As noted earlier, the Company did not grant equity incentive plan awards to any of its Named Executive Officers during fiscal year 2007.

Outstanding Equity Awards at Fiscal Year-End

The following table presents information regarding the outstanding equity awards held by each of the Named Executive Officers as of September 29, 2007, including the vesting dates for the portions of these awards that had not vested as of that date.

Option Awards

Name (a)	Option Grant Date (b)	Number of Securities Underlying Unexercised Options Exercisable (#) (c)	Number of Securities Underlying Unexercised Options Unexercisable (#) (d)	Option Exercise Price ($) (e)	Option Expiration Date (f)
Steven P. Jobs	—	—	—	—	—
Totals		—	—		
Timothy D. Cook	—	—	—	—	—
Totals		—	—		
Peter Oppenheimer	—	—	—	—	—
Totals		—	—		
Ronald B. Johnson	2/14/1999	1,150,000	—	23.72	2/14/2009
	5/21/2002	150,000	—	11.73	5/21/2012
Totals		1,300,000	—		
Tony Fadell	2/4/2004	19,312	12,875(1)	10.90	2/4/2011
	6/1/2004	115,250	56,250(2)	14.03	6/1/2011
	8/30/2005	24,875	25,000(3)	46.57	8/30/2012
Totals		159,437	94,125		

(1) The unvested portion of this option award is scheduled to vest in two (2) substantially equal installments on November 4, 2007 and February 4, 2008.

(2) The unvested portion of this option award is scheduled to vest in three (3) substantially equal installments on December 1, 2007, March 1, 2008 and June 1, 2008.

(3) The unvested portion of this option award is scheduled to vest in eight (8) substantially equal installments on November 30, 2007 and each successive three (3) month anniversary of November 30, 2007.

Stock Awards

Name (a)	Award Grant Date (g)	Number of Shares or Units of Stock That Have Not Vested (#) (h)	Market Value of Shares or Units of Stock That Have Not Vested ($)(1) (i)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#) (j)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($) (k)
Steven P. Jobs	—	—	—	—	—
Totals		—	—		
Timothy D. Cook	3/24/2004	300,000(2)	46,041,000	—	—
	12/14/2005	300,000(3)	46,041,000	—	—
Totals		600,000	92,082,000	—	—
Peter Oppenheimer	3/24/2004	250,000(2)	38,367,500	—	—
	12/14/2005	200,000(3)	30,694,000	—	—
Totals		450,000	69,061,500	—	—
Ronald B. Johnson	3/24/2004	250,000(2)	38,367,500	—	—
	12/14/2005	200,000(3)	30,694,000	—	—
Totals		450,000	69,061,500	—	—
Tony Fadell	8/30/2005	10,000(4)	1,534,700	—	—
	2/2/2006	200,000(5)	30,694,000	—	—
Totals		210,000	32,228,700	—	—

(1) The dollar amounts shown in Column (i) are determined by multiplying (x) the number of shares or units reported in Column (h) by (y) $153.47 (the closing price of the Company's common stock on September 28, 2007, the last trading day of fiscal year 2007).

(2) The unvested portion of this restricted stock unit award is scheduled to vest in its entirety on March 24, 2008.

(3) The unvested portion of this restricted stock unit award is scheduled to vest in its entirety on March 24, 2010.

(4) The unvested portion of this restricted stock unit award is scheduled to vest in two (2) substantially equal installments on August 30, 2008 and August 30, 2009.

(5) The unvested portion of this restricted stock unit award is scheduled to vest in two (2) substantially equal installments on March 24, 2008 and March 24, 2010.

Option Exercises and Stock Vested

The following table presents information regarding the exercise of stock options by Named Executive Officers during fiscal year 2007, and on the vesting during fiscal year 2007 of other stock awards previously granted to the Named Executive Officers.

	Option Awards		Stock Awards	
Name (a)	Number of Shares Acquired on Exercise (#) (b)	Value Realized on Exercise ($)(1) (c)	Number of Shares Acquired on Vesting (#) (d)	Value Realized on Vesting ($)(1) (e)
Steven P. Jobs	120,000(2)	14,644,800	—	—
Timothy D. Cook	—	—	—	—
Peter Oppenheimer	—	—	—	—
Ronald B. Johnson	600,000	36,614,020	—	—
Tony Fadell	83,313	5,946,344	5,000	681,250

(1) The dollar amounts shown in Column (c) above for option awards are determined by multiplying (i) the number of shares of the Company's common stock to which the exercise of the option related, by (ii) the difference between the per-share closing price of the Company's common stock on the date of exercise and the exercise price of the options. The dollar amounts shown in Column (e) above for stock awards are determined by multiplying the number of shares or units, as applicable, that vested by the per-share closing price of the Company's common stock on the vesting date.

(2) These shares were acquired by Mr. Jobs on August 13, 2007 through an exercise of stock options granted to him under the 1997 Director Stock Option Plan that were to expire on August 14, 2007. Mr. Jobs has not sold any of the shares acquired in that exercise.

Potential Payments Upon Termination or Change in Control

As noted above, the Company does not have employment agreements with any of its Named Executive Officers, nor does the Company maintain any other plans or arrangements that provide for any Named Executive Officer to receive cash severance or other cash payments in connection with a termination of their employment with the Company and/or a change in control of the Company.

Effective for grants made after April 9, 2007, the Company's 2003 Employee Stock Plan (the "2003 Plan") was amended to eliminate accelerated vesting of outstanding awards in connection with a change in control of the Company. With respect to awards granted under the 2003 Plan prior to that date, such awards, to the extent then outstanding and unvested, will generally become fully vested and, in the case of options, exercisable upon a change in control of the Company, unless the Compensation Committee provides for the substitution, assumption, exchange or other continuation of such awards. Any options that become vested in connection with a change in control generally must be exercised prior to the change in control, or they will be canceled in exchange for the right to receive a cash payment in connection with the change in control transaction.

The award agreements evidencing certain grants of restricted stock units to the Company's Named Executive Officers prior to January 1, 2005 generally provide that if, in connection with a change in control of the Company, the executive's employment is terminated by the Company without cause or by the executive for good reason (as those terms are defined in the applicable award agreement), the restricted stock units that are then outstanding and unvested will vest in full.

The following table lists the Named Executive Officers and the estimated amounts they would have become entitled to under the terms of stock option and restricted stock unit awards granted to them under the 2003 Plan prior to April 9, 2007 had a change of control of the Company occurred on September 29, 2007, unless the Compensation Committee had provided for the substitution, assumption, exchange or other continuation of such awards.

Name (a)	Estimated Total Value of Equity Acceleration ($) (b)
Steven P. Jobs	—
Timothy D. Cook	92,082,000
Peter Oppenheimer	69,061,500
Ronald B. Johnson	69,061,500
Tony Fadell	44,580,353

Director Compensation

The following table presents information regarding the compensation paid during fiscal year 2007 to members of the Company's Board of Directors who are not also employees (the "Non-Employee Directors"). The compensation paid to Mr. Jobs, the Company's Chief Executive Officer, is presented above in the Summary Compensation Table and the related explanatory tables.

Name (a)	Fees Earned or Paid in Cash ($) (b)	Stock Awards ($)(1)(2)(3) (c)	Option Awards ($)(1)(2)(3) (d)	Non-Equity Incentive Plan Compensation ($) (e)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($) (f)	All Other Compensation ($)(4) (g)	Total ($) (h)
William V. Campbell	50,000	—	476,200	—	—	4,783	530,983
Millard S. Drexler	50,000	—	378,400	—	—	7,462	435,862
Albert A. Gore, Jr.	50,000	—	300,300	—	—	15,245	365,545
Arthur D. Levinson, Ph.D.	50,000	—	448,000	—	—	7,592	505,592
Eric E. Schmidt, Ph.D.	—	—	—	—	—	—	—
Jerome B. York	50,000	—	476,200	—	—	4,724	530,924

(1) The amounts reported in Columns (c) and (d) of the table above reflect the aggregate dollar amounts recognized for stock awards and option awards, respectively, for financial statement reporting purposes with respect to fiscal year 2007 (disregarding any estimate of forfeitures related to service-based vesting conditions). For a discussion of the assumptions and methodologies used to calculate the amounts referred to above, please see the discussion of stock awards and option awards contained in Part II, Item 8, "Financial Statements and Supplementary Data" of this Form 10-K in Notes to Consolidated Financial Statements at Note 7, "Stock-Based Compensation."

(2) The following table presents the number of outstanding and unexercised option awards and the number of unvested stock awards held by each of the Non-Employee Directors as of September 29, 2007.

Director	Number of Shares Subject to Outstanding Options as of 9/29/07	Number of Unvested Shares of Restricted Stock as of 9/29/07
William V. Campbell	110,000	—
Millard S. Drexler	190,000	—
Albert A. Gore, Jr.	70,000	—
Arthur D. Levinson, Ph.D.	110,000	—
Eric E. Schmidt, Ph.D.	—	—
Jerome B. York	50,000	—

(3) As described below, the Company granted each of its Non-Employee Directors (other than Dr. Schmidt) an option to purchase 10,000 shares of the Company's common stock during fiscal year 2007. These grants were made on the anniversary of the director's initial election or appointment to the Board of Directors and had the following fair values on the applicable grant date: Mr. Campbell, $476,200; Mr. Drexler, $378,400; Mr. Gore, $300,300; Dr. Levinson, $448,000; and Mr. York, $476,200. See footnote (1) for the assumptions used to value these awards.

(4) The amount reported in column (g) above consists solely of one or more of a limited number of free computer systems and/or additional equipment pursuant to the Board of Directors Equipment Program.

Compensation of Directors

The form and amount of director compensation are determined by the Board after a review of recommendations made by the Nominating Committee. The current practice of the Board is to base a substantial portion of a director's annual retainer on equity. Under the Company's 1997 Director Stock Option Plan (the "Director Plan"), the Company's Non-Employee Directors are granted an option to acquire 30,000 shares of the Company's common stock upon their initial election to the Board (an "Initial Option"). Initial Options vest and become exercisable in equal installments on each of the first three anniversaries of the grant date. On the fourth anniversary of a Non-Employee Director's initial election to the Board and on each subsequent anniversary thereafter, the director is granted an option to acquire 10,000 shares of the Company's common stock (an "Annual Option"). Annual Options are fully vested and immediately exercisable on the date of grant.

Upon his initial appointment to the Board on August 29, 2006, Dr. Schmidt declined the annual retainer fee and the automatic stock option grant to purchase 30,000 shares to which new directors are entitled under the Director Plan. Instead, Dr. Schmidt purchased 10,000 shares of the Company's common stock on the open market.

Non-Employee directors also receive a $50,000 annual retainer paid in quarterly installments. Beginning in the 2008 fiscal year, the chairperson of the Audit and Finance Committee will also be entitled to an annual retainer of $25,000, in addition to the annual retainer paid to all non-employee directors. Directors do not receive any additional consideration for serving as a member or chairperson of any other committee. In addition, directors receive up to two free computer systems per year and are eligible to purchase additional equipment at a discount.

Compensation Committee Interlocks and Insider Participation

The Compensation Committee members whose names appear on the Compensation Committee Report above were committee members during all of fiscal year 2007. Mr. Campbell formerly served as an officer of the Company and of FileMaker, Inc., a subsidiary of the Company. No other member of the Compensation Committee is or has been a former or current executive officer of the Company, and no member of the Compensation Committee had any relationships requiring disclosure by the Company under the SEC's rules requiring disclosure of certain relationships and related-party transactions. None of the Company's executive officers served as a director or a member of a compensation committee (or other committee serving an equivalent function) of any other entity, the executive officers of which served as a director or member of the Compensation Committee during the fiscal year ended September 29, 2007.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Equity Compensation Plan Information

The following table sets forth certain information, as of September 29, 2007, concerning shares of common stock authorized for issuance under all of the Company's equity compensation plans.

	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a)	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)
Equity compensation plans approved by shareholders	37,597,439	$ 54.75	74,851,763(1)
Equity compensation plans not approved by shareholders	12,153,315	$ 10.38	—
Total equity compensation plans (2)	49,750,754	$ 43.91	74,851,763

(1) This number includes 7,025,104 shares of common stock reserved for issuance under the Employee Stock Purchase Plan, 370,000 shares available for issuance under the 1997 Director Stock Option Plan, and 67,456,659 shares available for issuance under the 2003 Employee Stock Plan. The grant of 4,675,000 restricted stock units has been deducted from the number of shares available for future issuance. Shares of restricted stock and restricted stock units granted after April 2005 count against the shares available for grant as two shares for every share granted. This number excludes shares under the 1990 Stock Option Plan that was terminated in 1997. No new options can be granted under the 1990 Stock Option Plan.

(2) This table does not include 350 shares of common stock underlying options assumed in connection with a prior acquisition of a company that originally granted those options. These assumed options have a weighted average exercise price of $3.42 per share. No additional options may be granted under the assumed plan.

Security Ownership of Certain Beneficial Owners

The following table sets forth certain information as of September 29, 2007 (the "Table Date") with respect to the beneficial ownership of the Company's common stock by (i) each person the Company believes beneficially holds more than 5% of the outstanding shares of common stock; (ii) each director; (iii) each Named Executive Officer listed in the Summary Compensation Table under the heading **"Information Regarding Executive Compensation;"** and (iv) all directors and executive officers as a group. On the Table Date, 872,328,972 shares of the Company's common stock were issued and outstanding. Unless otherwise indicated, all persons named as beneficial owners of the Company's common stock have sole voting power and sole investment power with respect to the shares indicated as beneficially owned. In addition, unless otherwise indicated, all persons named below can be reached at Apple Inc., 1 Infinite Loop, Cupertino, California 95014.

Security Ownership of 5% Holders, Directors, Nominees and Executive Officers

Name of Beneficial Owner	Shares of Common Stock Beneficially Owned(1)	Percent of Common Stock Outstanding
Fidelity Investments	56,583,870 (2)	6.49%
Steven P. Jobs	5,546,451	*
William V. Campbell	112,900 (3)	*
Timothy D. Cook	13,327 (4)	*
Millard S. Drexler	230,000 (5)	*
Tony Fadell	288,702 (6)	*
Albert A. Gore, Jr.	70,000 (7)	*
Ronald B. Johnson	1,450,620 (8)	*
Arthur D. Levinson	365,015 (9)	*
Peter Oppenheimer	14,873 (10)	*
Eric E. Schmidt	12,284 (11)	*
Jerome B. York	90,000 (12)	*
All current executive officers and directors as a group (14 persons)	8,352,396 (13)	1.00%

(1) Represents shares of the Company's common stock held and options held by such individuals that were exercisable at the Table Date or within 60 days thereafter. This does not include options or restricted stock units that vest more than 60 days after the Table Date.

(2) Based on a Form 13G/A filed February 14, 2007 by FMR Corp. FMR Corp. lists its address as 82 Devonshire Street, Boston, MA 02109, in such filing.

(3) Includes 110,000 shares of the Company's common stock that Mr. Campbell has the right to acquire by exercise of stock options.

(4) Excludes 600,000 unvested restricted stock units.

(5) Includes 40,000 shares of the Company's common stock that Mr. Drexler holds indirectly and 190,000 shares of the Company's common stock that Mr. Drexler has the right to acquire by exercise of stock options.

(6) Includes 275 shares of the Company's common stock that Mr. Fadell holds indirectly, 165,875 shares of the Company's common stock that Mr. Fadell has the right to acquire by exercise of stock options within 60 days after the Table Date, 1,157 shares of the Company's common stock held by Mr. Fadell's spouse, and 117,375 shares of the Company's common stock that Mr. Fadell's spouse has the right to acquire by exercise of stock options within 60 days after the Table Date. Excludes 210,000 unvested restricted stock units held by Mr. Fadell and 40,000 unvested restricted stock units held by Mr. Fadell's spouse.

(7) Consists of 70,000 shares of the Company's common stock that Mr. Gore has the right to acquire by exercise of stock options.

(8) Includes 1,300,000 shares of the Company's common stock that Mr. Johnson has the right to acquire by exercise of stock options and excludes 450,000 unvested restricted stock units.

(9) Includes 2,000 shares of the Company's common stock held by Dr. Levinson's spouse and 110,000 shares of the Company's common stock that Dr. Levinson has the right to acquire by exercise of stock options.

(10) Excludes 450,000 unvested restricted stock units.

(11) Consists of 12,284 shares of the Company's common stock that Dr. Schmidt holds indirectly. Dr. Schmidt has declined to participate in the 1997 Director Stock Option Plan.

(12) Includes 40,000 shares of the Company's common stock that Mr. York holds jointly with his spouse and 50,000 shares of the Company's common stock that Mr. York has the right to acquire by exercise of stock options.

(13) Includes 2,146,546 shares of the Company's common stock that executive officers or directors have the right to acquire by exercise of stock options and excludes 2,950,000 unvested restricted stock units.

* Represents less than 1% of the issued and outstanding shares of the Company's common stock on the Table Date.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Review, Approval or Ratification of Transactions with Related Persons

The Board of Directors has adopted a written policy for approval of transactions between the Company and its directors, director nominees, executive officers, greater than five percent beneficial owners and their respective immediate family members, where the amount involved in the transaction exceeds or is expected to exceed $120,000 in a single calendar year. A copy of this policy is available on the Company's website at www.apple.com/investor.

The policy provides that the Audit Committee reviews certain transactions subject to the policy and determines whether or not to approve or ratify those transactions. In doing so, the Audit Committee takes into account, among other factors it deems appropriate:

- the related person's interest in the transaction;
- the approximate dollar value of the amount involved in the transaction;
- the approximate dollar value of the amount of the related person's interest in the transaction without regard to the amount of any profit or loss;
- whether the transaction was undertaken in the ordinary course of business of the Company;
- whether the transaction with the related person is proposed to be, or was, entered into on terms no less favorable to the Company than terms that could have been reached with an unrelated third party;
- the purpose of, and the potential benefits to the Company of, the transaction; and
- any other information regarding the transaction or the related person in the context of the proposed transaction that would be material to investors in light of the circumstances of the particular transaction.

In addition, the Audit Committee has delegated authority to the Chair of the Audit Committee to pre-approve or ratify certain transactions. A summary of any new transactions pre-approved or ratified by the Chair is provided to the full Audit Committee for its review in connection with its next scheduled Audit Committee meeting.

The Audit Committee has considered and adopted standing pre-approvals under the policy for limited transactions with related persons. Pre-approved transactions include:

- employment of executive officers, subject to certain conditions;
- any compensation paid to a director if the compensation is required to be reported in the Company's proxy statement under Item 402 of Regulation S-K promulgated by the SEC;

- any transaction with another company at which a related person's only relationship is as an employee (other than an executive officer or director) or beneficial owner of less than ten percent of that company's equity, if the aggregate amount involved does not exceed the greater of $1,000,000, or two percent of that company's total annual revenue;

- any charitable contribution, grant or endowment by the Company to a charitable organization, foundation or university at which a related person's only relationship is as an employee (other than an executive officer or director), if the aggregate amount involved does not exceed the lesser of $1,000,000, or two percent of the charitable organization's total annual receipts; and

- any transaction where the related person's interest arises solely from the ownership of the Company's common stock and all holders of the Company's common stock received the same benefit on a pro rata basis, such as dividends.

A summary of new transactions covered by the standing pre-approvals described above is provided to the Audit Committee for its review at each regularly scheduled Audit Committee meeting. The related person transactions described below were approved by the Board of Directors before this policy was adopted.

Transactions with Related Persons

- The Company entered into a Reimbursement Agreement with its CEO, Steve Jobs, for the reimbursement of expenses incurred by Mr. Jobs in the operation of his private plane when used for Apple business. The Company recognized a total of $776,000, $202,000, and $1,100,000 in expenses pursuant to the Reimbursement Agreement during 2007, 2006, and 2005, respectively.

- The Company enters into commercial dealings with The Walt Disney Company, Genentech and Google that it considers arms-length, including sales arrangements and, in the case of Google, licensing agreements and similar arrangements and, in the case of The Walt Disney Company, iTunes Store content licensing agreements and similar agreements. The Company enters into these commercial dealings in the ordinary course of its business. Mr. Jobs is a Director of The Walt Disney Company. Dr. Levinson is the Chief Executive Officer and a Director of Genentech. Dr. Schmidt is the Chief Executive Officer and a Director of Google and Mr. Gore is a Senior Advisor to Google. The Company does not believe that any of Messrs. Jobs or Gore or Drs. Levinson or Schmidt has a material direct or indirect interest in any of such commercial dealings.

  The Board has determined all Board members, excluding Steve Jobs, are independent under the applicable NASDAQ rules. The Board has also determined the members of each committee of the Board are independent under the listing standards of the NASDAQ Global Select Market. In making these determinations, the Board considered, among other things, the types and amounts of the commercial dealings between the Company and the companies and organizations with which the directors are affiliated.

- Tony Fadell's spouse is the Vice President, Human Resources of the Company. She earned $318,467 in salary and $218,750 in bonus during fiscal year 2007 and participates in the Company's equity award and benefit programs. Her compensation is commensurate with that of her peers.

Director Independence

The Board has determined all Board members, excluding Steve Jobs, are independent under the applicable NASDAQ rules. The Board has also determined the members of each committee of the Board are independent under the listing standards of the NASDAQ Global Select Market. In making these determinations, the Board considered, among other things, the types and amounts of the commercial dealings between the Company and the companies and organizations with which the directors are affiliated.

Item 14. Principal Accountant Fees and Services

The following table sets forth the fees accrued or paid to the Company's independent registered public accounting firm, KPMG LLP, during fiscal years 2007 and 2006.

Audit and Non-Audit Fees

	2007	2006
Audit Fees (1)	$ 7,943,900	$ 7,912,700
Audit-Related Fees (2)	432,000	28,000
Tax Fees (3)	600,400	820,500
All Other Fees	—	—
Total	$ 8,976,300	$ 8,761,200

(1) Audit fees relate to professional services rendered in connection with the audit of the Company's annual financial statements and internal control over financial reporting, quarterly review of financial statements included in the Company's Forms 10-Q, and audit services provided in connection with other statutory and regulatory filings. Fiscal years 2007 and 2006 includes fees incurred in connection with the Special Committee of the Board of Directors' investigation into stock option practices.

(2) Audit-related fees comprise fees for professional services that are reasonably related to the performance of audit or review of the Company's financial statements.

(3) The 2007 and 2006 tax fees include $581,200 and $728,600, respectively, for professional services rendered in connection with tax compliance and preparation relating to the Company's expatriate program, tax audits and international tax compliance; and $19,200 and $91,900, respectively, for international tax consulting and planning services. The Company does not engage KPMG to perform personal tax services for its executive officers.

Policy on Audit Committee Pre-Approval of Audit and Non-Audit Services Performed by the Independent Auditors

Prior to the enactment of the Sarbanes-Oxley Act of 2002 (the "Act"), the Company adopted an auditor independence policy that banned its auditors from performing non-financial consulting services, such as information technology consulting and internal audit services. This auditor independence policy also mandates that the audit and non-audit services and related budget be approved by the Audit Committee in advance, and that the Audit Committee be provided with quarterly reporting on actual spending. In accordance with this policy, all services to be performed by KPMG were pre-approved by the Audit Committee.

Subsequent to the enactment of the Act, the Audit Committee met with KPMG to further understand the provisions of the Act as it relates to auditor independence. KPMG previously rotated the lead audit partner in fiscal year 2005 in compliance with the Act. KPMG also rotated other partners in 2007 and 2006, and will rotate additional partners as appropriate. The Audit Committee will continue to monitor the activities undertaken by KPMG to comply with the Act.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) Documents filed as part of this report

(1) All financial statements

(2) Financial Statement Schedules

All financial statement schedules have been omitted, since the required information is not applicable or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Consolidated Financial Statements and Notes thereto.

(4) Exhibits required by Item 601 of Regulation S-K

The information required by this item is set forth on the exhibit index that follows the signature page of this report.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, this 15th day of November 2007.

APPLE INC.

By: /s/ PETER OPPENHEIMER

Peter Oppenheimer
Senior Vice President and
Chief Financial Officer

Power of Attorney

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Steven P. Jobs and Peter Oppenheimer, jointly and severally, his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this Annual Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Name	Title	Date
/s/ STEVEN P. JOBS STEVEN P. JOBS	Chief Executive Officer and Director (Principal Executive Officer)	November 15, 2007
/s/ PETER OPPENHEIMER PETER OPPENHEIMER	Senior Vice President and Chief Financial Officer (Principal Financial and Principal Accounting Officer)	November 15, 2007
/s/ WILLIAM V. CAMPBELL WILLIAM V. CAMPBELL	Director	November 15, 2007
/s/ MILLARD S. DREXLER MILLARD S. DREXLER	Director	November 15, 2007
/s/ ALBERT GORE, JR. ALBERT GORE, JR.	Director	November 15, 2007
/s/ ARTHUR D. LEVINSON ARTHUR D. LEVINSON	Director	November 15, 2007
/s/ ERIC E. SCHMIDT ERIC E. SCHMIDT	Director	November 15, 2007
/s/ JEROME B. YORK	Director	November 15, 2007

JEROME B. YORK

EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference Form	Filing Date/ Period End Date
3.1	Restated Articles of Incorporation, filed with the Secretary of State of the State of California on January 27, 1988.	S-3	7/27/88
3.2	Certificate of Amendment to Restated Articles of Incorporation, filed with the Secretary of State of the State of California on May 4, 2000.	10-Q	5/11/00
3.3	Certificate of Amendment to Restated Articles of Incorporation, as amended, filed with the Secretary of State of the State of California on February 25, 2005.	10-Q	3/26/05
3.4	Certificate of Determination of Preferences of Series A Non-Voting Convertible Preferred Stock of the Registrant.	10-K	9/26/97
3.5**	By-Laws of the Registrant, as amended through November 13, 2007.		
10.1*	1990 Stock Option Plan, as amended through November 5, 1997.	10-Q	12/26/97
10.2*	Employee Stock Purchase Plan, as amended through May 10, 2007.	8-K	5/16/07
10.3*	Form of Indemnification Agreement between the Registrant and each officer of the Registrant.	10-K	9/26/97
10.4*	NeXT Computer, Inc. 1990 Stock Option Plan, as amended.	S-8	3/21/97
10.5*	1997 Employee Stock Option Plan, as amended through October 19, 2001.	10-K	9/28/02
10.6*	1997 Director Stock Option Plan, as amended through May 10, 2007.	8-K	5/16/07
10.7*	2003 Employee Stock Plan, as amended through May 10, 2007.	8-K	5/16/07
10.8*	Reimbursement Agreement dated as of May 25, 2001 by and between the Registrant and Steven P. Jobs.	10-Q	6/29/02
10.9*	Form of Restricted Stock Unit Award Agreement.	10-Q	3/27/04
10.10*	Alternative Form of Restricted Stock Unit Award Agreement.	10-K	9/24/05
10.11*	Performance Bonus Plan dated April 21, 2005.	10-Q	3/26/05
10.12*	Form of Election to Satisfy Tax Withholding with Stock.	8-K	8/15/05
10.13*	Form of Option Agreements.	10-K	9/24/05
10.14*	Consulting Agreement dated as of April 17, 2006 by and between the Registrant and J.R. Ruby Consulting Corp.	10-Q	7/1/06
10.15**	Form of Restricted Stock Unit Award Agreement effective as of August 28, 2007.		
14.1	Code of Ethics of the Registrant.	10-K	9/27/03
21**	Subsidiaries of the Registrant.		
23.1**	Consent of Independent Registered Public Accounting Firm.		
24.1**	Power of Attorney (included on the Signature Page of this Annual Report on Form 10-K).		
31.1**	Rule13a-14(a) / 15d-14(a) Certification of Chief Executive Officer.		
31.2**	Rule13a-14(a) / 15d-14(a) Certification of Chief Financial Officer.		
32.1***	Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer.		

* Indicates management contract or compensatory plan or arrangement.

** Filed herewith.

*** Furnished herewith.

QuickLinks

EXHIBIT 8

10-K 1 d10k.htm FOR THE FISCAL YEAR ENDED SEPTEMBER 26, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended September 26, 2009

Or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____________ to ____________

Commission file number: 000-10030

APPLE INC.

(Exact name of registrant as specified in its charter)

California (State or other jurisdiction of incorporation or organization)	**94-2404110** (I.R.S. Employer Identification No.)
1 Infinite Loop **Cupertino, California** (Address of principal executive offices)	**95014** (Zip Code)

Registrant's telephone number, including area code: (408) 996-1010

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, no par value (Title of class)	**The NASDAQ Global Select Market** (Name of exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒	Accelerated filer ☐
Non-accelerated filer ☐ (Do not check if smaller reporting company)	Smaller Reporting Company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes ☐ No ☒

The aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant, as of March 28, 2009, was approximately $94,593,000,000 based upon the closing price reported for such date on the NASDAQ Global Select Market. For purposes of this disclosure, shares of common stock held by persons who hold more than 5% of the outstanding shares of common stock and shares held by executive officers and directors of the registrant have been excluded because such persons may be deemed to be affiliates. This determination of executive officer or affiliate status is not necessarily a conclusive determination for other purposes.

900,678,473 shares of Common Stock Issued and Outstanding as of October 16, 2009

DOCUMENTS INCORPORATED BY REFERENCE

(1) Portions of the registrant's definitive Proxy Statement relating to its 2010 Annual Meeting of Shareholders are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated. Such Proxy Statement will be filed with the U.S. Securities and Exchange Commission within 120 days after the end of the fiscal year to which this report relates.

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The Business section and other parts of this Annual Report on Form 10-K ("Form 10-K") contain forward-looking statements that involve risks and uncertainties. Many of the forward-looking statements are located in "Management's Discussion and Analysis of Financial Condition and Results of Operations." Forward-looking statements provide current expectations of future events based on certain assumptions and include any statement that does not directly relate to any historical or current fact. Forward-looking statements can also be identified by words such as "anticipates," "believes," "estimates," "expects," "intends," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and the Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Risk Factors" under Part I, Item 1A of this Form 10-K, which are incorporated herein by reference. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

PART I

Item 1. Business

Company Background

Apple Inc. and its wholly-owned subsidiaries (collectively "Apple" or the "Company") design, manufacture, and market personal computers, mobile communication devices, and portable digital music and video players and sell a variety of related software, services, peripherals, and networking solutions. The Company sells its products worldwide through its online stores, its retail stores, its direct sales force, and third-party wholesalers, resellers, and value-added resellers. In addition, the Company sells a variety of third-party Macintosh® ("Mac"), iPhone® and iPod® compatible products, including application software, printers, storage devices, speakers, headphones, and various other accessories and peripherals through its online and retail stores, and digital content and applications through the iTunes Store®. The Company sells to consumer, small and mid-sized business ("SMB"), education, enterprise, government and creative customers. The Company's fiscal year is the 52 or 53-week period that ends on the last Saturday of September. Unless otherwise stated, all information presented in this Form 10-K is based on the Company's fiscal calendar. The Company is a California corporation founded in 1977.

Business Strategy

The Company is committed to bringing the best personal computing, mobile communication and portable digital music and video experience to consumers, students, educators, businesses, and government agencies through its innovative hardware, software, peripherals, services, and Internet offerings. The Company's business strategy leverages its unique ability to design and develop its own operating system, hardware, application software, and services to provide its customers new products and solutions with superior ease-of-use, seamless integration, and innovative industrial design. The Company believes continual investment in research and development is critical to the development and enhancement of innovative products and technologies. In addition to evolving its personal computers and related solutions, the Company continues to capitalize on the convergence of the personal computer, mobile communications and digital consumer electronics by creating and refining innovations, such as iPhone, iPod and the iTunes Store. The Company desires to support a community for the development of third-party products that complement the Company's offerings through its developer programs. The Company offers various third-party software applications and hardware accessories for Mac® computers, iPhones and iPods through its retail and online stores, as well as software applications for the iPhone and iPod touch platforms through its App Store™. The Company's strategy also includes expanding its distribution network to effectively reach more of its targeted customers and provide them with a high-quality sales and post-sales support experience.

Consumer and Small and Mid-Sized Business

The Company believes a high-quality buying experience with knowledgeable salespersons who can convey the value of the Company's products and services greatly enhances its ability to attract and retain customers. The Company sells many of its products and resells certain third-party products in most of its major markets directly

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to consumers and businesses through its retail and online stores. The Company has also invested in programs to enhance reseller sales, including the Apple Sales Consultant Program, which places Apple employees and contractors at selected third-party reseller locations, and the Apple Premium Reseller Program, through which independently run businesses focus on the Apple platform and provide a high level of customer service and product expertise. The Company believes providing direct contact with its targeted customers is an efficient way to demonstrate the advantages of its products over those of its competitors.

At the end of fiscal 2009, the Company had opened a total of 273 retail stores, including 217 stores in the U.S. and 56 stores internationally. The Company has typically located its stores at high-traffic locations in quality shopping malls and urban shopping districts. By operating its own stores and locating them in desirable high-traffic locations, the Company is better positioned to control the customer buying experience and attract new customers. The stores are designed to simplify and enhance the presentation and marketing of the Company's products and related solutions. To that end, retail store configurations have evolved into various sizes to accommodate market-specific demands. The stores employ experienced and knowledgeable personnel who provide product advice, service and training. The stores offer a wide selection of third-party hardware, software, and various other accessories and peripherals that complement the Company's products.

Education

Throughout its history, the Company has focused on the use of technology in education and has been committed to delivering tools to help educators teach and students learn. The Company believes effective integration of technology into classroom instruction can result in higher levels of student achievement, especially when used to support collaboration, information access, and the expression and representation of student thoughts and ideas. The Company has designed a range of products and services to address the needs of education customers, which includes one-to-one ("1:1") learning. A 1:1 learning solution typically consists of a networked environment that includes a portable computer for every student and teacher. In addition, the Company supports mobile learning and real-time distribution and accessibility of education related materials through iTunes U, which allows students and teachers to share and distribute educational media directly through their computers and mobile communication devices.

Enterprise, Government and Creative

The Company also sells its hardware and software products to customers in enterprise, government and creative markets in each of its geographic segments. These markets are also important to many third-party developers who provide Mac-compatible hardware and software solutions. Customers in these markets utilize the Company's products because of their high-powered computing performance and expansion capabilities, networking functionality, and seamless integration with complementary products. The Company designs its high-end hardware solutions, including Mac Pro desktops, MacBook® Pro and MacBook Air® portable systems, and Xserve® servers, to incorporate the power, expandability, and other features desired by these professionals. The Company's operating system, Mac OS® X, incorporates powerful graphics and audio technologies and features developer tools to optimize system and application performance.

Other

In addition to consumer, SMB, education, enterprise, government and creative markets, the Company provides hardware and software products and solutions for customers in the information technology and scientific markets.

Business Organization

The Company manages its business primarily on a geographic basis. The Company's reportable operating segments consist of the Americas, Europe, Japan and Retail. The Americas, Europe and Japan reportable segments do not include activities related to the Retail segment. The Americas segment includes both North and

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South America. The Europe segment includes European countries as well as the Middle East and Africa. The Retail segment operates Apple-owned retail stores in the U.S. and in international markets. Each reportable geographic operating segment and the Retail operating segment provide similar hardware and software products and similar services. Further information regarding the Company's operating segments may be found in Part II, Item 7 of this Form 10-K under the subheading "Segment Operating Performance," and in Part II, Item 8 of this Form 10-K in Notes to Consolidated Financial Statements at Note 9, "Segment Information and Geographic Data."

Products

The Company offers a range of personal computing products, mobile communication devices, and portable digital music and video players, as well as a variety of related software, services, peripherals, networking solutions and various third-party hardware and software products. The Company designs, develops, and markets to Mac and Windows users its iPhone mobile communication devices and its family of iPod digital music and video players, along with related accessories and services, including the online distribution of third-party digital content and applications through the Company's iTunes Store. In addition, the Company offers its own software products, including Mac OS X, the Company's proprietary operating system software for the Mac; server software and related solutions; professional application software; and consumer, education, and business oriented application software. The Company's primary products are discussed below.

Mac Hardware Products

The Company offers a range of personal computing products including desktop and notebook computers, servers, related devices and peripherals, and various third-party hardware products. The Company's Mac desktop and portable systems feature Intel microprocessors, the Company's Mac OS X Version 10.6 Snow Leopard® ("Mac OS X Snow Leopard") operating system and iLife® suite of software for creation and management of digital photography, music, movies, DVDs and websites.

MacBook® Pro

The MacBook Pro family of notebook computers is designed for professionals and consumers. In June 2009, the Company updated its aluminum unibody MacBook Pro line to include 13-inch, 15-inch and 17-inch models. Each MacBook Pro includes an LED-backlit display, a glass Multi-Touch™ trackpad, an illuminated keyboard, an SD card or ExpressCard slot, a FireWire® 800 port, built-in AirPort Extreme® 802.11n wireless networking and Bluetooth 2.1. The 13-inch MacBook Pro includes up to 2.53 GHz in processor speed and an NVIDIA GeForce 9400M graphics processor. The 15-inch and 17-inch MacBook Pro models offer up to 3.06 GHz in processor speed and the NVIDIA GeForce 9600M GT discrete graphics processor.

MacBook®

The MacBook is designed for consumer and education users. In October 2009, the Company updated its MacBook with a new polycarbonate unibody design that includes an LED-backlit display and a glass Multi-Touch™ trackpad. The MacBook includes up to 2.26 GHz in processor speed, NVIDIA GeForce 9400M graphics processor, support for up to 4GB of 1066 MHz SDRAM memory, up to a 500 GB Serial ATA hard drive, a SuperDrive®, built-in AirPort Extreme 802.11n wireless networking and Bluetooth 2.1.

MacBook Air®

In June 2009, the Company updated its MacBook Air, an ultra-slim notebook computer that measures 0.16-inches at its thinnest point and 0.76-inches at its maximum height when closed. The MacBook Air includes up to 2.13 GHz processor speed with 6MB of Level 2 cache, NVIDIA GeForce 9400M graphics processor, 2GB of memory, and a 128GB hard drive. The MacBook Air includes a 13.3-inch LED-backlit widescreen display, a full-size backlit keyboard, a built-in iSight® video camera, a trackpad with Multi-Touch gesture support, and built-in AirPort Extreme 802.11n wireless networking and Bluetooth 2.1.

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Mac® Pro

The Mac Pro desktop computer is targeted at business and professional customers and is designed to meet the performance, expansion, and networking needs of the most demanding Mac user. In March 2009, the Company introduced an updated Mac Pro featuring up to two Intel Quad-Core Xeon processors running at up to 2.93 GHz, 8GB of shared Level 3 cache per processor, and up to 32GB of 1066 MHz SDRAM memory. The Mac Pro also features a direct attach storage solution for snap-in installation of up to four 1TB hard drives for a total of 4TB of internal storage, up to two double-layer SuperDrive disk drives, Bluetooth 2.1 and optional AirPort Extreme 802.11n wireless networking.

iMac®

The iMac desktop computer is targeted at consumer, education and business customers. In October 2009, the Company introduced new iMac models, which feature 21.5-inch or 27-inch LED-backlit displays in a glass and aluminum enclosure. The iMac includes up to 3.33 GHz processor speed, up to 16GB of 1066 MHz SDRAM memory, multiple graphics card options, up to a 2TB Serial ATA hard drive and a slot-loading double-layer SuperDrive. The 27-inch iMac model also features an Intel Quad-Core i5 or i7 processor running at up to 2.8 GHz, and is expected to be available in November 2009. All iMac models include a built-in iSight video camera, AirPort Extreme 802.11n wireless networking, Bluetooth 2.1 and come with the new wireless Magic Mouse, the first mouse with Multi-Touch technology.

Mac® mini

The Mac mini is a desktop computer measuring 6.5 by 6.5 by 2-inches. In October 2009, the Company updated the Mac mini line to include up to 2.66 GHz processor speed, up to 4GB of 1066 MHz SDRAM memory, up to a 500GB hard drive and NVIDIA GeForce 9400M integrated graphics. All Mac mini models include built-in AirPort Extreme 802.11n wireless networking, Bluetooth 2.1, a total of five USB 2.0 ports, and one FireWire 800 port. Mac mini includes dual display support and can operate displays with Mini DisplayPort or DVI connections. The Company also offers a Mac mini that is configured with Mac OS X Snow Leopard Server, featuring two 500GB hard drives for a total of 1TB of server storage.

Xserve®

Xserve is a 1U rack-mount server available with up to two 2.93 GHz Quad-Core Intel Xeon processors and features Mac OS X Server 10.6 Snow Leopard, which became available in August 2009. Xserve supports up to 24GB of random access memory, remote management, storage drives of up to 3TB, an optional 128GB solid state drive and an optional internal Xserve RAID card.

iPhone®

iPhone combines a mobile phone, a widescreen iPod with touch controls, and an Internet communications device in a single handheld product. Based on the Company's Multi Touch user interface, iPhone features desktop-class email, web browsing, searching, and maps and is compatible with both Macs and Windows-based computers. iPhone automatically syncs content from users' iTunes libraries, as well as contacts, bookmarks, and email accounts. iPhone allows users to wirelessly access the iTunes Store to purchase and/or download audio and video content as well as thousands of applications. In July 2008, the Company launched the App Store that allows a user to browse, search for, or purchase third-party applications through either a Mac or Windows-based computer or by wirelessly downloading directly to an iPhone or iPod touch.

In June 2009, the Company announced iPhone 3GS, the third-generation iPhone. It combines the features of iPhone 3G, which was released in July 2008, with a built-in three megapixel auto-focus camera, video recording and hands free voice control. iPhone 3GS is a quad-band GSM phone featuring 3G, EDGE and Wi-Fi wireless technologies for data networking, Bluetooth 2.1, and a 3.5-inch touch widescreen with 480-by-320 resolution at

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163 pixels per inch. iPhone 3GS provides up to 12 hours of talk time on 2G networks and five hours using 3G networks, up to nine hours of web browsing, up to ten hours of video playback, or up to 30 hours of audio playback. It is available in 16GB and 32GB configurations. The Company also continues to offer the iPhone 3G in a 8GB configuration.

In September 2009, the Company released iPhone 3.1 software, which features Genius technology enhancements including Genius Mixes and Genius recommendations for applications. iPhone 3.1 also incorporates improved syncing capabilities, which allows users to organize their applications in iTunes and sync back to their iPhones. iPhone 3.1 includes Cut, Copy and Paste, Spotlight® Search, MMS messaging and a landscape keyboard for Mail, Notes and Safari®. Certain features of the iPhone 3.1 software are not supported by some of iPhone's cellular network carriers.

The Company has signed multi-year agreements with various cellular network carriers authorizing them to distribute and provide cellular network services for iPhones. These agreements are generally not exclusive with a specific carrier, except in the U.S., Germany, Spain, Ireland, and certain other countries.

In addition to the Company's own iPhone accessories, third-party iPhone compatible products, including headsets, cables and docks, power supplies, and carrying cases, are available through the Company's online and retail stores or from third parties.

Music Products and Services

The Company offers its iPod line of portable digital music and video players and related accessories to Mac and Windows users. All iPods work with the Company's iTunes digital music management software ("iTunes") available for both Mac and Windows-based computers. The Company also provides an online service to distribute third-party music, audio books, music videos, short films, television shows, movies, podcasts, and applications through its iTunes Store. In addition to the Company's own iPod accessories, third-party iPod compatible products are available, either through the Company's online and retail stores or from third parties, including portable and desktop speaker systems, headphones, car radio solutions, voice recorders, cables and docks, power supplies and chargers, and carrying cases and armbands.

iPod® shuffle

In September 2009, the Company updated the third-generation iPod shuffle, a flash-memory-based iPod which is nearly half the size of the second generation model and is the first music player with the VoiceOver feature enabling it to speak song titles, artists and playlist names. iPod shuffle holds up to 1,000 songs and is the first iPod shuffle to accommodate playlists. iPod shuffles include a shuffle switch feature that allows users to listen to their music in random order or in the order of their playlists synced through iTunes. iPod shuffle works with iTunes' patent-pending AutoFill option that automatically selects songs to fill the iPod shuffle from a user's iTunes library. The new iPod shuffle is available in 2GB and 4GB configurations in an aluminum design in a variety of colors, or a special edition 4GB configuration in a stainless steel design.

iPod® nano

In September 2009, the Company introduced the new iPod nano, a flash-memory-based iPod. The new iPod nano includes a video camera, microphone and speaker, a built-in FM radio with live pause functionality, iTunes Tagging, and a built-in pedometer. The new iPod nano incorporates a larger 2.2-inch display with 204 pixels per inch, a built-in accelerometer, and an updated user interface featuring Cover Flow® and Shake to Shuffle mode. The new iPod nano also features Genius Mixes, allowing users to automatically create song mixes from their music libraries. The new iPod nano provides up to 24 hours of audio playback or up to five hours of video playback and is available in 8GB and 16GB configurations in a variety of colors.

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iPod® classic

The iPod classic is an upgraded version of the original iPod, the Company's hard-drive based portable digital music and video player. In September 2009, the Company introduced an updated version of the iPod classic, which has 160 GB of storage and is capable of holding up to 40,000 songs, 200 hours of video, or 25,000 photos. The iPod classic provides up to 36 hours of audio playback or up to six hours of video playback, features "Genius" technology, and includes a 2.5-inch color screen that can display album artwork, photos, and video content including music videos, video and audio podcasts, short films, television shows, movies, and games.

iPod® touch

In September 2009, the Company introduced the third-generation iPod touch, a flash-memory-based iPod that is 0.33-inches thin and features a 3.5-inch widescreen display, Genius technology, a built-in speaker, and an accelerometer. The new iPod touch features peer-to-peer connections, which gives users the ability to play multi-player games with other users, Genius Mixes, and iPhone 3.1 software. The iPod touch's user interface is based on the Company's Multi-Touch user interface. It also includes Wi-Fi wireless networking, which allows users to access the iTunes Wi-Fi Music Store and the App Store to purchase and/or download audio and video files, as well as a variety of other applications. The iPod touch is available in 8GB, 32GB and 64GB configurations and features up to 30 hours of audio playback and up to six hours of video playback.

iTunes® 9

iTunes is an application for playing, downloading, and organizing digital audio and video files and is available for both Mac and Windows-based computers. iTunes is integrated with the iTunes Store, a service that allows customers to find, purchase, rent, and download third-party digital music, audio books, music videos, short films, television shows, movies, games, and other applications. Originally introduced in the U.S. in April 2003, the iTunes Store now serves customers in 23 countries. In September 2009, the Company announced iTunes 9, which includes Genius Mixes, a new feature in Genius technology, Home Sharing, which allows users to transfer music, movies and TV shows among up to five authorized computers, and improved syncing functionality that allows users to organize their iPhone applications in iTunes, to sync music by artist and genre, and to sync photos by Events and Faces. In January 2009, the Company announced it would offer all songs in the iTunes catalog without digital rights management software and that iTunes songs would be available at three standard price points, beginning in April 2009 in most countries.

Peripheral Products

The Company sells a variety of Apple-branded and third-party Mac-compatible peripheral products directly to end-users through its retail and online stores, including printers, storage devices, computer memory, digital video and still cameras, and various other computing products and supplies.

Displays

The Company manufactures the Apple Cinema High Definition Display™, a 30-inch widescreen flat panel display. In October 2008, the Company introduced a 24-inch LED Cinema Display that features a built-in iSight camera, microphone, built-in 2.1 speaker system and MagSafe® charger.

Apple TV®

Apple TV is a device that permits users to wirelessly play iTunes content on a widescreen television. Compatible with a Mac or Windows-based computer, Apple TV includes a 160GB hard drive capable of storing up to 200 hours of video, 36,000 songs, 25,000 photos, or a combination of each and is compatible with high definition televisions with resolution up to 1080p. Apple TV connects to a broad range of widescreen televisions and home theater systems and comes standard with high-definition multimedia interface, component video, and both analog

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and digital optical audio ports. Using AirPort Extreme 802.11n wireless networking, Apple TV can auto-sync content from one computer or stream content from up to five additional computers directly to a television.

Software Products and Computer Technologies

The Company offers a range of software products for consumer, SMB, education, enterprise, government, and creative customers, including the Company's proprietary operating system software; server software and related solutions; professional application software; and consumer, education, and business oriented application software.

Operating System Software

Mac OS® X is built on an open-source UNIX-based foundation. Mac OS X Snow Leopard is the sixth major release of Mac OS X and became available in August 2009. Mac OS X Snow Leopard features upgraded speed and performance and includes a new version of QuickTime® X, support for Microsoft Exchange Server 2007 and VoiceOver integration with the Multi-Touch trackpad. Mac OS X Snow Leopard refines 90 percent of the projects in Mac OS X, is about half the size of the previous version, and frees up to 7GB of drive space once installed. Snow Leopard retains Stacks, a means of easily accessing files from the Dock; Finder™ that lets users quickly browse and share files between multiple Macs; Quick Look, a way to instantly see files without opening an application; Spaces®, a feature used to create groups of applications and instantly switch between them; and Time Machine®, a way to automatically back up all of the contents of a Mac.

Application Software

iLife® '09

In January 2009, the Company introduced iLife '09, the latest release of its consumer-oriented digital lifestyle application suite, which features iPhoto®, iMovie®, iDVD®, GarageBand®, and iWeb™. iPhoto is the Company's consumer-oriented digital photo software application, which includes new features for organizing and browsing photos, including Faces and Places which use face detection, face recognition and GPS geo-tagging technologies. iMovie is the Company's consumer-oriented digital video editing software application and features the new Precision Editor, video stabilization, advanced drag and drop, and animated travel maps. iDVD® is the Company's consumer-oriented software application that enables users to turn iMovie files, QuickTime® files, and digital pictures into interactive DVDs. GarageBand® is the Company's consumer-oriented music creation software application that allows users to play, record and create music using a simple interface. iWeb™ allows users to create online photo albums, blogs and podcasts, and to customize websites using editing tools.

iWork® '09

In January 2009, the Company introduced iWork '09, the latest version of the Company's integrated productivity suite designed to help users create, present, and publish documents, presentations, and spreadsheets. iWork '09 includes updates to Pages® '09 for word processing and page layout, Keynote® '09 for presentations, and Numbers® '09 for spreadsheets. Among the new features in iWork, Keynote introduces advanced object transitions, Pages features a new full screen view, and Numbers introduces a quick way to group and summarize data and a simplified way to create complex formulas.

Final Cut Studio®

In July 2009, the Company updated Final Cut Studio®, the Company's video production suite designed for video professionals. Final Cut Studio 2 features Final Cut Pro® 7 for video editing, DVD Studio Pro® 4 for DVD authoring, Motion 4 for real-time motion graphics, Soundtrack® Pro 3 for audio editing and sound design, Color 1.5 for color grading and finishing, and Compressor 3.5 for encoding media in multiple formats. The Company also offers Final Cut Express 4, a consumer version of the Company's movie making software, and Final Cut Server 1.5.

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Logic Studio®

In July 2009, the Company updated Logic Studio, a comprehensive suite of professional tools used by musicians and professionals to create, perform, and record music. Logic Studio features Logic® Pro 9, an upgraded version of the Company's music creation and audio production software application; MainStage® 2, a live performance application; Soundtrack® Pro 3, a professional audio post production software; Compressor 3.5 for encoding in a variety of formats; Studio Instruments, made up of 40 instrument plug-ins; Studio Effects, with 80 professional effect plug-ins; and studio Sound Library. In addition, the Company offers Logic Express 9, a version that includes many of the features of Logic Studio Pro and provides an easy entry into professional music production.

FileMaker® Pro

The FileMaker Pro database software offers relational databases and desktop-to-web publishing capabilities. In January 2009, the Company introduced FileMaker Pro 10, which features a new interface, a redesigned and customizable Status Toolbar, the ability to save the results of search and Script Triggers, which launch scripts triggered by user actions or based on time limits. The Company also offers FileMaker Pro 10 Advanced, FileMaker Server 10 and FileMaker Server 10 Advanced.

Internet Software and Services

The Company is focused on delivering seamless integration with and access to the Internet throughout the Company's products and services. The Company's Internet solutions adhere to many industry standards to provide an optimized user experience.

Safari®

In June 2009, the Company released Safari 4, a web browser compatible with Macs and Windows PCs. Safari 4 features the Nitro engine, which runs JavaScript faster than Safari 3 and includes enhanced browsing functionality with Top Sites, Full History Search and Cover Flow. Safari 4 supports video and audio tags in HTML 5 and supports CSS 3 Animations and Web Fonts, which provide designers additional choices of fonts to create web sites.

QuickTime®

QuickTime, the Company's multimedia software for Mac or Windows-based computers, features streaming of live and stored video and audio over the Internet and playback of high-quality audio and video on computers. QuickTime 7 features H.264 encoding and can automatically determine a user's connection speed to ensure they are getting the highest-quality content stream possible. QuickTime 7 also delivers multi-channel audio and supports a wide range of industry standard audio formats. The Company also offers QuickTime X, a new version of QuickTime that ships with Mac OS X Snow Leopard, and QuickTime 7 Pro, a suite of software tools, allows creation and editing of Internet-ready audio and video files.

MobileMe™

In June 2008, the Company introduced MobileMe, an annual subscription-based suite of Internet services that delivers email, contacts and calendars to and from native applications on iPhone, iPod touch, Macs, and Windows-based computers. MobileMe services include Internet message access protocol mail, an ad-free email service; website hosting for publishing websites from iWeb; iDisk®, a virtual hard drive accessible anywhere with Internet access; Web Gallery for viewing and sharing photos that is fully integrated with iPhoto and iMovie; MobileMe Sync, which keeps Safari bookmarks, iCal® calendars, Address Book information, Keychain®, and Mac OS X Mail preferences up-to-date across multiple computers, iPhones, and iPod touches. When combined with iPhone, MobileMe features Find My iPhone, which helps users locate their lost iPhones, and a new Remote Wipe feature that allows users to erase all data and content if their iPhones cannot be located. MobileMe provides combined email and file storage of 20GB for individuals and 40GB for families with additional storage options.

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Product Support and Services

AppleCare® offers a range of support options for the Company's customers. These options include assistance that is built into software products, printed and electronic product manuals, online support including comprehensive product information as well as technical assistance, and the AppleCare Protection Plan. The AppleCare Protection Plan is a fee-based service that typically includes two to three years of phone support and hardware repairs, dedicated web-based support resources, and user diagnostic tools.

Markets and Distribution

The Company's customers are primarily in the consumer, SMB, education, enterprise, government and creative markets. The Company distributes its products through wholesalers, resellers, national and regional retailers and cataloguers. No individual customer accounted for more than 10% of net sales in 2009, 2008 or 2007. The Company also sells many of its products and resells certain third-party products in most of its major markets directly to customers through its own sales force and retail and online stores.

Competition

The Company is confronted by aggressive competition in all areas of its business. The markets for personal computers, mobile communication devices, consumer electronics, related software, services and peripheral products are highly competitive. These markets are characterized by rapid technological advances in both hardware and software that have substantially increased the capabilities and use of personal computers, mobile communication devices, and other digital electronic devices that have resulted in the frequent introduction of new products with competitive price, feature, and performance characteristics. Over the past several years, price competition in these markets has been particularly intense. The Company's competitors who sell personal computers based on other operating systems have aggressively cut prices and lowered their product margins to gain or maintain market share. The Company's financial condition and operating results can be adversely affected by these and other industry-wide downward pressures on gross margins. The principal competitive factors include price, product features, relative price/performance, product quality and reliability, design innovation, availability of software and peripherals, marketing and distribution capability, service and support, and corporate reputation. Further, as the personal computer industry and its customers place more reliance on the Internet, an increasing number of Internet devices that are smaller, simpler and less expensive than traditional personal computers may compete with the Company's products.

The Company is focused on expanding its market opportunities related to mobile communication devices including the iPhone. The mobile communications industry is highly competitive and includes several large, well-funded and experienced participants. The Company expects competition in the mobile communication industry to intensify significantly as competitors attempt to imitate some of the iPhone's functionality and applications within their own smart phones or, alternatively, collaborate with each other to offer solutions that are more competitive than those they currently offer. This industry is characterized by aggressive pricing practices, frequent product introductions, evolving design approaches and technologies, rapid adoption of technological and product advancements by competitors, and price sensitivity on the part of consumers and businesses.

The Company's music products and services have faced significant competition from other companies promoting their own digital music and content products and services, including those offering free peer-to-peer music and video services. The Company believes it currently retains a competitive advantage by offering superior innovation and integration of the entire solution including the hardware (personal computer, iPhone and iPod), software (iTunes), and distribution of digital content and applications (iTunes Store, iTunes Wi-Fi Music Store and App Store). Some of the Company's current and potential competitors have substantial resources and may be able to provide such products and services at little or no profit or even at a loss to compete with the Company's offerings. Alternatively, these competitors may collaborate with each other to offer solutions that are more integrated than those they currently offer.

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The Company's future financial condition and operating results are substantially dependent on the Company's ability to continue to develop and offer new innovative products and services in each of the markets it competes in.

Raw Materials

Although most components essential to the Company's business are generally available from multiple sources, certain key components including but not limited to microprocessors, enclosures, certain liquid crystal displays ("LCDs"), certain optical drives, and application-specific integrated circuits ("ASICs") are currently obtained by the Company from single or limited sources, which subjects the Company to significant supply and pricing risks. Many of these and other key components available from multiple sources including but not limited to NAND flash memory, dynamic random access memory ("DRAM"), and certain LCDs, are subject at times to industry-wide shortages and significant commodity pricing fluctuations. In addition, the Company has entered into certain agreements for the supply of key components including but not limited to microprocessors, NAND flash memory, DRAM and LCDs at favorable pricing, but there is no guarantee the Company will be able to extend or renew these agreements on similar favorable terms, or at all, upon expiration or otherwise obtain favorable pricing in the future. Therefore, the Company remains subject to significant risks of supply shortages and price increases that can materially adversely affect its financial condition and operating results.

The Company and other participants in the personal computer, mobile communication and consumer electronics industries also compete for various components with other industries that have experienced increased demand for their products. In addition, the Company uses some custom components that are not common to the rest of the personal computer, mobile communication and consumer electronics industries, and new products introduced by the Company often utilize custom components available from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. When a component or product uses new technologies, initial capacity constraints may exist until the suppliers' yields have matured or manufacturing capacity has increased. If the Company's supply of a key single-sourced component for a new or existing product were delayed or constrained, if such components were available only at significantly higher prices, or if a key manufacturing vendor delayed shipments of completed products to the Company, the Company's financial condition and operating results could be materially adversely affected. The Company's business and financial performance could also be adversely affected depending on the time required to obtain sufficient quantities from the original source, or to identify and obtain sufficient quantities from an alternative source. Continued availability of these components at acceptable prices, or at all, may be affected if those suppliers decided to concentrate on the production of common components instead of components customized to meet the Company's requirements.

Significant portions of the Company's Mac computers, iPhones, iPods, logic boards and other assembled products are manufactured by outsourcing partners, primarily in various parts of Asia. A significant concentration of this outsourced manufacturing is currently performed by only a few of the Company's outsourcing partners, often in single locations. Certain of these outsourcing partners are the sole-sourced suppliers of components and manufacturing outsourcing for many of the Company's key products, including but not limited to final assembly of substantially all of the Company's portable Mac computers, iPhones, iPods and most of the Company's desktop products. Although the Company works closely with its outsourcing partners on manufacturing schedules, the Company's operating results could be adversely affected if its outsourcing partners were unable to meet their production commitments. The Company's purchase commitments typically cover the Company's requirements for periods ranging from 30 to 150 days.

The Company believes there are several component suppliers and manufacturing vendors whose loss to the Company if they were to encounter financial distress or become insolvent, incur capacity or supply constraints, become unable to obtain credit, or for any other reason could materially adversely affect the Company's business and financial condition. At this time, such vendors include, without limitation, 3M Co., Advanced Micro Devices Inc., AKM Semiconductor Inc., Amkor Technology Inc., Analog Devices Inc., Aptina Imaging Corp., ARM Holdings PLC., Atheros Communications Inc., Atmel Corp., AU Optronics Corp., Avago Technologies Ltd.,

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Broadcom Corp., Cirrus Logic Inc., Corning Inc., Cypress Semiconductor Corp., Dover Corp., Flextronics Inc., Foxconn Technology Co. Ltd., Hon Hai Precision Industry Co. Ltd., Imagination Technologies Group PLC., Infineon Technologies AG, Intel Corp., Inventec Appliances Corp., LG Display Co. Ltd., Linear Technology Corp., MagnaChip Semiconductor Corp., Maxim Integrated Products Inc., Mitsumi Electric Co. Ltd., Murata Mfg. Co. Ltd., National Semiconductor Corp., Nichia Corp., NVIDIA Corp., NXP B.V., OmniVision Technologies Inc., Quanta Computer, Inc., Pegatron Corp., Philips Lumileds Lighting Co., Renesas Semiconductor Co. Ltd., RF Micro Devices Inc., ROHM Co. Ltd., Samsung Electronics Co. Ltd., Skyworks Solutions Inc., STMicroelectronics NV, Sumitomo Chemical Co. Ltd., Texas Instruments Inc., Toshiba Corp., Toyoda Gosei Co. Ltd., and TriQuint Semiconductor Inc.

Research and Development

Because the personal computer, mobile communication and consumer electronics industries are characterized by rapid technological advances, the Company's ability to compete successfully is heavily dependent upon its ability to ensure a continual and timely flow of competitive products, services and technologies to the marketplace. The Company continues to develop new products and technologies and to enhance existing products in the areas of computer hardware and peripherals, mobile communication devices, consumer electronics products, system software, applications software, networking and communications software and solutions, and Internet services and solutions. The Company may expand the range of its product offerings and intellectual property through licensing and acquisition of third-party business and technology. The Company's research and development expenditures totaled $1.3 billion, $1.1 billion and $782 million in 2009, 2008 and 2007, respectively.

Patents, Trademarks, Copyrights and Licenses

The Company currently holds rights to patents and copyrights relating to certain aspects of its computer systems, iPhone and iPod devices, peripherals, software and services. In addition, the Company has registered and/or has applied to register, trademarks and service marks in the U.S. and a number of foreign countries for "Apple," the Apple logo, "Macintosh," "Mac," "iPhone," "iPod," "iTunes," "iTunes Store," "Apple TV," "MobileMe" and numerous other trademarks and service marks. Although the Company believes the ownership of such patents, copyrights, trademarks and service marks is an important factor in its business and that its success does depend in part on the ownership thereof, the Company relies primarily on the innovative skills, technical competence and marketing abilities of its personnel.

The Company regularly files patent applications to protect inventions arising from its research and development, and is currently pursuing thousands of patent applications around the world. Over time, the Company has accumulated a portfolio of several thousand issued patents in the U.S. and worldwide. In addition, the Company currently holds copyrights relating to certain aspects of its products and services. No single patent or copyright is solely responsible for protecting the Company's products. The Company believes the duration of the applicable patents it has been granted is adequate relative to the expected lives of its products. Due to the fast pace of innovation and product development, the Company's products are often obsolete before the patents related to them expire, and sometimes are obsolete before the patents related to them are even granted.

Many of the Company's products are designed to include intellectual property obtained from third parties. While it may be necessary in the future to seek or renew licenses relating to various aspects of its products and business methods, the Company believes, based upon past experience and industry practice, such licenses generally could be obtained on commercially reasonable terms; however, there is no guarantee such licenses could be obtained at all. Because of technological changes in the computer, digital music player and mobile communications industries, current extensive patent coverage, and the rapid rate of issuance of new patents, it is possible certain components of the Company's products and business methods may unknowingly infringe existing patents or intellectual property rights of others. From time to time, the Company has been notified that it may be infringing certain patents or other intellectual property rights of third parties.

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Foreign and Domestic Operations and Geographic Data

The U.S. represents the Company's largest geographic marketplace. Approximately 54% of the Company's net sales in 2009 came from sales to customers inside the U.S. Final assembly of the Company's products is currently performed in the Company's manufacturing facility in Ireland, and by external vendors in California, Texas, the People's Republic of China ("China"), the Czech Republic and the Republic of Korea ("Korea"). Currently, the supply and manufacture of many critical components is performed by sole-sourced third-party vendors in the U.S., China, Germany, Ireland, Israel, Japan, Korea, Malaysia, the Netherlands, the Philippines, Taiwan, Thailand and Singapore. Sole-sourced third-party vendors in China perform final assembly of substantially all of the Company's portable Mac products, iPhone, iPods and most of the Company's desktop products. Margins on sales of the Company's products in foreign countries, and on sales of products that include components obtained from foreign suppliers, can be adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including tariffs and antidumping penalties.

Information regarding financial data by geographic segment is set forth in Part II, Item 7 and Item 8 of this Form 10-K and in Notes to Consolidated Financial Statements at Note 9, "Segment Information and Geographic Data."

Seasonal Business

The Company has historically experienced increased net sales in its first and fourth fiscal quarters compared to other quarters in its fiscal year due to seasonal demand related to the holiday season and the beginning of the school year. This historical pattern should not be considered a reliable indicator of the Company's future net sales or financial performance.

Warranty

The Company offers a basic limited parts and labor warranty on most of its hardware products, including Mac computers, iPhones and iPods. The basic warranty period is typically one year from the date of purchase by the original end-user. The Company also offers a 90-day basic warranty for its service parts used to repair the Company's hardware products. In addition, consumers may purchase the AppleCare Protection Plan, which extends service coverage on many of the Company's hardware products in most of its major markets.

Backlog

In the Company's experience, the actual amount of product backlog at any particular time is not a meaningful indication of its future business prospects. In particular, backlog often increases in anticipation of or immediately following new product introductions as dealers anticipate shortages. Backlog is often reduced once dealers and customers believe they can obtain sufficient supply. Because of the foregoing, backlog should not be considered a reliable indicator of the Company's ability to achieve any particular level of revenue or financial performance.

Environmental Laws

Compliance with federal, state, local and foreign laws enacted for the protection of the environment has to date had no material effect on the Company's capital expenditures, earnings, or competitive position. In the future, compliance with environmental laws could materially adversely affect the Company.

Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations including, in some instances, the requirement to provide customers the ability to return product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have been passed in several jurisdictions in which the Company operates including various countries within Europe and Asia and certain states and provinces within North America. Although the Company does not anticipate any material adverse effects in the future based on the nature of its operations and the thrust of such laws, there is no assurance that such existing laws or future laws will not materially adversely affect the Company's financial condition or operating results.

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Employees

As of September 26, 2009, the Company had approximately 34,300 full-time equivalent employees and an additional 2,500 full-time equivalent temporary employees and contractors.

Available Information

The Company's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), are filed with the U.S. Securities and Exchange Commission (the "SEC"). Such reports and other information filed by the Company with the SEC are available free of charge on the Company's website at http://www.apple.com/investor when such reports are available on the SEC website. The public may read and copy any materials filed by the Company with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at http://www.sec.gov. The contents of these websites are not incorporated into this filing. Further, the Company's references to the URLs for these websites are intended to be inactive textual references only.

Item 1A. Risk Factors

Because of the following factors, as well as other factors affecting the Company's financial condition and operating results, past financial performance should not be considered to be a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

Economic conditions could materially adversely affect the Company.

The Company's operations and performance depend significantly on worldwide economic conditions. Uncertainty about current global economic conditions poses a risk as consumers and businesses may continue to postpone spending in response to tighter credit, unemployment, negative financial news and/or declines in income or asset values, which could have a material negative effect on demand for the Company's products and services. Demand also could differ materially from the Company's expectations since the Company generally raises prices on goods and services sold outside the U.S. to offset the effect of the strengthening of the U.S. dollar, a trend that has been very pronounced recently. Other factors that could influence demand include increases in fuel and other energy costs, conditions in the real estate and mortgage markets, labor and healthcare costs, access to credit, consumer confidence, and other macroeconomic factors affecting consumer spending behavior. These and other economic factors could materially adversely affect demand for the Company's products and services and on the Company's financial condition and operating results.

In the event of renewed financial turmoil affecting the banking system and financial markets, additional consolidation of the financial services industry, or significant financial service institution failures, there could be a new or incremental tightening in the credit markets, low liquidity, and extreme volatility in fixed income, credit, currency, and equity markets. In addition, the risk remains that there could be a number of follow-on effects from the credit crisis on the Company's business, including the insolvency of key suppliers or their inability to obtain credit to finance development and/or manufacture products resulting in product delays; inability of customers, including channel partners, to obtain credit to finance purchases of the Company's products and/or customer, including channel partner, insolvencies; and failure of derivative counterparties and other financial institutions negatively impacting the Company's treasury operations. Other income and expense also could vary materially from expectations depending on gains or losses realized on the sale or exchange of financial instruments; impairment charges resulting from revaluations of debt and equity securities and other investments; interest rates; cash balances; and changes in fair value of derivative instruments. Increased volatility in the financial markets and overall economic uncertainty would increase the risk of the actual amounts realized in the future on the Company's financial instruments differing significantly from the fair values currently assigned to them.

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Uncertainty about current global economic conditions could also continue to increase the volatility of the Company's stock price.

Global markets for personal computers, mobile communication devices, digital music and video devices, and related peripherals and services are highly competitive and subject to rapid technological change. If the Company is unable to compete effectively in these markets, its financial condition and operating results could be materially adversely affected.

The Company competes in highly competitive global markets characterized by aggressive price cutting, with resulting downward pressure on gross margins, frequent introduction of new products, short product life cycles, evolving industry standards, continual improvement in product price/performance characteristics, rapid adoption of technological and product advancements by competitors, and price sensitivity on the part of consumers.

The Company's ability to compete successfully depends heavily on its ability to ensure a continuing and timely introduction of innovative new products and technologies to the marketplace. The Company believes it is unique in that it designs and develops nearly the entire solution for its personal computers, mobile communication devices, and consumer electronics, including the hardware, operating system, numerous software applications, and related services. As a result, the Company must make significant investments in research and development and as such, the Company currently holds a significant number of patents and copyrights and has registered and/or has applied to register numerous patents, trademarks and service marks. By contrast, many of the Company's competitors seek to compete primarily through aggressive pricing and very low cost structures. If the Company is unable to continue to develop and sell innovative new products with attractive margins or if other companies infringe on the Company's intellectual property, the Company's ability to maintain a competitive advantage could be negatively affected and its financial condition and operating results could be materially adversely affected.

In the market for personal computers and peripherals, the Company faces a significant number of competitors, many of which have broader product lines, lower priced products, and larger installed customer bases. Consolidation in this market has resulted in larger and potentially stronger competitors. Price competition has been particularly intense as competitors selling Windows-based personal computers have aggressively cut prices and lowered product margins. The Company also faces increased competition in key market segments, including consumer, SMB, education, enterprise, government and creative markets. An increasing number of Internet devices that include software applications and are smaller and simpler than traditional personal computers compete for market share with the Company's existing products.

The Company is currently the only authorized maker of hardware using the Mac OS. The Mac OS has a minority market share in the personal computer market, which is dominated by computer makers using competing operating systems, most notably Windows. The Company's financial condition and operating results depend substantially on the Company's ability to continually improve the Mac platform to maintain functional and design advantages. Use of unauthorized copies of the Mac OS on other companies' hardware products may result in decreased demand for the Company's hardware products, and could materially adversely affect the Company's financial condition and operating results.

The Company is currently focused on certain mobile communication devices, such as iPhone, consumer electronic devices, including the iPod family of digital music and video players and third-party digital content and applications distribution. The Company faces substantial competition from companies that have significant technical, marketing, distribution and other resources, as well as established hardware, software and digital content supplier relationships. The Company also competes with illegitimate ways to obtain third-party digital content and applications. The Company has only recently entered the mobile communications market, and many of its competitors in the mobile communications market have significantly greater experience, product breadth and distribution channels than the Company. Because some current and potential competitors have substantial resources and experience and a lower cost structure, they may be able to provide such products and services at little or no profit or even at a loss. The Company also expects competition to intensify as competitors attempt to

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imitate the Company's approach to providing these components seamlessly within their individual offerings or work collaboratively to offer integrated solutions.

The Company currently receives subsidies from its exclusive and non-exclusive carriers providing cellular network service for iPhone. There is no assurance that such subsidies will be continued at all or in the same amounts upon renewal of the Company's agreements with these carriers or in agreements the Company enters into with new carriers.

There can be no assurance the Company will be able to continue to provide products and services that compete effectively.

To remain competitive and stimulate customer demand, the Company must successfully manage frequent product introductions and transitions.

Due to the highly volatile and competitive nature of the personal computer, mobile communication and consumer electronics industries, the Company must continually introduce new products, services and technologies, enhance existing products and services, and effectively stimulate customer demand for new and upgraded products. The success of new product introductions depends on a number of factors including but not limited to timely and successful product development, market acceptance, the Company's ability to manage the risks associated with new products and production ramp issues, the availability of application software for new products, the effective management of purchase commitments and inventory levels in line with anticipated product demand, the availability of products in appropriate quantities and costs to meet anticipated demand, and the risk that new products may have quality or other defects in the early stages of introduction. Accordingly, the Company cannot determine in advance the ultimate effect of new product introductions and transitions on its financial condition and operating results.

The Company faces substantial inventory and other asset risk.

The Company records a write-down for product and component inventories that have become obsolete or exceed anticipated demand or net realizable value and accrues necessary cancellation fee reserves for orders of excess products and components. The Company also reviews its long-lived assets for impairment whenever events or changed circumstances indicate the carrying amount of an asset may not be recoverable. If the Company determines that impairment has occurred, it records a write-down equal to the amount by which the carrying value of the assets exceeds its fair market value. Although the Company believes its inventory and other asset related provisions are currently adequate, no assurance can be given that, given the rapid and unpredictable pace of product obsolescence in the global personal computer, mobile communication, and consumer electronics industries, the Company will not incur additional inventory or asset related charges. Such charges have, and could, materially adversely affect the Company's financial condition and operating results.

The Company must order components for its products and build inventory in advance of product announcements and shipments. Consistent with industry practice, components are normally acquired through a combination of purchase orders, supplier contracts, open orders and, where appropriate, prepayments, in each case based on projected demand. Such purchase commitments typically cover forecasted component and manufacturing requirements for 30 to 150 days. Because the Company's markets are volatile, competitive and subject to rapid technology and price changes, there is a risk the Company will forecast incorrectly and order or produce excess or insufficient inventories of components or products. The Company's financial condition and operating results have been in the past and could be in the future materially adversely affected by the Company's ability to manage its inventory levels and respond to short-term shifts in customer demand patterns.

Future operating results depend upon the Company's ability to obtain key components including but not limited to microprocessors, NAND flash memory, DRAM and LCDs at favorable prices and in sufficient quantities.

Because the Company currently obtains certain key components including but not limited to microprocessors, enclosures, certain LCDs, certain optical drives, and ASICs, from single or limited sources, the Company is

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subject to significant supply and pricing risks. Many of these and other key components that are available from multiple sources including but not limited to NAND flash memory, DRAM and certain LCDs, are subject at times to industry-wide shortages and significant commodity pricing fluctuations. The Company has entered into certain agreements for the supply of key components including but not limited to microprocessors, NAND flash memory, DRAM and LCDs at favorable pricing, but there is no guarantee that the Company will be able to extend or renew these agreements on similar favorable terms, or at all, upon expiration or otherwise obtain favorable pricing in the future. The follow-on effects from the credit crisis on the Company's key suppliers, referred to in "*Economic conditions could materially adversely affect the Company*" above, which is incorporated herein by reference, also could affect the Company's ability to obtain key components. Therefore, the Company remains subject to significant risks of supply shortages and/or price increases that could materially adversely affect the Company's financial condition and operating results. The Company expects to experience decreases in its gross margin percentage in future periods, as compared to levels achieved during 2009 and 2008, due largely to the anticipated impact of product transitions, flat or reduced pricing on new and innovative products that have higher cost structures, both expected and potential future cost increases for key components, a stronger U.S. dollar and higher logistical costs. For additional information refer to Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," under the subheading "Gross Margin," which is incorporated herein by reference.

The Company and other participants in the personal computer, mobile communication and consumer electronics industries compete for various components with other industries that have experienced increased demand for their products. The Company uses some custom components that are not common to the rest of the personal computer, mobile communication and consumer electronics industries. The Company's new products often utilize custom components available from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. When a component or product uses new technologies, initial capacity constraints may exist until the suppliers' yields have matured or manufacturing capacity has increased. Continued availability of these components at acceptable prices, or at all, may be affected if those suppliers decided to concentrate on the production of common components instead of components customized to meet the Company's requirements. If the supply of a key single-sourced component for a new or existing product were delayed or constrained, if such components were available only at significantly higher prices, or if a key manufacturing vendor delayed shipments of completed products to the Company, the Company's financial condition and operating results could be materially adversely affected.

The Company depends on component and product manufacturing and logistical services provided by third parties, many of whom are located outside of the U.S.

Most of the Company's components and products are manufactured in whole or in part by a few third-party manufacturers. Many of these manufacturers are located outside of the U.S., and are concentrated in several general locations. The Company has also outsourced much of its transportation and logistics management. While these arrangements may lower operating costs, they also reduce the Company's direct control over production and distribution. It is uncertain what effect such diminished control will have on the quality or quantity of products or services, or the Company's flexibility to respond to changing conditions. In addition, the Company relies on third-party manufacturers to adhere to the Company's supplier code of conduct. Although arrangements with such manufacturers may contain provisions for warranty expense reimbursement, the Company may remain responsible to the consumer for warranty service in the event of product defects. Any unanticipated product defect or warranty liability, whether pursuant to arrangements with contract manufacturers or otherwise, could materially adversely affect the Company's reputation, financial condition and operating results.

Final assembly of the Company's products is currently performed in the Company's manufacturing facility in Ireland, and by external vendors in California, Texas, China, the Czech Republic and Korea. Currently, the supply and manufacture of many critical components is performed by sole-sourced third-party vendors in the U.S., China, Germany, Ireland, Israel Japan, Korea, Malaysia, the Netherlands, the Philippines, Taiwan, Thailand and Singapore. Sole-sourced third-party vendors in China perform final assembly of substantially all of the

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Company's portable Mac products, iPhones, iPods and most of the Company's desktop products. If manufacturing or logistics in these locations is disrupted for any reason, including natural disasters, information technology system failures, military actions or economic, business, labor, environmental, public health, or political issues, the Company's financial condition and operating results could be materially adversely affected.

The Company relies on third-party digital content and applications, which may not be available to the Company on commercially reasonable terms or at all.

The Company contracts with certain third parties to offer their digital content and applications through the Company's iTunes Store. The Company pays substantial fees to obtain the rights to audio and video content. The Company's licensing arrangements with these third parties are short-term and do not guarantee the continuation or renewal of these arrangements on reasonable terms, if at all. Some third-party content providers currently or in the future may offer competing products and services, and could take action to make it more difficult or impossible for the Company to license their content in the future. Other content owners, providers or distributors may seek to limit the Company's access to, or increase the total cost of, such content. If the Company is unable to continue to offer a wide variety of content at reasonable prices with acceptable usage rules, or continue to expand its geographic reach, the Company's financial condition and operating results may be materially adversely affected.

Many third-party content providers require that the Company provide certain digital rights management ("DRM") and other security solutions. If these requirements change, the Company may have to develop or license new technology to provide these solutions. There is no assurance the Company will be able to develop or license such solutions at a reasonable cost and in a timely manner. In addition, certain countries have passed or may propose legislation that would force the Company to license its DRM, which could lessen the protection of content and subject it to piracy and also could affect arrangements with the Company's content providers.

The Company relies on access to third-party patents and intellectual property, and the Company's future results could be materially adversely affected if it is alleged or found to have infringed intellectual property rights.

Many of the Company's products are designed to include third-party intellectual property, and in the future the Company may need to seek or renew licenses relating to various aspects of its products and business methods. Although the Company believes that, based on past experience and industry practice, such licenses generally could be obtained on reasonable terms, there is no assurance that the necessary licenses would be available on acceptable terms or at all.

Because of technological changes in the global personal computer, mobile communication and consumer electronics industries, current extensive patent coverage, and the rapid issuance of new patents, it is possible that certain components of the Company's products and business methods may unknowingly infringe the patents or other intellectual property rights of third parties. From time to time, the Company has been notified that it may be infringing such rights. Regardless of merit, responding to such claims can consume significant time and expense. At present, the Company is vigorously defending more than 47 patent infringement cases, 27 of which were filed during fiscal 2009, and several pending claims are in various stages of evaluation. In certain cases, the Company may consider the desirability of entering into licensing agreements, although no assurance can be given that such licenses can be obtained on acceptable terms or that litigation will not occur. If the Company is found to be infringing such rights, it may be required to pay substantial damages. If there is a temporary or permanent injunction prohibiting the Company from marketing or selling certain products or a successful claim of infringement against the Company requires it to pay royalties to a third party, the Company's financial condition and operating results could be materially adversely affected, regardless of whether it can develop non-infringing technology. While in management's opinion the Company does not have a potential liability for damages or royalties from any known current legal proceedings or claims related to the infringement of patent or other intellectual property rights that would individually or in the aggregate materially adversely affect its financial condition and operating results, the results of such legal proceedings cannot be predicted with certainty. Should

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the Company fail to prevail in any of the matters related to infringement of patent or other intellectual property rights of others or should several of these matters be resolved against the Company in the same reporting period, the Company's financial condition and operating results could be materially adversely affected.

With the June 2007 introduction of iPhone, the Company has begun to compete with mobile communication device companies that hold significant patent portfolios. Regardless of the scope or validity of such patents or the merits of any potential patent claims by competitors, the Company may have to engage in protracted litigation, enter into expensive agreements or settlements and/or modify its products. Any of these events could have a material adverse impact on the Company's financial condition and operating results.

The Company's future performance depends on support from third-party software developers. If third-party software applications and services cease to be developed and maintained for the Company's products, customers may choose not to buy the Company's products.

The Company believes decisions by customers to purchase its hardware products, including its Macs, iPhones and iPods, are often based to a certain extent on the availability of third-party software applications and services. There is no assurance that third-party developers will continue to develop and maintain applications and services for the Company's products on a timely basis or at all, and discontinuance or delay of these applications and services could materially adversely affect the Company's financial condition and operating results.

With respect to its Mac products, the Company believes the availability of third-party software applications and services depends in part on the developers' perception and analysis of the relative benefits of developing, maintaining, and upgrading such software for the Company's products compared to Windows-based products. This analysis may be based on factors such as the perceived strength of the Company and its products, the anticipated revenue that may be generated, continued acceptance by customers of Mac OS X, and the costs of developing such applications and services. If the Company's minority share of the global personal computer market causes developers to question the Company's prospects, developers could be less inclined to develop or upgrade software for the Company's products and more inclined to devote their resources to developing and upgrading software for the larger Windows market. The Company's development of its own software applications and services may also negatively affect the decisions of third-party developers, such as Microsoft, Adobe and Google, to develop, maintain, and upgrade similar or competitive software and services for the Company's products. Mac OS X Version 10.5 Leopard ("Mac OS X Leopard"), which became available in October 2007, includes a new feature that enables Intel-based Mac systems to run Microsoft Windows XP and Windows Vista operating systems. This feature may deter developers from creating software applications for Mac OS X if such applications are already available for the Windows platform.

With respect to iPhone and iPod touch, the Company relies on the continued availability and development of compelling and innovative software applications. Unlike third-party software applications for Mac products, the software applications for the iPhone and iPod touch platforms are distributed through a single distribution channel, the App Store. The absence of multiple distribution channels, which are available for competing platforms, may limit the availability and acceptance of third-party applications by the Company's customers, thereby causing developers to curtail significantly, or stop, development for the Company's platforms. In addition, iPhone and iPod touch are subject to rapid technological change, and, if third-party developers are unable to keep up with this pace of change, third-party applications might not successfully operate and may result in dissatisfied customers. Further, if the Company develops its own software applications and services, such development may negatively affect the decisions of third-party developers to develop, maintain, and upgrade similar or competitive applications for the iPhone and iPod touch platforms. As with applications for the Company's Mac products, the availability and development of these applications also depend on developers' perceptions and analysis of the relative benefits of developing software for the Company's products rather than its competitors' products, including devices that use competing platforms. If developers focus their efforts on these competing platforms, the availability and quality of applications for the Company's devices may suffer.

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The Company's future operating performance depends on the performance of distributors, carriers and other resellers.

The Company distributes its products through wholesalers, resellers, national and regional retailers, value-added resellers, and cataloguers, many of whom distribute products from competing manufacturers. The Company also sells many of its products and resells third-party products in most of its major markets directly to end-users, certain education customers, and certain resellers through its online and retail stores. iPhone is distributed through the Company, its cellular network carriers' distribution channels and certain third-party resellers.

Many resellers operate on narrow operating margins and have been negatively affected in the past by weak economic conditions. Some resellers have perceived the expansion of the Company's direct sales as conflicting with their business interests as distributors and resellers of the Company's products. Such a perception could discourage resellers from investing resources in the distribution and sale of the Company's products or lead them to limit or cease distribution of those products. The Company's financial condition and operating results could be materially adversely affected if the financial condition of these resellers weakens, if resellers stopped distributing the Company's products, or if uncertainty regarding demand for the Company's products caused resellers to reduce their ordering and marketing of the Company's products. The Company has invested and will continue to invest in programs to enhance reseller sales, including staffing selected resellers' stores with Company employees and contractors and improving product placement displays. These programs could require a substantial investment while providing no assurance of return or incremental revenue.

The Company's retail business has required and will continue to require a substantial investment and commitment of resources and is subject to numerous risks and uncertainties.

Through September 26, 2009, the Company had opened 273 retail stores. The Company's retail stores have required substantial fixed investment in equipment and leasehold improvements, information systems, inventory and personnel. The Company also has entered into substantial operating lease commitments for retail space with terms ranging from five to 20 years, the majority of which are for ten years. Certain stores have been designed and built to serve as high-profile venues to promote brand awareness and serve as vehicles for corporate sales and marketing activities. Because of their unique design elements, locations and size, these stores require substantially more investment than the Company's more typical retail stores. Due to the high fixed cost structure associated with the Retail segment, a decline in sales or the closure or poor performance of individual or multiple stores could result in significant lease termination costs, write-offs of equipment and leasehold improvements, and severance costs that could materially adversely affect the Company's financial condition and operating results.

Many factors unique to retail operations, some of which are beyond the Company's control, pose risks and uncertainties that could materially adversely affect the Company's financial condition and operating results. These risks and uncertainties include, among other things, macro-economic factors that could have a negative effect on general retail activity, as well as the Company's inability to manage costs associated with store construction and operation, inability to sell third-party products at adequate margins, failure to manage relationships with existing retail channel partners, more challenging environment in managing retail operations outside the U.S., costs associated with unanticipated fluctuations in the value of retail inventory, and inability to obtain and renew leases in quality retail locations at a reasonable cost.

Investment in new business strategies and initiatives could disrupt the Company's ongoing business and present risks not originally contemplated.

The Company has invested, and in the future may invest, in new business strategies or acquisitions. Such endeavors may involve significant risks and uncertainties, including distraction of management from current operations, insufficient revenue to offset liabilities assumed and expenses associated with the strategy, inadequate return of capital, and unidentified issues not discovered in the Company's due diligence. Because

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these new ventures are inherently risky, no assurance can be given that such strategies and initiatives will be successful and will not materially adversely affect the Company's financial condition and operating results.

The Company's products and services experience quality problems from time to time that can result in decreased sales and operating margin.

The Company sells highly complex hardware and software products and services that can contain defects in design and manufacture. Sophisticated operating system software and applications, such as those sold by the Company, often contain "bugs" that can unexpectedly interfere with the software's intended operation. Defects may also occur in components and products the Company purchases from third parties. There can be no assurance the Company will be able to detect and fix all defects in the hardware, software and services it sells. Failure to do so could result in lost revenue, harm to reputation, and significant warranty and other expenses, and could have a material adverse impact on the Company's financial condition and operating results.

In certain countries, including the U.S., the Company relies on a single cellular network carrier to provide service for iPhone.

In the U.S., Germany, Spain, Ireland and certain other countries, the Company has contracted with a single carrier to provide cellular network services for iPhone on an exclusive basis. If these exclusive carriers cannot successfully compete with other carriers in their markets on any basis, including but not limited to the quality and coverage of wireless voice and data services, performance and timely build-out of advanced wireless networks, and pricing and other terms of conditions of end-user contracts, or if these exclusive carriers fail to promote iPhone aggressively or favor other handsets in their promotion and sales activities or service plans, sales may be materially adversely affected.

The Company is subject to risks associated with laws, regulations and industry-imposed standards related to mobile communications devices.

Laws and regulations related to mobile communications devices in the many jurisdictions in which the Company operates are extensive and subject to change. Such changes, which could include but are not limited to restrictions on production, manufacture, distribution, and use of the device, locking the device to a carrier's network, or mandating the use of the device on more than one carrier's network, could materially adversely affect the Company's financial condition and operating results.

Mobile communication devices, such as iPhone, are subject to certification and regulation by governmental and standardization bodies, as well as by cellular network carriers for use on their networks. These certification processes are extensive and time consuming, and could result in additional testing requirements, product modifications or delays in product shipment dates, which could materially adversely affect the Company's financial condition and operating results.

The Company's success depends largely on the continued service and availability of key personnel.

Much of the Company's future success depends on the continued availability and service of key personnel, including its CEO, its executive team and highly skilled employees in technical, marketing and staff positions. Experienced personnel in the technology industry are in high demand and competition for their talents is intense, especially in the Silicon Valley, where most of the Company's key personnel are located. There can be no assurance that the Company will continue to attract and retain key personnel.

In addition, the Company has relied on equity awards in the form of stock options and restricted stock units as one means for recruiting and retaining highly skilled talent. Significant adverse volatility in the Company's stock price could result in a stock option's exercise price exceeding the underlying stock's market value or a significant deterioration in the value of restricted stock units granted, thus lessening the effectiveness of stock-based awards for retaining employees.

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Political events, war, terrorism, public health issues, natural disasters and other circumstances could materially adversely affect the Company.

War, terrorism, geopolitical uncertainties, public health issues, and other business interruptions have caused and could cause damage or disruption to international commerce and the global economy, and thus could have a strong negative effect on the Company, its suppliers, logistics providers, manufacturing vendors and customers, including channel partners. The Company's business operations are subject to interruption by natural disasters, fire, power shortages, terrorist attacks, and other hostile acts, labor disputes, public health issues, and other events beyond its control. Such events could decrease demand for the Company's products, make it difficult or impossible for the Company to make and deliver products to its customers, including channel partners, or to receive components from its suppliers, and create delays and inefficiencies in the Company's supply chain. Should major public health issues, including pandemics, arise, the Company could be negatively affected by more stringent employee travel restrictions, additional limitations in freight services, governmental actions limiting the movement of products between regions, delays in production ramps of new products, and disruptions in the operations of the Company's manufacturing vendors and component suppliers. The majority of the Company's research and development activities, its corporate headquarters, information technology systems, and other critical business operations, including certain component suppliers and manufacturing vendors, are located near major seismic faults. Because the Company does not carry earthquake insurance for direct quake-related losses and significant recovery time could be required to resume operations, the Company's financial condition and operating results could be materially adversely affected in the event of a major earthquake.

The Company may be subject to information technology system failures, network disruptions and breaches in data security.

Information technology system failures, network disruptions and breaches of data security caused by such factors including without limitation earthquakes, fire, theft, or other causes could disrupt the Company's operations by causing delays or cancellation of customer, including channel partner, orders, negatively affecting the Company's online, iTunes, MobileMe and retail offerings and services, impeding the manufacture or shipment of products, processing transactions and reporting financial results, resulting in the unintentional disclosure of customer or Company information, or damage to the Company's reputation. While management has taken steps to address these concerns by implementing sophisticated network security and internal control measures, there can be no assurance that a system failure or loss or data security breach will not materially adversely affect the Company's financial condition and operating results.

The Company expects its quarterly revenue and operating results to fluctuate for a variety of reasons.

The Company's profit margins vary among its products and its distribution channels. The Company's software, accessories, and service and support contracts generally have higher gross margins than certain of the Company's other products. Gross margins on the Company's hardware products vary across product lines and can change over time as a result of product transitions, pricing and configuration changes, and component, warranty, and other cost fluctuations. The Company's direct sales generally have higher associated gross margins than its indirect sales through its channel partners. In addition, the Company's gross margin and operating margin percentages, as well as overall profitability, may be materially adversely impacted as a result of a shift in product, geographic or channel mix, new products, component cost increases, strengthening U.S. dollar, or price competition. The Company has typically experienced greater net sales in the first and fourth fiscal quarters compared to the second and third fiscal quarters due to seasonal demand related to the holiday season and the beginning of the school year, respectively. Furthermore, the Company sells more products from time-to-time during the third month of a quarter than it does during either of the first two months. Developments late in a quarter, such as lower-than-anticipated demand for the Company's products, an internal systems failure, or failure of one of the Company's key logistics, components supply, or manufacturing partners, could have a material adverse impact on the Company's financial condition and operating results.

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The Company's stock price continues to be volatile.

The Company's stock has at times experienced substantial price volatility due to a number of factors, including but not limited to variations between its actual and anticipated financial results, announcements by the Company and its competitors, and uncertainty about current global economic conditions. The stock market as a whole also has experienced extreme price and volume fluctuations that have affected the market price of many technology companies in ways that may have been unrelated to these companies' operating performance. Furthermore, the Company believes its stock price reflects high future growth and profitability expectations. If the Company fails to meet these expectations its stock price may significantly decline.

The Company's business is subject to the risks of international operations.

The Company derives a large and growing portion of its revenue and earnings from its international operations. Compliance with U.S. and foreign laws and regulations that apply to the Company's international operations, including without limitation import and export requirements, the Foreign Corrupt Practices Act, tax laws (including U.S. taxes on foreign subsidiaries), foreign exchange controls and cash repatriation restrictions, data privacy requirements, labor laws, and anti-competition regulations, increases the costs of doing business in foreign jurisdictions, and such costs may rise in the future as a result of changes in these laws and regulations or in their interpretation. Furthermore, the Company has implemented policies and procedures designed to facilitate compliance with these laws and regulations, but there can be no assurance that the Company's employees, contractors, or agents will not violate such laws and regulations or the Company's policies. Any such violations could individually or in the aggregate materially adversely affect the Company's financial condition or operating results.

The Company's financial condition and operating results also could be significantly affected by other risks associated with international activities, including but not limited to, economic and labor conditions, political instability, and changes in the value of the U.S. dollar versus local currencies. Margins on sales of the Company's products in foreign countries, and on sales of products that include components obtained from foreign suppliers, could be materially adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including duties, tariffs and antidumping penalties.

The Company's primary exposure to movements in foreign currency exchange rates relate to non-U.S. dollar denominated sales in Europe, Japan, Australia, Canada and certain parts of Asia, as well as non-U.S. dollar denominated operating expenses incurred throughout the world. Weakening of foreign currencies relative to the U.S. dollar will adversely affect the U.S. dollar value of the Company's foreign currency-denominated sales and earnings, and generally will lead the Company to raise international pricing, potentially reducing demand for the Company's products. In some circumstances, due to competition or other reasons, the Company may decide not to raise local prices to the full extent of the dollar's strengthening, or at all, which would adversely affect the U.S. dollar value of the Company's foreign currency denominated sales and earnings. Conversely, a strengthening of foreign currencies, while generally beneficial to the Company's foreign currency-denominated sales and earnings, could cause the Company to reduce international pricing, thereby limiting the benefit. Additionally, strengthening of foreign currencies may also increase the Company's cost of product components denominated in those currencies, thus adversely affecting gross margins.

The Company has used derivative instruments, such as foreign currency forward and option contracts, to hedge certain exposures to fluctuations in foreign currency exchange rates. The use of such hedging activities may not offset any or more than a portion of the adverse financial effects of unfavorable movements in foreign exchange rates over the limited time the hedges are in place.

The Company is exposed to credit risk and fluctuations in the market values of its investment portfolio.

Although the Company has not recognized any material losses on its cash, cash equivalents and marketable securities, any significant future declines in their market values could materially adversely affect the Company's financial condition and operating results. Given the global nature of its business, the Company has investments

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both domestically and internationally. Additionally, the Company's overall investment portfolio has concentrations in the financial sector, which has been negatively impacted by adverse market liquidity conditions in the recent past. Credit ratings and pricing of these investments can be negatively impacted by liquidity, credit deterioration or losses, financial results, or other factors. As a result, the value or liquidity of the Company's cash, cash equivalents and marketable securities could decline and result in a material impairment, which could materially adversely affect the Company's financial condition and operating results.

The Company is exposed to credit risk on its accounts receivable and prepayments related to long-term supply agreements. This risk is heightened during periods when economic conditions worsen.

A substantial majority of the Company's outstanding trade receivables are not covered by collateral or credit insurance. The Company also has unsecured non-trade receivables resulting from purchases of components by contract manufacturers and other vendors that manufacture sub-assemblies or assemble final products for the Company. In addition, the Company has made prepayments associated with long-term supply agreements to secure supply of certain inventory components. While the Company has procedures to monitor and limit exposure to credit risk on its trade and non-trade receivables as well as long-term prepayments, there can be no assurance such procedures will effectively limit its credit risk and avoid losses, which could materially adversely affect the Company's financial condition and operating results.

The matters relating to the Company's past stock option practices and its restatement of consolidated financial statements may result in additional litigation.

The Company's investigation into its past stock option practices and its restatement of prior financial statements in the Annual Report on Form 10-K for the year ended September 30, 2006 gave rise to litigation and government investigations. As described in Part I, Item 3, "Legal Proceedings," several derivative and class action complaints regarding stock options were filed against the Company and current and former officers and directors. These actions have been dismissed following a comprehensive settlement. Two former officers of the Company were also named as defendants in an SEC enforcement action, which has been settled.

No assurance can be given that additional actions will not be filed against the Company and current and former officers and directors as a result of past stock option practices. If such actions are filed and result in adverse findings, the remedies could materially adversely affect the Company's financial condition and operating results.

Unfavorable results of legal proceedings could materially adversely affect the Company.

The Company is subject to various legal proceedings and claims that have arisen out of the ordinary conduct of its business and are not yet resolved and additional claims may arise in the future. Results of legal proceedings cannot be predicted with certainty. Regardless of merit, litigation may be both time-consuming and disruptive to the Company's operations and cause significant expense and diversion of management attention. In recognition of these considerations, the Company may enter into material settlements. Should the Company fail to prevail in certain matters, or should several of these matters be resolved against the Company in the same reporting period, the Company may be faced with significant monetary damages or injunctive relief against it that would materially adversely affect a portion of its business and might materially affect the Company's financial condition and operating results.

The Company is subject to risks associated with laws and regulations related to health, safety and environmental protection.

The Company's products and services, and the production and distribution of those goods and services, are subject to a variety of laws and regulations. These may require the Company to offer customers the ability to return a product at the end of its useful life and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have been passed in several jurisdictions in which the Company

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operates, including various countries within Europe and Asia and certain states and provinces within North America. Although the Company does not anticipate any material adverse effects based on the nature of its operations and the focus of such laws, there is no assurance such existing laws or future laws will not materially adversely affect the Company's financial condition and operating results.

Changes in the Company's tax rates, the adoption of new U.S. tax legislation or exposure to additional tax liabilities could affect its future results.

The Company is subject to taxes in the United States and numerous foreign jurisdictions. The Company's future effective tax rates could be affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, or changes in tax laws or their interpretation. In addition, the current administration and Congress have recently announced proposals for new U.S. tax legislation that, if adopted, could adversely affect the Company's tax rate. Any of these changes could have a material adverse affect on the Company's profitability. The Company is also subject to the continual examination of its income tax returns by the Internal Revenue Service and other tax authorities. The Company regularly assesses the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of its provision for taxes. There can be no assurance that the outcomes from these examinations will not materially adversely affect the Company's financial condition and operating results.

The Company is subject to risks associated with the availability and coverage of insurance.

For certain risks, the Company does not maintain insurance coverage because of cost and/or availability. Because the Company retains some portion of its insurable risks, and in some cases self-insures completely, unforeseen or catastrophic losses in excess of insured limits could materially adversely affect the Company's financial condition and operating results.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Company's headquarters are located in Cupertino, California. As of September 26, 2009, the Company owned and leased approximately 19.7 million square feet of space, primarily in the U.S., and to a lesser extent, in Europe, Japan, Canada, and the Asia Pacific region. The Company's total leased space was approximately 4.5 million square feet, of which approximately 2.0 million square feet was retail space, a majority of which is in the U.S.

As of September 26, 2009, the Company owned a manufacturing facility in Cork, Ireland that also housed a customer support call center and facilities in Elk Grove, California that included warehousing and distribution operations and a customer support call center. In addition, the Company owned facilities for research and development and corporate functions in Cupertino, California, including land for the future development of the Company's second corporate campus. The Company also owned a data center in Newark, California and, during 2009, purchased additional land in North Carolina for a future data center facility. Outside the U.S., the Company owned additional facilities for various purposes.

The Company believes its existing facilities and equipment are in good operating condition and are suitable for the conduct of its business. The Company has invested in internal capacity and strategic relationships with outside manufacturing vendors, and believes it has adequate manufacturing capacity for the foreseeable future. The Company continues to make investments in capital equipment as needed to meet anticipated demand for its products.

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Item 3. Legal Proceedings

As of September 26, 2009, the end of the annual period covered by this report, the Company was subject to the various legal proceedings and claims discussed below, as well as certain other legal proceedings and claims that have not been fully resolved and that have arisen in the ordinary course of business. In the opinion of management, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate materially adversely affect its financial condition or operating results. However, the results of legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected. The Company settled certain matters during the fourth quarter of 2009 that did not individually or in the aggregate have a material impact on the Company's financial condition and results of operations.

Bader v. Anderson, et al.

Plaintiff filed this purported shareholder derivative action against the Company and each of its then current executive officers and members of its Board of Directors on May 19, 2005 in Santa Clara County Superior Court asserting claims for breach of fiduciary duty, material misstatements and omissions and violations of California Business & Professions Code §17200 (unfair competition). The complaint alleged that the Company's March 14, 2005, proxy statement was false and misleading for failure to disclose certain information relating to the Apple Computer, Inc. Performance Bonus Plan, which was approved by shareholders at the annual meeting held on April 21, 2005. Plaintiff, who ostensibly brought suit on the Company's behalf, made no demand on the Board of Directors and alleged that such demand was excused. The complaint sought injunctive and other relief for purported injury to the Company. On July 27, 2005, plaintiff filed an amended complaint alleging that, in addition to the purported derivative claims, adoption of the bonus plan and distribution of the proxy statement describing that plan also inflicted injury on her directly as an individual shareholder. On January 10, 2006, the Court sustained defendants' demurrer to the amended complaint, with leave to amend. Plaintiff filed a second amended complaint on February 7, 2006, and the Company filed a demurrer. After a hearing on June 13, 2006, the Court sustained the demurrer without leave to amend as to the non-director officers and with leave to amend as to the directors. On July 24, 2006, plaintiff filed a third amended complaint, which purported to bring claims derivatively as well as directly on behalf of a class of common stockholders who have been or will be harmed by virtue of the allegedly misleading proxy statement. In addition to reasserting prior causes of action, the third amended complaint included a claim that the Company violated the terms of the plan, and a claim for waste related to restricted stock unit grants to certain officers in 2003 and 2004 and an option grant to the Company's CEO in January 2000. The Company filed a demurrer to the third amended complaint. On January 30, 2007, the Court sustained the Company's demurrer with leave to amend. On May 8, 2007, plaintiff filed a fourth amended complaint. The Company filed a demurrer to the fourth amended complaint, which the Court sustained, without leave to amend, on October 12, 2007. On October 25, 2007, the Court entered a final judgment in favor of defendant and ordered the case dismissed with prejudice. On November 26, 2007, plaintiff filed a notice of appeal. A hearing on plaintiff's appeal is scheduled for October 29, 2009.

Birdsong v. Apple Computer, Inc.

This action alleges that the Company's iPod music players, and the ear bud headphones sold with them, are inherently defective in design and are sold without adequate warnings concerning the risk of noise-induced hearing loss by iPod users. The Birdsong action was initially filed on January 30, 2006 in the United States District Court for the Western District of Louisiana asserting Louisiana causes of action on behalf of a purported Louisiana class of iPod purchasers. A similar action *(Patterson v. Apple Computer, Inc.)* was filed on January 31, 2006 in the United States District Court for the Northern District of California asserting California causes of action on behalf of a purported class of all iPod purchasers within the four-year period before January 31, 2006. The Birdsong action was transferred to the Northern District of California, and the Patterson action was dismissed. An amended complaint was subsequently filed in Birdsong, dropping the Louisiana law-based claims and adding California law-based claims equivalent to those in Patterson. After the Company filed a motion to

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dismiss on November 3, 2006, plaintiffs agreed not to oppose the motion and filed a second amended complaint on January 16, 2007. That complaint alleges California law-based claims for breaches of implied and express warranties, violations of California Business & Professions Code §17200 (unfair competition), California Business & Professions Code §17500 (false advertising), the Consumer Legal Remedies Act and negligent misrepresentation on behalf of a putative nationwide class and a Louisiana law-based claim for redhibition for a Louisiana sub-class. On March 1, 2007, the Company filed a motion to dismiss the California law-based claims, which was heard on June 4, 2007. On December 14, 2007, the Court issued an order granting the Company's motion, with leave to amend the complaint. On January 11, 2008, plaintiffs filed a third amended complaint, which seeks restitution, injunctive relief, unspecified damages and attorneys' fees. On February 15, 2008, the Company filed a motion to dismiss the third amended complaint. On June 16, 2008, the Court granted the Company's motion to dismiss the third amended complaint with prejudice. On July 11, 2008, plaintiffs filed a notice of appeal. A hearing on plaintiffs' appeal took place on October 8, 2009.

A similar complaint, *Royer-Brennan v. Apple Computer, Inc. and Apple Canada, Inc.*, was filed in Montreal, Quebec, Canada, on February 1, 2006, seeking authorization to institute a class action on behalf of iPod purchasers in Quebec. Plaintiffs filed a motion to amend their complaint to add a minor plaintiff and claims regarding alleged risks of hearing loss to young people. The hearing on the motion to amend took place on April 24, 2009, and the Court denied plaintiffs' motion with leave to resubmit it.

Branning et al. v. Apple Computer, Inc.

Plaintiffs originally filed this purported class action in San Francisco County Superior Court on February 17, 2005. The initial complaint alleged violations of California Business & Professions Code §17200 (unfair competition) and violation of the Consumer Legal Remedies Act regarding a variety of purportedly unfair and unlawful conduct including but not limited to allegedly selling used computers as new and failing to honor warranties. Plaintiffs also brought causes of action for misappropriation of trade secrets, breach of contract and violation of the Song-Beverly Consumer Warranty Act. Plaintiffs requested unspecified damages and other relief. On May 2, 2005, plaintiffs filed an amended complaint adding two new named plaintiffs and three new causes of action including a claim for treble damages under the Cartwright Act (California Business & Professions Code §16700 et seq.) and a claim for false advertising. On May 9, 2005, the Court granted the Company's motion to transfer the case to Santa Clara County Superior Court. The Company filed a demurrer to the amended complaint, which the Court sustained in its entirety on November 10, 2005. The Court granted plaintiffs leave to amend and they filed an amended complaint on December 29, 2005. Plaintiffs' amended complaint added three plaintiffs and alleged many of the same factual claims as the previous complaints, such as alleged selling of used equipment as new, alleged failure to honor warranties and service contracts for the consumer plaintiffs, and alleged fraud related to the opening of the Apple retail stores. Plaintiffs continued to assert causes of action for unfair competition (§17200), violations of the Consumer Legal Remedies Act, breach of contract, misappropriation of trade secrets, violations of the Cartwright Act, and alleged new causes of action for fraud, conversion, and breach of the implied covenant of good faith and fair dealing. The Company filed a demurrer to the amended complaint on January 31, 2006, which the Court sustained on March 3, 2006 on sixteen of seventeen causes of action. Plaintiffs filed an amended complaint adding one new plaintiff. The Company filed a demurrer, which was granted in part on September 9, 2006. Plaintiffs filed a further amended complaint on September 21, 2006. On October 2, 2006, the Company filed an answer denying all allegations and asserting numerous affirmative defenses. On November 30, 2007, the Company filed a motion for judgment on the pleadings, which the Court denied. Plaintiffs filed a Fifth Amended Complaint on March 19, 2008 and a Corrected Fifth Amended Complaint on April 1, 2008. The Company filed an answer to the Corrected Fifth Amended Complaint on April 18, 2008. The Company filed a motion for judgment on the pleadings for an order dismissing plaintiffs' fraud claim based upon the statute of limitations, which was granted by the Court on June 24, 2008, with leave to amend. Plaintiffs filed a Sixth Amended Complaint on July 14, 2008 and a Seventh Amended Complaint on August 22, 2008, adding three new reseller plaintiffs. On August 22, 2008, plaintiffs also filed a motion to certify the consumer class. On September 22, 2008, the Company filed its answer to the consumer-related claims denying all allegations and asserting numerous affirmative defenses, and also filed a

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demurrer to the new reseller claims, which the Court heard on January 30, 2009. The Court sustained the demurrer as to all plaintiffs except one, with leave to amend. Plaintiffs filed an Eighth Amended Complaint further amending the reseller claims on February 24, 2009, and on March 26, 2009, the Company filed a demurrer which was overruled, and a motion to strike which was denied. The Company filed motions for summary adjudication for certain claims of two named plaintiffs, which the Court granted on November 10, 2008. Plaintiffs petitioned the Court of Appeal for a writ of certiorari from the summary adjudication ruling and a motion to stay the class certification hearing, which the Court of Appeal denied on December 17, 2008. On December 19, 2008, the Court held a hearing on plaintiffs' class certification motion. The Court requested further briefing and an additional hearing, which did not take place because on February 23, 2009, Hon. Jamie A. Jacobs-May disqualified herself from the case. The Company filed a petition for a writ of mandate from this order, which the Court of Appeal denied on May 19, 2009. The case has been reassigned to Hon. Joseph H. Huber. The class certification hearing on the consumer-related claims took place on July 14, 2009. The Company has filed two additional motions for summary adjudication as to all of the named plaintiffs' claims. The Company has also filed a motion to sever the consumer class and the reseller class for the purpose of trial. Plaintiffs' motion for class certification of the reseller class is due November 16, 2009.

Harvey v. Apple Inc.

Plaintiff filed this action on August 6, 2007 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement by the Company of U.S. Patent No. 6,753,671 entitled "Recharger for use with a portable electronic device and which includes a proximally located light emitting device" and U.S. Patent No. 6,762,584 entitled "Recharger for use with a portable electronic device and which includes a connector terminus for communicating with rechargeable batteries contained within the device." The complaint seeks unspecified damages and other relief. The Company filed an answer on October 12, 2007 denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims for declaratory judgment of non-infringement and invalidity. On April 7, 2008, plaintiff filed an amended complaint further alleging infringement of the reissue patent of U.S. Patent No. 6,753,671. On April 28, 2008, the Company filed an answer denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims for declaratory judgment of non-infringement and invalidity. The Markman hearing is set for October 28, 2009, and trial is scheduled for April 5, 2010. On February 3, 2009, the Court stayed the proceedings pending the U.S. Patent and Trademark Office's allowance of the '671 reissue patent. On July 7, 2009, the Company filed a motion to transfer the case to the Northern District of California. On September 19, 2009, the Company filed a motion to vacate the Markman hearing set for October 28, 2009, given the still pending reissue proceeding regarding U.S. Patent No. 6,753,671.

Honeywell International, Inc., et al. v. Apple Computer, Inc., et al.

Plaintiffs Honeywell International, Inc. and Honeywell Intellectual Properties, Inc. filed this action on October 6, 2004 in the United States District Court in Delaware alleging infringement by the Company and other defendants of U.S. Patent No. 5,280,371 entitled "Directional Diffuser for a Liquid Crystal Display." Plaintiffs seek unspecified damages and other relief. The Company filed an answer on December 21, 2004 denying all material allegations and asserting numerous affirmative defenses. The Company has tendered the case to several liquid crystal display manufacturer suppliers. On May 18, 2005 the Court stayed the case against the Company and the other non-manufacturer defendants. Plaintiffs filed an amended complaint on November 7, 2005 adding additional defendants and expanding the scope of the accused products. The Company's response to the amended complaint is not yet due. On April 2, 2008, the Court lifted the stay for the purpose of determining whether the liquid crystal display manufacturer suppliers used by the Company and certain other defendants are licensed under the '371 patent. On October 31, 2008, the Company filed a motion for summary judgment of non-infringement based on the contention that its suppliers are licensed under the '371 patent. A hearing on the motion has been postponed and has not been rescheduled.

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In re Apple iPod Nano Products Liability Litigation (formerly Wimmer v. Apple Computer, Inc.; Moschella, et al., v. Apple Computer, Inc.; Calado, et al. v. Apple Computer, Inc.; Kahan, et al., v. Apple Computer, Inc.; Jennings, et al., v. Apple Computer, Inc.; Rappel v. Apple Computer, Inc.; Mayo v. Apple Computer, Inc.; Valencia v. Apple Computer, Inc.; Williamson v. Apple Computer, Inc.; Sioson v. Apple Computer, Inc.

Beginning on October 19, 2005, eight complaints were filed in various United States District Courts and two complaints were filed in California State Court alleging that the Company's iPod nano was defectively designed so that it scratches excessively during normal use, rendering the screen unreadable.

The federal actions were coordinated in the United States District Court for the Northern District of California and assigned to the Hon. Ronald Whyte pursuant to an April 17, 2006 order of the Judicial Panel on Multidistrict Litigation. Plaintiffs filed a First Consolidated and Amended Master Complaint on September 21, 2006, alleging violations of California and other states' consumer protection and warranty laws and claiming unjust enrichment. The Master Complaint alleges two putative plaintiff classes: (1) all U.S. residents (excluding California residents) who purchased an iPod nano that was not manufactured or designed using processes necessary to ensure normal resistance to scratching of the screen; and (2) all iPod nano purchasers other than U.S. residents who purchased an iPod nano that was not manufactured or designed using processes necessary to ensure normal resistance to scratching of the screen. The Company answered the Master Complaint on November 20, 2006.

The two California State Court actions were coordinated on May 4, 2006, and assigned to the Hon. Carl West in Los Angeles County Superior Court. Plaintiffs filed a Consolidated Amended Class Action Complaint on June 8, 2006, alleging violations of California state consumer protection, unfair competition, false advertising and warranty laws and claiming unjust enrichment. The Consolidated Complaint alleges a putative plaintiff class of all California residents who own an iPod nano containing a manufacturing defect that results in the nano being susceptible to excessive scratching. The Company answered the Consolidated Amended Complaint on October 6, 2006. The parties have reached a settlement and on April 28, 2009, the Court granted final approval of the settlement. On May 21, 2009, an objector filed a notice of appeal.

Individual Networks, LLC v. Apple, Inc.

Plaintiff filed this action against the Company on April 24, 2007 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement of U.S. Patent No. 7,117,516, entitled "Method and System for Providing a Customized Media List." Plaintiff alleges certain features of the iTunes store infringe the patent. The complaint seeks unspecified damages and other relief. The Company filed an answer on July 2, 2007, denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims for declaratory judgment of non-infringement and invalidity, as well as a counterclaim against Individual Networks LLC for infringement of U.S. Patent No. 5,724,567. The trial is scheduled for November 9, 2009. The Company has filed a petition with the United States Patent and Trademark Office requesting reexamination of U.S. Patent No. 7,117,516. The Markman hearing took place on October 8, 2008, and the Court issued its Markman ruling on January 12, 2009. The Company filed a motion for summary judgment of inequitable conduct on April 10, 2009, and filed motions for summary judgment of invalidity and lack of written description on April 30, 2009. The Company has also filed a motion to exclude portions of plaintiff's expert's report and testimony regarding damages. Plaintiff has filed a motion to exclude damages testimony relating to U.S. Patent No. 5,724,567. The Company has also filed a motion for sanctions.

Mediostream, Inc. v. Acer America Corp. et al.

Plaintiff filed this action against the Company, Acer America Corp., Dell, Inc. and Gateway, Inc. on August 28, 2007 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement of U.S. Patent No. 7,009,655, entitled "Method and System for Direct Recording of Video Information onto a Disk Medium." An amended complaint was served on November 7, 2007. The amended complaint seeks unspecified damages and other relief. On January 25, 2008, the Company filed an answer to the

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complaint denying all material allegations and asserting numerous affirmative defenses and also filed a motion to transfer the case to the Northern District of California, which the Court denied. The Markman hearing is set for August 4, 2010 and trial is scheduled for January 4, 2011.

Nokia Corporation v. Apple Inc.

Plaintiff Nokia Corporation filed this action against the Company on October 22, 2009 in the United States District Court for the District of Delaware, alleging infringement of U.S. Patent No. 5,802,465, U.S. Patent No. 5,862,178, U.S. Patent No. 5,946,651, U.S. Patent No. 6,359,904, U.S. Patent No. 6,694,135, U.S. Patent No. 6,755,548, U.S. Patent No. 6,882,727, U.S. Patent No. 7,009,940, U.S. Patent No. 7,092,672, and U.S. Patent No. 7,403,621. The complaint alleges that these patents are essential to one or more of the GSM, UMTS and 802.11 wireless communications standards, and that the Company has the right to license these patents from plaintiff on fair, reasonable, and non-discriminatory ("FRAND") terms and conditions. Plaintiff seeks unspecified FRAND compensation and other relief. The Company's response to the complaint is not yet due. The Company intends to defend the case vigorously.

OPTi Inc. v. Apple Inc.

Plaintiff filed this action against the Company on January 16, 2007 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement of U.S. Patent Nos. 5,710,906, 5,813,036 and 6,405,291, all entitled "Predictive Snooping of Cache Memory for Master-Initiated Accesses." The complaint seeks unspecified damages and other relief. The Company filed an answer on April 17, 2007 denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims for declaratory judgment of non-infringement and invalidity. The Markman hearing took place on November 26, 2008 and the Court issued its Markman ruling on December 5, 2008. On April 3, 2009, the Court ruled that the accused computers sold between 2005 and 2007 infringed the '291 patent. A trial regarding validity, damages and willfulness commenced on April 17, 2009. On April 23, 2009, the jury returned a verdict that the patent was valid and willfully infringed, and awarded $19 million in damages. On May 1, 2009, plaintiff filed a motion for entry of judgment, including a request for enhanced damages based on the willfulness finding, seeking a total of $31 million plus attorneys' fees. The Company has opposed that motion and has filed its own motions for judgment as a matter of law or, alternatively, for a new trial and/or remittitur, on the issues of validity, willfulness and damages. The Court has not entered a judgment and has not set hearing dates for any of the pending motions.

Saito Shigeru Kenchiku Kenkyusho (Shigeru Saito Architecture Institute) v. iPod; Apple Japan Inc. v. Shigeru Saito Architecture Institute

Plaintiff Saito filed a petition in the Japan Customs Office in Tokyo on January 23, 2007 alleging infringement by the Company of Japanese Patent No. 3852854, entitled "Touch Operation Input Device and Electronic Parts Thereof." The petition sought an order barring the importation into Japan of fifth generation iPods and second generation iPod nanos. The Customs Office held a hearing on March 22, 2007. The Customs Office rejected the petition to bar importation and dismissed plaintiff's case.

Apple Japan, Inc. filed a Declaratory Judgment action against Saito on February 6, 2007 in the Tokyo District Court, seeking a declaration that the '854 patent is invalid and not infringed. Saito filed a Counter Complaint for infringement seeking damages. Plaintiff filed a motion to add new accused products into the case, which the Court granted at a hearing on June 30, 2009.

St-Germain v. Apple Canada, Inc.

Plaintiff filed this case in Montreal, Quebec, Canada, on August 5, 2005, seeking authorization to institute a class action for the refund by the Company of the Canadian Private Copying Levy that was applied to the iPod

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purchase price in Quebec between December 12, 2003 and December 14, 2004 but later declared invalid by the Canadian Court. The Company has completed a refund program for this levy. A class certification hearing took place January 13, 2006. On February 24, 2006, the Court granted class certification and notice was published during the last week of March 2006. The trial was conducted on October 15 and 16, 2007. On January 11, 2008, the Court issued a ruling in plaintiff's favor. The Court ruled that despite the Company's good faith efforts with the levy refund program, the Company must pay the amount claimed, and that the class is comprised of 20,000 persons who purchased an iPod in Quebec between December 12, 2003 and December 14, 2004. The Court ordered the Company to submit a statement of account showing the amount received by the Canadian Private Copying Collective, and the amount that has already been paid to class members in Quebec under the Company's levy refund program. The Court also ordered the parties to submit further briefing regarding the collective recovery award by February 23, 2008. On February 11, 2008, the Company filed an appeal. A hearing on the appeal is set for October 27, 2009.

The Apple iPod iTunes Antitrust Litigation (formerly Charoensak v. Apple Computer, Inc. and Tucker v. Apple Computer, Inc.); Somers v. Apple Inc.

The first-listed action is a consolidated case combining two cases previously pending under the names *Charoensak v. Apple Computer Inc. (formerly Slattery v. Apple Computer Inc.)* and *Tucker v. Apple Computer, Inc.* The original plaintiff (Slattery) in the Charoensak case filed a purported class action on January 3, 2005 in the United States District Court for the Northern District of California alleging various claims including alleged unlawful tying of music purchased on the iTunes Store with the purchase of iPods and unlawful acquisition or maintenance of monopoly market power. Plaintiff's complaint alleged violations of §§1 and 2 of the Sherman Act (15 U.S.C. §§1 and 2), California Business & Professions Code §16700 et seq. (the Cartwright Act), California Business & Professions Code §17200 (unfair competition), common law unjust enrichment and common law monopolization. Plaintiff sought unspecified damages and other relief. The Company filed a motion to dismiss on February 10, 2005. On September 9, 2005, the Court denied the motion in part and granted it in part. Plaintiff filed an amended complaint on September 23, 2005 and the Company filed an answer on October 18, 2005. In August 2006, the Court dismissed Slattery without prejudice and allowed plaintiffs to file an amended complaint naming two new plaintiffs (Charoensak and Rosen). On November 2, 2006, the Company filed an answer to the amended complaint denying all material allegations and asserting numerous affirmative defenses.

The Tucker case was filed as a purported class action on July 21, 2006 in the United States District Court for the Northern District of California alleging various claims including alleged unlawful tying of music and videos purchased on the iTunes Store with the purchase of iPods and vice versa and unlawful acquisition or maintenance of monopoly market power. The complaint alleges violations of §§1 and 2 of the Sherman Act (15 U.S.C. §§1 and 2), California Business & Professions Code §16700 et seq. (the Cartwright Act), California Business & Professions Code §17200 (unfair competition) and the California Consumer Legal Remedies Act. Plaintiff sought unspecified damages and other relief. On November 3, 2006, the Company filed a motion to dismiss the complaint. On December 20, 2006, the Court denied the motion to dismiss. On January 11, 2007, the Company filed an answer denying all material allegations and asserting numerous defenses.

On March 20, 2007, the Court consolidated the two cases. Plaintiffs filed a consolidated complaint on April 19, 2007. On June 6, 2007, the Company filed an answer to the consolidated complaint denying all material allegations and asserting numerous affirmative defenses. On July 17, 2008, plaintiffs filed a motion for class certification and on October 17, 2008, the Company filed its opposition to plaintiffs' motion. The class certification hearing took place on December 16, 2008. On December 22, 2008, the Court granted certification of the monopolization claims and denied without prejudice certification of the tying claims pending reconsideration of its denial of the Company's motion to dismiss. On February 13, 2009, the Company filed a motion for judgment on the pleadings as to plaintiffs' tying claims. On May 15, 2009, the Court issued an order granting the Company's motion in part, dismissing the federal per se tying claim and related state court tying claims and inviting the Company to file another motion for judgment on the pleadings if plaintiffs pursue a rule of reason

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tying claim. On July 17, 2009, the Court invited the Company to file a motion for reconsideration of the certification of an injunctive-relief class or a motion to strike plaintiffs' prayer for the type of injunctive relief sought. On August 3, 2009, the Company filed a motion for judgment on the pleadings as to the plaintiffs' Rule of Reason tying claim. On August 31, 2009, the Company filed a motion seeking reconsideration and denial of an injunctive relief class. The Company also filed a motion seeking decertification of the Rule 23 (b)(3) damages class or alternatively for leave to move for reconsideration. A hearing on the Company's motion for judgment on the pleadings as to plaintiffs' Rule of Reason tying claim took place on October 5, 2009.

A related complaint, *Somers v. Apple Inc.*, was filed on December 31, 2007 in the United States District Court for the Northern District of California on behalf of a purported class of indirect purchasers, alleging various claims including alleged unlawful tying of music and videos purchased on the iTunes Store with the purchase of iPods and vice versa and unlawful acquisition or maintenance of monopoly market power. The complaint alleges violations of §§1 and 2 of the Sherman Act (15 U.S.C. §§1 and 2), California Business & Professions Code §16700 et seq. (the Cartwright Act), California Business & Professions Code §17200 (unfair competition), the California Consumer Legal Remedies Act and California monopolization law. Plaintiff seeks unspecified damages and other relief. On February 21, 2008, the Company filed an answer denying all material allegations and asserting numerous defenses. On February 23, 2009, plaintiff filed a motion for class certification and on April 20, 2009, the Company filed its opposition to that motion. An evidentiary hearing on the class certification motion took place on June 30, 2009. On July 17, 2009, the Court denied certification of plaintiff's damage claims and deferred ruling on certification of plaintiff's injunctive claims pending resolution of the additional briefing requested by the Court, which is described above.

Tse v. Apple Computer, Inc. et al.

Plaintiff Ho Keung Tse filed this action against the Company and other defendants on August 5, 2005 in the United States District Court for the District of Maryland alleging infringement of U.S. Patent No. 6,665,797 entitled "Protection of Software Again [sic] Against Unauthorized Use." The complaint seeks unspecified damages and other relief. The Company filed an answer on October 31, 2005 denying all material allegations and asserting numerous affirmative defenses. On October 28, 2005, the Company and the other defendants filed a motion to transfer the case to the Northern District of California, which was granted on August 31, 2006. On July 24, 2007, the Company filed a petition for reexamination of the patent, which the U.S. Patent and Trademark Office granted. On July 25, 2007, the Company filed a motion to stay the litigation pending the outcome of the reexamination, which the Court granted on October 4, 2007. On July 21, 2009, the U.S. Patent and Trademark Office issued a final Office Action rejecting all asserted claims except for claim 16. On September 20, 2009, plaintiff filed a Notice of Appeal to the Board of Patent Appeals and Interferences from the final Office Action. The Court action remains stayed pending plaintiff's appeal.

Vitt v. Apple Computer, Inc.

Plaintiff filed this purported class action on November 7, 2006 in the United States District Court for the Central District of California on behalf of a purported nationwide class of all purchasers of the iBook G4 alleging that the computer's logic board fails at an abnormally high rate. The complaint alleges violations of California Business & Professions Code §17200 (unfair competition) and California Business & Professions Code §17500 (false advertising). Plaintiff seeks unspecified damages and other relief. The Company filed a motion to dismiss on January 19, 2007, which the Court granted on March 13, 2007. Plaintiffs filed an amended complaint on March 26, 2007. The Company filed a motion to dismiss on August 16, 2007, which was heard on October 4, 2007. The Court has not yet issued a ruling.

Vogel v. Jobs et al. (2006 Action)

Plaintiffs filed this purported class action on August 24, 2006, in the United States District Court for the Northern District of California against the Company and certain of the Company's current and former officers and

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directors alleging improper backdating of stock option grants to maximize certain defendants' profits, failing to properly account for those grants and issuing false financial statements. On January 19, 2007, the Court appointed the New York City Employees' Retirement System as lead plaintiff. On March 23, 2007, plaintiffs filed a Consolidated Class Action Complaint. The Consolidated Complaint purports to be brought on behalf of several classes of holders of the Company's stock and asserts claims under Section 14(a) and 20(a) of the Exchange Act as well as state law. The Consolidated Complaint seeks rescission of amendments to various stock option and other incentive compensation plans, an accounting and damages in an unspecified amount. Defendants filed a motion to dismiss on June 8, 2007, which was heard on September 7, 2007. On November 14, 2007, the Court issued an order dismissing all securities claims with prejudice, and held that any amended complaint could only be styled as a derivative case. On December 14, 2007, plaintiff filed a motion for leave to file a first amended consolidated class action complaint. On January 23, 2008, defendants filed an opposition to plaintiff's motion. Plaintiff's motion was heard on March 21, 2008. On May 14, 2008, the Court issued an order denying plaintiffs' motion for leave to amend. The court entered judgment dismissing the case on June 12, 2008. On June 17, 2008, plaintiffs filed a notice of appeal. A hearing on plaintiffs' appeal took place on October 7, 2009.

Vogel v. Apple Inc., et al. (2008 Action)

Plaintiff filed this purported class action on June 27, 2008, in the United States District Court for the Northern District of California against the Company and certain of the Company's current and former officers and directors. The allegations, which arise out of the Company's past stock option practices, are similar to those in the 2006 *Vogel v. Jobs et al.* action that was dismissed on June 12, 2008, as described above. The complaint purports to be brought on behalf of several classes of holders of the Company's stock and asserts claims under Sections 10(b) and 20(a) of the Exchange Act. The complaint seeks rescission of amendments to various stock option and other incentive compensation plans, an accounting and damages in an unspecified amount. On July 22, 2008, the Court stayed this case pending the appeal in the 2006 Action.

Item 4. Submission of Matters to a Vote of Security Holders

None.

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's common stock is traded on the over-the-counter market and is quoted on the NASDAQ Global Select Market under the symbol AAPL and on the Frankfurt Stock Exchange under the symbol APCD.

Price Range of Common Stock

The price range per share of common stock presented below represents the highest and lowest sales prices for the Company's common stock on the NASDAQ Global Select Market during each quarter of the two most recent years.

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Fiscal 2009 price range per common share	$ 188.90 - $134.42	$ 146.40 - $102.61	$ 109.98 - $ 78.20	$ 119.68 - $ 79.14
Fiscal 2008 price range per common share	$ 180.91 - $120.68	$ 192.24 - $142.52	$ 200.50 - $115.44	$ 202.96 - $150.63

Holders

As of October 16, 2009, there were 30,573 shareholders of record.

Dividends

The Company did not declare or pay cash dividends in either 2009 or 2008. The Company anticipates that for the foreseeable future it will retain any earnings for use in the operation of its business.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

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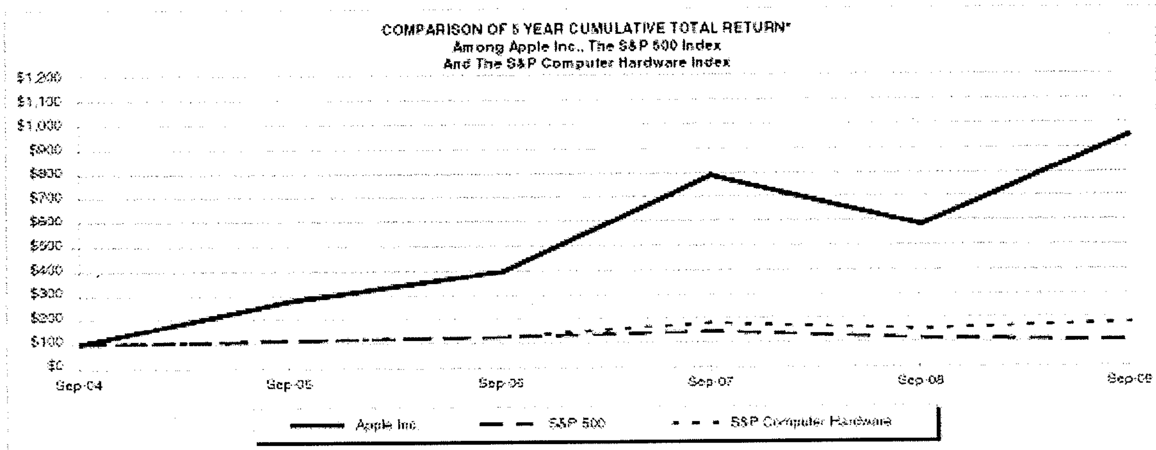
Company Stock Performance

The following graph shows a five-year comparison of cumulative total shareholder return, calculated on a dividend reinvested basis, for the Company, the S&P 500 Composite Index and the S&P Computer Hardware Index. The graph assumes $100 was invested in each of the Company's common stock, the S&P 500 Composite Index, and the S&P Computer Hardware Index on September 30, 2004. Data points on the graph are annual. Note that historic stock price performance is not necessarily indicative of future stock price performance.



*$100 invested on 9/30/04 in stock or index, including reinvestment of dividends.
Fiscal year ending September 30.

	September 2004	September 2005	September 2006	September 2007	September 2008	September 2009
Apple Inc.	$ 100	$ 277	$ 397	$ 792	$ 587	$ 957
S&P 500 Composite Index	$ 100	$ 112	$ 124	$ 145	$ 113	$ 105
S&P Computer Hardware Index	$ 100	$ 115	$ 123	$ 181	$ 152	$ 180

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Item 6. Selected Financial Data

The information set forth below for the five years ended September 26, 2009, is not necessarily indicative of results of future operations, and should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and related notes thereto included in Item 8 of this Form 10-K to fully understand factors that may affect the comparability of the information presented below (in millions, except share amounts which are reflected in thousands and per share amounts).

	2009	2008	2007	2006	2005
Net sales	$ 36,537	$ 32,479	$ 24,006	$ 19,315	$ 13,931
Net income	$ 5,704	$ 4,834	$ 3,496	$ 1,989	$ 1,328
Earnings per common share:					
Basic	$ 6.39	$ 5.48	$ 4.04	$ 2.36	$ 1.64
Diluted	$ 6.29	$ 5.36	$ 3.93	$ 2.27	$ 1.55
Cash dividends declared per common share	$ —	$ —	$ —	$ —	$ —
Shares used in computing earnings per share:					
Basic	893,016	881,592	864,595	844,058	808,439
Diluted	907,005	902,139	889,292	877,526	856,878
Cash, cash equivalents and marketable securities	$ 33,992	$ 24,490	$ 15,386	$ 10,110	$ 8,261
Total assets	$ 53,851	$ 39,572	$ 25,347	$ 17,205	$ 11,516
Long-term debt	$ —	$ —	$ —	$ —	$ —
Total liabilities	$ 26,019	$ 18,542	$ 10,815	$ 7,221	$ 4,088
Shareholders' equity	$ 27,832	$ 21,030	$ 14,532	$ 9,984	$ 7,428

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This section and other parts of this Form 10-K contain forward-looking statements that involve risks and uncertainties. Forward-looking statements can also be identified by words such as "anticipates," "expects," "believes," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and the Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Risk Factors" above, which are incorporated herein by reference. The following discussion should be read in conjunction with the consolidated financial statements and notes thereto included in Item 8 of this Form 10-K. All information presented herein is based on the Company's fiscal calendar. Unless otherwise stated, references in this report to particular years or quarters refer to the Company's fiscal years ended in September and the associated quarters of those fiscal years. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Executive Overview

The Company designs, manufactures, and markets personal computers, mobile communication devices, and portable digital music and video players and sells a variety of related software, services, peripherals, and networking solutions. The Company's products and services include the Mac line of desktop and portable computers, iPhone, the iPod line of portable digital music and video players, Apple TV, Xserve, a portfolio of consumer and professional software applications, the Mac OS X operating system, third-party digital content and applications through the iTunes Store, and a variety of accessory, service and support offerings. The Company sells its products worldwide through its online stores, its retail stores, its direct sales force, and third-party wholesalers, retailers, and value-added resellers. In addition, the Company sells a variety of third-party Mac, iPhone and iPod compatible products, including application software, printers, storage devices, speakers, headphones, and various other accessories and peripherals through its online and retail stores. The Company sells to consumer, small and mid-sized business ("SMB"), education, enterprise, government, and creative markets.

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The Company is focused on providing innovative products and solutions to consumer, SMB, education, enterprise, government and creative customers that greatly enhance their evolving digital lifestyles and work environments. The Company's overall business strategy is to control the design and development of the hardware and software for all of its products, including the personal computer, mobile communications and consumer electronics devices. The Company's business strategy leverages its unique ability to design and develop its own operating system, hardware, application software, and services to provide its customers new products and solutions with superior ease-of-use, seamless integration, and innovative industrial design. The Company believes continual investment in research and development is critical to the development and enhancement of innovative products and technologies. In conjunction with its strategy, the Company continues to build and host a robust platform for the discovery and delivery of third-party digital content and applications through the iTunes Store. Most recently the Company launched the App Store that allows users to browse, search for, and purchase third-party applications through either a Mac or Windows-based computer or by wirelessly downloading directly to an iPhone or iPod touch. The Company also desires to support a community for the development of third-party products that complement the Company's offerings through its developer programs. The Company is therefore uniquely positioned to offer superior and well-integrated digital lifestyle and productivity solutions.

The Company participates in several highly competitive markets, including personal computers with its Mac line of personal computers, mobile communications with iPhone, consumer electronics with its iPod product families, and distribution of third-party digital content and applications through its online iTunes Store. While the Company is widely recognized as a leading innovator in the personal computer, mobile communications and consumer electronics markets as well as a leader in the emerging market for distribution of digital content and applications, these markets are highly competitive and subject to aggressive pricing. To remain competitive, the Company believes that increased investment in research and development and marketing and advertising is necessary to maintain or expand its position in the markets where it competes. The Company's research and development spending is focused on further developing its existing Mac line of personal computers, its operating system, application software, iPhone and iPods; developing new digital lifestyle consumer and professional software applications; and investing in new product areas and technologies. The Company also believes increased investment in marketing and advertising programs is critical to increasing product and brand awareness.

The Company utilizes a variety of direct and indirect distribution channels. The Company believes that sales of its innovative and differentiated products are enhanced by knowledgeable salespersons who can convey the value of the hardware, software, and peripheral integration, demonstrate the unique digital lifestyle solutions that are available on Mac computers, and demonstrate the compatibility of the Mac with the Windows platform and networks. The Company further believes providing a high-quality sales and after-sales support experience is critical to attracting new and retaining existing customers. To ensure a high-quality buying experience for its products in which service and education are emphasized, the Company continues to expand and improve its distribution capabilities by opening its own retail stores in the U.S. and in international markets. The Company had 273 stores open as of September 26, 2009.

The Company has also invested in programs to enhance reseller sales, including the Apple Sales Consultant Program, which places Apple employees and contractors at selected third-party reseller locations, and the Apple Premium Reseller Program, through which independently run businesses focus on the Apple platform and provide a high level of customer service and product expertise. The Company believes providing direct contact with its targeted customers is an efficient way to demonstrate the advantages of its Mac computers and other products over those of its competitors. The Company also sells to customers directly through its online stores around the world and through its direct sales force.

The Company distributes iPhone in over 80 countries, through its direct channels, its cellular network carriers' distribution channels and certain third-party resellers. The Company has signed multi-year agreements with various cellular network carriers authorizing them to distribute and provide cellular network services for iPhones. These agreements are generally not exclusive with a specific carrier, except in the U.S., Germany, Spain, Ireland and certain other countries.

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The Company's iPods are sold through a significant number of distribution points to provide broad access. iPods can be purchased in certain department stores, member-only warehouse stores, large retail chains and specialty retail stores, as well as through the channels for Mac distribution listed above.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles ("GAAP") and the Company's discussion and analysis of its financial condition and operating results require the Company's management to make judgments, assumptions and estimates that affect the amounts reported in its consolidated financial statements and accompanying notes. Note 1, "Summary of Significant Accounting Policies" of Notes to Consolidated Financial Statements in this Form 10-K describes the significant accounting policies and methods used in the preparation of the Company's consolidated financial statements. Management bases its estimates on historical experience and on various other assumptions it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates and such differences may be material.

Management believes the Company's critical accounting policies and estimates are those related to revenue recognition, valuation of marketable securities, allowance for doubtful accounts, inventory valuation and inventory purchase commitments, warranty costs, income taxes, and legal and other contingencies. Management considers these policies critical because they are both important to the portrayal of the Company's financial condition and operating results, and they require management to make judgments and estimates about inherently uncertain matters. The Company's senior management has reviewed these critical accounting policies and related disclosures with the Audit and Finance Committee of the Company's Board of Directors.

Revenue Recognition

Net sales consist primarily of revenue from the sale of hardware, software, third-party digital content and applications, peripherals, and service and support contracts. The Company recognizes revenue for software products (operating system software and applications software), or any product that is considered to be software-related, in accordance with industry specific accounting guidance for software and software related transactions (e.g., Mac computers, iPhones and iPod portable digital music and video players). For products that are not software or software-related, (e.g., third-party digital content sold on the iTunes Store and certain Mac, iPhone and iPod supplies and accessories), the Company recognizes revenue pursuant to various revenue-related GAAP as described below.

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection is probable. Product is considered delivered to the customer once it has been shipped and title and risk of loss have been transferred. For most of the Company's product sales, these criteria are met at the time the product is shipped. For online sales to individuals, for some sales to education customers in the U.S., and for certain other sales, the Company defers recognition of revenue until the customer receives the product because the Company retains a portion of the risk of loss on these sales during transit. If at the outset of an arrangement the Company determines the arrangement fee is not, or is presumed not to be, fixed or determinable, revenue is deferred and subsequently recognized as amounts become due and payable and all other criteria for revenue recognition have been met.

For both iPhone and Apple TV, the Company has indicated it may from time-to-time provide future unspecified features and additional software products free of charge to customers. Accordingly, iPhone handsets and Apple TV sales are accounted for under subscription accounting in accordance with GAAP. As such, the revenue and associated cost of sales are deferred at the time of sale, and are both recognized on a straight-line basis over the currently estimated 24-month economic lives of these products, with any loss recognized at the time of sale. If the Company's estimated economic life of a product accounted for under subscription accounting changes, the

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future rate at which deferred revenue and deferred costs are recognized in the Company's results of operations will change. Costs incurred by the Company for engineering, sales, marketing and warranty are expensed as incurred.

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end-user rebates, and other sales programs and volume-based incentives. For transactions involving price protection, the Company recognizes revenue net of the estimated amount to be refunded, provided the refund amount can be reasonably and reliably estimated and the other conditions for revenue recognition have been met. The Company's policy requires that, if refunds cannot be reliably estimated, revenue is not recognized until reliable estimates can be made or the price protection lapses. For customer incentive programs, the estimated cost of these programs is recognized at the later of the date at which the Company has sold the product or the date at which the program is offered. The Company also records reductions to revenue for expected future product returns based on the Company's historical experience. Future market conditions and product transitions may require the Company to increase customer incentive programs and incur incremental price protection obligations that could result in additional reductions to revenue at the time such programs are offered. Additionally, certain customer incentive programs require management to estimate the number of customers who will actually redeem the incentive. Management's estimates are based on historical experience and the specific terms and conditions of particular incentive programs. If a greater than estimated proportion of customers redeem such incentives, the Company would be required to record additional reductions to revenue, which would have a negative impact on the Company's results of operations.

Valuation and Impairment of Marketable Securities

The Company's investments in available-for-sale securities are reported at fair value. Unrealized gains and losses related to changes in the fair value of investments are included in accumulated other comprehensive income, net of tax, as reported in the Company's Consolidated Balance Sheets. Changes in the fair value of investments impact the Company's net income only when such investments are sold or an other-than-temporary impairment is recognized. Realized gains and losses on the sale of securities are determined by specific identification of each security's cost basis. The Company regularly reviews its investment portfolio to determine if any investment is other-than-temporarily impaired due to changes in credit risk or other potential valuation concerns, which would require the Company to record an impairment charge in the period any such determination is made. In making this judgment, the Company evaluates, among other things, the duration and extent to which the fair value of an investment is less than its cost, the financial condition of the issuer and any changes thereto, and the Company's intent to sell, or whether it is more likely than not it will be required to sell, the investment before recovery of the investment's amortized cost basis. The Company's assessment on whether an investment is other-than-temporarily impaired or not, could change in the future due to new developments or changes in assumptions related to any particular investment.

Allowance for Doubtful Accounts

The Company distributes its products through third-party distributors, cellular network carriers, and resellers and directly to certain education, consumer, and enterprise customers. The Company generally does not require collateral from its customers; however, the Company will require collateral in certain instances to limit credit risk. In addition, when possible the Company does attempt to limit credit risk on trade receivables with credit insurance for certain customers in Latin America, Europe, Asia, and Australia, or by requiring third-party financing, loans or leases to support credit exposure. These credit-financing arrangements are directly between the third-party financing company and the end customer. As such, the Company generally does not assume any recourse or credit-risk-sharing related to any of these arrangements. However, considerable trade receivables that are not covered by collateral, third-party financing arrangements, or credit insurance are outstanding with the Company's distribution and retail channel partners.

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The allowance for doubtful accounts is based on management's assessment of the ability to collect specific customer accounts and includes consideration of the credit-worthiness and financial condition of those specific customers. The Company records an allowance to reduce the specific receivables to the amount that it reasonably believes to be collectible. The Company also records an allowance for all other trade receivables based on multiple factors, including historical experience with bad debts, the general economic environment, the financial condition of the Company's distribution channels, and the aging of such receivables. If there is a deterioration of a major customer's financial condition, if the Company becomes aware of additional information related to the credit-worthiness of a major customer, or if future actual default rates on trade receivables in general differ from those currently anticipated, the Company may have to adjust its allowance for doubtful accounts, which would affect its results of operations in the period the adjustments are made.

Inventory Valuation and Inventory Purchase Commitments

The Company must order components for its products and build inventory in advance of product shipments. The Company records a write-down for inventories of components and products, including third-party products held for resale, which have become obsolete or are in excess of anticipated demand or net realizable value. The Company performs a detailed review of inventory each fiscal quarter that considers multiple factors including demand forecasts, product life cycle status, product development plans, current sales levels, and component cost trends. The personal computer, mobile communications and consumer electronics industries are subject to a rapid and unpredictable pace of product and component obsolescence and demand changes. If future demand or market conditions for the Company's products are less favorable than forecasted or if unforeseen technological changes negatively impact the utility of component inventory, the Company may be required to record additional write-downs, which would negatively affect its results of operations in the period when the write-downs were recorded.

The Company records accruals for estimated cancellation fees related to component orders that have been cancelled or are expected to be cancelled. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. These commitments typically cover the Company's requirements for periods ranging from 30 to 150 days. If there is an abrupt and substantial decline in demand for one or more of the Company's products or an unanticipated change in technological requirements for any of the Company's products, the Company may be required to record additional accruals for cancellation fees that would negatively affect its results of operations in the period when the cancellation fees are identified and recorded.

Warranty Costs

The Company provides for the estimated cost of hardware and software warranties at the time the related revenue is recognized based on historical and projected warranty claim rates, historical and projected cost-per-claim, and knowledge of specific product failures that are outside of the Company's typical experience. Each quarter, the Company reevaluates its estimates to assess the adequacy of its recorded warranty liabilities considering the size of the installed base of products subject to warranty protection and adjusts the amounts as necessary. For products accounted for under subscription accounting, the Company recognizes warranty expense as incurred. If actual product failure rates or repair costs differ from estimates, revisions to the estimated warranty liability would be required and could materially affect the Company's results of operations.

The Company periodically provides updates to its applications and operating system software to maintain the software's compliance with specifications. The estimated cost to develop such updates is accounted for as warranty cost that is recognized at the time related software revenue is recognized. Factors considered in determining appropriate accruals related to such updates include the number of units delivered, the number of updates expected to occur, and the historical cost and estimated future cost of the resources necessary to develop these updates.

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Income Taxes

The Company records a tax provision for the anticipated tax consequences of the reported results of operations. In accordance with GAAP, the provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. The Company records a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized.

The Company recognizes and measures uncertain tax positions in accordance with GAAP, whereby the Company only recognizes the tax benefit from an uncertain tax position if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement.

Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets. In the event that the Company determines all or part of the net deferred tax assets are not realizable in the future, the Company will make an adjustment to the valuation allowance that would be charged to earnings in the period such determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of GAAP and complex tax laws. Resolution of these uncertainties in a manner inconsistent with management's expectations could have a material impact on the Company's financial condition and operating results.

Legal and Other Contingencies

As discussed in Part I, Item 3 of this Form 10-K under the heading "Legal Proceedings" and in Note 8, "Commitments and Contingencies" in Notes to Consolidated Financial Statements, the Company is subject to various legal proceedings and claims that arise in the ordinary course of business. In accordance with GAAP, the Company records a liability when it is probable that a loss has been incurred and the amount is reasonably estimable. There is significant judgment required in both the probability determination and as to whether an exposure can be reasonably estimated. In management's opinion, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate materially adversely affect its financial condition or operating results. However, the outcomes of legal proceedings and claims brought against the Company are subject to significant uncertainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

Net Sales

Fiscal years 2009, 2008 and 2007 spanned 52 weeks. An additional week is included in the first fiscal quarter approximately every six years to realign fiscal quarters with calendar quarters.

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The following table summarizes net sales and Mac unit sales by operating segment and net sales and unit sales by product during the three years ended September 26, 2009 (in millions, except unit sales in thousands and per unit amounts):

	2009	Change	2008	Change	2007
Net Sales by Operating Segment:					
Americas net sales	$16,142	11%	$14,573	26%	$11,596
Europe net sales	9,365	23%	7,622	40%	5,460
Japan net sales	1,831	21%	1,509	39%	1,082
Retail net sales	6,574	4%	6,315	53%	4,115
Other Segments net sales (a)	2,625	7%	2,460	40%	1,753
Total net sales	$36,537	12%	$32,479	35%	$24,006
Mac Unit Sales by Operating Segment:					
Americas Mac unit sales	4,120	4%	3,980	32%	3,019
Europe Mac unit sales	2,840	13%	2,519	39%	1,816
Japan Mac unit sales	395	2%	389	29%	302
Retail Mac unit sales	2,115	4%	2,034	47%	1,386
Other Segments Mac unit sales (a)	926	17%	793	50%	528
Total Mac unit sales	10,396	7%	9,715	38%	7,051
Net Sales by Product:					
Desktops (b)	$ 4,308	(23)%	$ 5,603	39%	$ 4,020
Portables (c)	9,472	9%	8,673	38%	6,294
Total Mac net sales	13,780	(3)%	14,276	38%	10,314
iPod	8,091	(12)%	9,153	10%	8,305
Other music related products and services (d)	4,036	21%	3,340	34%	2,496
iPhone and related products and services (e)	6,754	266%	1,844	NM	123
Peripherals and other hardware (f)	1,470	(11)%	1,659	32%	1,260
Software, service and other sales (g)	2,406	9%	2,207	46%	1,508
Total net sales	$36,537	12%	$32,479	35%	$24,006
Unit Sales by Product:					
Desktops (b)	3,182	(14)%	3,712	37%	2,714
Portables (c)	7,214	20%	6,003	38%	4,337
Total Mac unit sales	10,396	7%	9,715	38%	7,051
Net sales per Mac unit sold (h)	$ 1,326	(10)%	$ 1,469	—%	$ 1,463
iPod unit sales	54,132	(1)%	54,828	6%	51,630
Net sales per iPod unit sold (i)	$ 149	(11)%	$ 167	4%	$ 161
iPhone unit sales	20,731	78%	11,627	NM	1,389

(a) Other Segments include Asia Pacific and FileMaker.
(b) Includes iMac, Mac mini, Mac Pro and Xserve product lines.
(c) Includes MacBook, MacBook Air and MacBook Pro product lines.
(d) Consists of iTunes Store sales, iPod services, and Apple-branded and third-party iPod accessories.
(e) Derived from handset sales, carrier agreements, and Apple-branded and third-party iPhone accessories.
(f) Includes sales of displays, wireless connectivity and networking solutions, and other hardware accessories.

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(g) Includes sales of Apple-branded operating system and application software, third-party software, AppleCare and Internet services.
(h) Derived by dividing total Mac net sales by total Mac unit sales.
(i) Derived by dividing total iPod net sales by total iPod unit sales.
NM = Not Meaningful

Fiscal Year 2009 versus 2008

Net sales during 2009 increased $4.1 billion or 12% compared to 2008. Several factors contributed positively to these increases, including the following:

- iPhone revenue and net sales of related products and services amounted to $6.8 billion in 2009, an increase of $4.9 billion or 266% compared to 2008. iPhone handset unit sales totaled 20.7 million during 2009, which represents an increase of 9.1 million or 78% during 2009 compared to 2008. This growth is attributed primarily to expanded distribution and strong overall demand for iPhones. iPhone 3GS was released in the U.S. on June 19, 2009 and in many other countries over the remainder of 2009. iPhone revenue includes the portion of handset revenue recognized in the relevant period in accordance with subscription accounting over the product's currently estimated 24-month economic life, as well as revenue from sales of iPhone accessories and carrier agreements. The year-over-year iPhone revenue growth is also largely attributable to the year-over-year increase in iPhone handset unit sales in both 2009 and 2008, which generated significant amounts of deferred revenue that is being recognized over the iPhone's estimated economic life.
- Net sales of other music-related products and services increased $696 million or 21% during 2009 compared to 2008. The increase was due predominantly to increased net sales of third-party digital content and applications from the iTunes Store, which experienced double-digit growth in each of the Company's geographic segments during 2009 compared to the same period in 2008. The Company believes this continued growth is the result of heightened consumer interest in downloading third-party digital content and applications, continued growth in its customer base of iPod and iPhone customers, the expansion of third-party audio and video content available for sale and rent via the iTunes Store, and the continued interest in and growth of the App Store. The Company continues to expand its iTunes content and applications offerings around the world.

Partially offsetting the favorable factors discussed above, net sales during 2009 were negatively impacted by certain factors, including the following:

- Mac net sales declined 3% during 2009 compared to 2008, although Mac unit sales increased by 7% over the same period. Net sales per Mac unit sold decreased by 10% during 2009 compared to 2008, due primarily to lower average selling prices across all Mac portable and desktop systems and a stronger U.S. dollar. Net sales of Macs accounted for 38% of the Company's total net sales for 2009. During 2009, Mac portable systems net sales and unit sales increased by 9% and 20%, respectively, compared to 2008. This growth was driven by strong demand for MacBook Pro, which was updated in June 2009 and October 2008, and experienced double digit net sales and unit growth in each of the Company's reportable operating segments compared to the same period in 2008. The Company also had a higher product mix of portable systems, which is consistent with the overall market trends. However, net sales and unit sales of the Company's Mac desktop systems decreased by 23% and 14%, respectively, during 2009 compared to 2008. The decrease in net sales of Mac desktop systems was due mainly to a shift in product mix towards lower-priced desktops, lower average selling prices across all Mac desktop systems and a stronger U.S. dollar.
- Net sales of iPods decreased $1.1 billion or 12% during 2009 compared to 2008. iPod unit sales decreased slightly by 1% during 2009 compared to 2008. Net sales per iPod unit sold decreased 11% to $149 in 2009 compared to 2008, resulting from lower average selling prices across all of the iPod product lines, which were due primarily to price reductions taken with the introduction of new iPods in

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September 2009 and September 2008 and a stronger U.S. dollar, offset partially by a higher product mix of iPod touch.

Fiscal Year 2008 versus 2007

Net sales during 2008 increased 35% or $8.5 billion from 2007. Several factors contributed to these increases including the following:

- Mac net sales increased $4.0 billion or 38% during 2008 compared to 2007, while Mac unit sales increased by 2.7 million units or 38%. Net sales related to the Company's Mac shipments accounted for 44% of the Company's total net revenue. Higher Mac unit sales, which contributed to the increases in net sales, were driven by higher sales of all of the Company's Mac portable products as well as the popularity of the iMac, which experienced strong growth in net sales and unit sales in all of the Company's reportable segments. Unit sales of the Company's Mac portable products accounted for 62% of the Company's personal computer shipments in both 2008 and 2007. Net sales and unit sales of the Company's Mac portable products both increased by 38% during 2008 compared to 2007. This growth was attributable to strong demand for all the Mac portable products, particularly the MacBook, which had double-digit growth in all of the Company's operating segments, and the addition of the MacBook Air, which was introduced to the Company's Mac portable product line in January 2008. Growth of the Company's Mac desktop systems was also strong, with increased net sales and unit sales of 39% and 37%, respectively, during 2008 due primarily to strong sales of the iMac in all of the Company's operating segments.
- Net sales of iPods increased $848 million or 10% during 2008 compared to 2007 whereas unit sales of iPods increased 6% compared to 2007. The iPod unit growth was due to strong demand for the iPod touch, and to a lesser extent, higher unit sales of the iPod shuffle due to a price reduction in February 2008. iPod net sales grew faster than iPod unit sales due to higher average selling prices caused by a shift in overall iPod product mix to the higher priced iPod touch.
- Net sales of iPhone and related products and services were $1.8 billion for 2008, with iPhone handset unit sales totaling 11.6 million. Net sales of iPhone and related products and services were $123 million in 2007, which represented sales for one fiscal quarter. iPhone revenue includes the portion of handset revenue recognized in the relevant period in accordance with subscription accounting over the product's currently estimated 24-month economic life, as well as revenue from sales of iPhone accessories and from carrier agreements.
- Net sales of other music related products and services increased $844 million or 34% during 2008 compared to 2007, due primarily to significantly increased net sales from the iTunes Store in each of the Company's geographic segments. The Company believes this success is the result of heightened consumer interest in downloading third-party digital content, the expansion of third-party audio and video content available for sale and rent via the iTunes Store, and the launch of the iTunes App Store. The Company continues to expand its iTunes content offerings around the world.

Segment Operating Performance

The Company manages its business primarily on a geographic basis. The Company's reportable operating segments consist of the Americas, Europe, Japan and Retail. The Americas, Europe and Japan reportable segments do not include activities related to the Retail segment. The Americas segment includes both North and South America. The Europe segment includes European countries as well as the Middle East and Africa. The Retail segment operates Apple-owned retail stores in the U.S. and in international markets. Each reportable geographic operating segment and the Retail operating segment provide similar hardware and software products and similar services. Further information regarding the Company's operating segments may be found in Note 9, "Segment Information and Geographic Data" in Notes to Consolidated Financial Statements of this Form 10-K.

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Americas

During 2009, net sales in the Americas segment increased $1.6 billion or 11% compared to 2008. The increase in net sales during 2009 was attributable to the significant year-over-year increase in iPhone revenue, higher sales of third-party digital content and applications from the iTunes Store, and increased sales of Mac portable systems, which were partially offset by a decrease in sales of Mac desktop systems and iPods. Americas Mac net sales decreased 6% due primarily to lower average selling prices, while Mac unit sales increased by 4% on a year-over-year basis. The increase in Mac unit sales was due primarily to strong demand for the MacBook Pro, which was updated in June 2009 and October 2008. The Americas segment represented approximately 44% and 45% of the Company's total net sales in 2009 and 2008, respectively.

During 2008, net sales in the Americas segment increased $3.0 billion or 26% compared to 2007. The primary drivers of this growth were the significant year-over-year increase in sales of the iPod touch, Mac portable systems, content from the iTunes Store, and iPhone. The Company began shipping iPhone in June 2007 and the growth in iPhone sales in 2008 resulted from a full year of iPhone shipments as well as stronger demand for iPhones in the fourth quarter of 2008. The increase in Mac net sales of $1.3 billion or 30% and Mac unit sales of 961 million or 32% is attributable to growth in sales of all of the Mac portable systems, particularly the MacBook, and higher sales of the iMac. Net sales of iPods increased due to a shift in product mix toward higher priced iPods, particularly the iPod touch, which was upgraded in June 2008. In 2008, the Americas segment represented 45% of the Company's total net sales as compared to 48% in the same period of 2007.

Europe

During 2009, net sales in Europe increased $1.7 billion or 23% compared to 2008. The increase in net sales was due mainly to increased iPhone revenue and Mac portable systems, offset partially by lower net sales of Mac desktop systems, iPods, and a stronger U.S. dollar. Mac unit sales increased 13% in 2009 compared to 2008, which was driven primarily by increased sales of Mac portable systems, particularly MacBook Pro, while total Mac net sales declined as a result of lower average selling prices across all Mac products. Although iPod net sales decreased in Europe year-over-year as a result of lower average selling prices, iPod unit sales increased due to iPod touch and market share increases. The Europe segment represented 26% and 23% of total net sales in 2009 and 2008, respectively.

Europe's net sales and Mac unit sales increased 40% and 39%, respectively, during 2008 compared to 2007. The main drivers of this growth were strong sales of Mac portable systems and iMac, increased sales from the iTunes Store, and iPhone. Also contributing to the increase in net sales were higher iPod net sales due primarily to the iPod touch, which was upgraded in June 2008. Sales of Mac portable products increased due to stronger demand for the MacBook Pro and the MacBook, both updated in February 2008, as well as sales of the MacBook Air, introduced in January 2008. Mac desktop sales also increased due primarily to the popularity of the iMac, which was updated in April 2008. The Europe segment represented 23% of total net sales in 2008, consistent with 2007.

Japan

Japan's net sales increased $322 million or 21% in 2009 compared to 2008. The key contributors to this growth were increased iPhone revenue, stronger demand for certain Mac portable systems and iPods, and strength in the Japanese Yen, partially offset by decreased sales of Mac desktop systems. Net sales and unit sales of Mac portable systems increased during 2009 compared to 2008, driven primarily by stronger demand for MacBook Pro, which was updated in June 2009 and October 2008. Net sales and unit sales of iPods increased during 2009 compared to 2008, driven by strong demand for iPod touch and iPod nano.

Japan net sales increased $427 million or 39% in 2008 compared to 2007. The primary contributors to the growth in net sales were increases in sales of iPods, iMac, Mac portable systems, and strong sales from the iTunes Store. Net sales, unit sales and the average selling price of iPods increased during 2008 compared to 2007, driven by

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strong demand for iPod touch and iPod nano. Additionally, Mac net sales and unit sales grew 42% and 29%, respectively, in 2008 compared to 2007 due to increases in sales of iMac and Mac portable systems, particularly MacBook, as well as the introduction of MacBook Air in January 2008.

Retail

Retail net sales increased $259 million or 4% during 2009 compared to 2008. The growth in net sales was driven largely by increased iPhone revenue and Mac portable systems, offset partially by a decrease in sales of iPods and Mac desktop systems. The Company opened 26 new retail stores during 2009, including a total of 14 international stores, ending the year with 273 stores open. This compares to 247 stores open as of September 27, 2008 and 197 open stores as of September 29, 2007.

The year-over-year growth rate of Retail net sales was less than the increase in the average number of stores open during the same period, which the Company believes reflects the challenging consumer-spending environment and continued third-party channel expansion, particularly in the U.S. where most of its stores are located. With an average of 254 stores and 211 stores opened during 2009 and 2008, respectively, average revenue per store decreased to $25.9 million for 2009 from $29.9 million in 2008.

The Retail segment's net sales grew by 53% during 2008 compared to 2007, due in large part to increased sales of Mac portable and desktop systems, strong demand for the iPhone and iPod touch, and new store openings. The Company opened 50 new retail stores during 2008, bringing the total number of open stores to 247 as of September 27, 2008. This compares to 197 open stores as of September 29, 2007. With an average of 211 stores and 178 stores opened during 2008 and 2007, respectively, average revenue per store increased to $29.9 million for 2008 from $23.1 million in 2007.

As measured by the Company's operating segment reporting, the Retail segment reported operating income of $1.4 billion during 2009, as compared to operating income of $1.3 billion and $875 million during 2008 and 2007, respectively. This increase in operating income in 2009 was driven by increased total Retail net sales attributable to a 20% increase in average stores open and higher gross margin percentage consistent with that experienced Company-wide. The Retail segment's operating income increased by $462 million during 2008 as compared to 2007 due primarily to the significant Retail net sales growth of 53% as compared to 2007.

Expansion of the Retail segment has required and will continue to require a substantial investment in fixed assets and related infrastructure, operating lease commitments, personnel, and other operating expenses. Capital asset purchases associated with the Retail segment were $369 million in 2009, bringing the total capital asset purchases since inception of the Retail segment to $1.8 billion. As of September 26, 2009, the Retail segment had approximately 16,500 full-time equivalent employees and had outstanding operating lease commitments associated with retail store space and related facilities of $1.5 billion. The Company would incur substantial costs if it were to close multiple retail stores. Such costs could adversely affect the Company's financial condition and operating results.

Other Segments

The Company's Other Segments, which consist of its Asia Pacific and FileMaker operations, experienced an increase in net sales of $165 million, or 7%, during 2009 as compared to 2008 reflecting strong growth in sales of iPhone and Mac portable systems offset partially by a decline in sales related to iPods and Mac desktop systems in the Asia Pacific region, as well as a strengthening of the U.S. dollar against the Australian dollar and other Asian currencies. Mac net sales and unit sales grew in the Asia Pacific region by 4% and 17%, respectively, due to increased sales of the MacBook Pro.

The Company's Other Segments experienced an increase in net sales of $707 million, or 40% during 2008 as compared to 2007. These increases are related primarily to strong growth in sales of all Mac portable systems,

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iPods, the iMac, and content from the iTunes Store in the Company's Asia Pacific region. Sales from the iTunes Store in the Company's Asia Pacific region grew 109% compared to 2007.

Gross Margin

Gross margin for the three years ended September 26, 2009, are as follows (in millions, except gross margin percentages):

	2009	2008	2007
Net sales	$36,537	$32,479	$24,006
Cost of sales	23,397	21,334	15,852
Gross margin	$13,140	$11,145	$ 8,154
Gross margin percentage	36.0%	34.3%	34.0%

The gross margin percentage in 2009 was 36.0% compared to 34.3% in 2008. The primary drivers of the increase in 2009 as compared to 2008 were significantly lower commodity and other product costs and a favorable sales mix toward products with higher gross margins, which were partially offset by product price reductions. Gross margin percentage was relatively flat in 2008 as compared to 2007.

The Company expects its gross margin percentage to decrease in future periods compared to levels achieved during 2009 and anticipates gross margin levels of about 34% in the first quarter of 2010. This expected decline is due largely to the anticipated impact of product transitions, flat or reduced pricing on new and innovative products that have higher cost structures, and both expected and potential future cost increases for key components.

The foregoing statements regarding the Company's expected gross margin percentage are forward-looking and could differ from anticipated levels because of several factors, including but not limited to certain of those set forth below in Part I, Item 1A, "Risk Factors" under the subheading "*Future operating results depend upon the Company's ability to obtain key components including but not limited to microprocessors, NAND flash memory, DRAM and LCDs at favorable prices and in sufficient quantities*," which is incorporated herein by reference. There can be no assurance that targeted gross margin percentage levels will be achieved. In general, gross margins and margins on individual products will remain under downward pressure due to a variety of factors, including continued industry wide global product pricing pressures, increased competition, compressed product life cycles, product transitions and expected increases in the cost of key components including but not limited to microprocessors, NAND flash memory, dynamic random access memory ("DRAM") and liquid crystal displays ("LCDs"), as well as potential increases in the costs of outside manufacturing services and a potential shift in the Company's sales mix towards products with lower gross margins. In response to these competitive pressures, the Company expects it will continue to take product pricing actions, which would adversely affect gross margins. Gross margins could also be affected by the Company's ability to manage product quality and warranty costs effectively and to stimulate demand for certain of its products. Due to the Company's significant international operations, financial results can be significantly affected in the short-term by fluctuations in exchange rates.

Operating Expenses

Operating expenses for the three years ended September 26, 2009, are as follows (in millions, except for percentages):

	2009	2008	2007
Research and development	$ 1,333	$ 1,109	$ 782
Percentage of net sales	3.6%	3.4%	3.3%
Selling, general and administrative	$ 4,149	$ 3,761	$ 2,963
Percentage of net sales	11.4%	11.6%	12.3%

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Research and Development ("R&D")

R&D expenditures increased 20% or $224 million to $1.3 billion in 2009 compared to 2008. These increases were due primarily to an increase in headcount and higher stock-based compensation expenses in the current year to support expanded R&D activities. In addition, $71 million of software development costs were capitalized related to Mac OS X Snow Leopard and excluded from R&D expense during 2009, compared to $11 million of software development costs capitalized during 2008. Although total R&D expense increased 20% during 2009, it remained relatively flat as a percentage of net sales given the 12% increase in revenue in 2009. The Company continues to believe that focused investments in R&D are critical to its future growth and competitive position in the marketplace and are directly related to timely development of new and enhanced products that are central to the Company's core business strategy. As such, the Company expects to make further investments in R&D to remain competitive.

Expenditures for R&D increased 42% or $327 million to $1.1 billion in 2008 compared to 2007. These increases were due primarily to an increase in headcount in 2008 and higher stock-based compensation expenses. In 2008, $11 million of software development costs were capitalized related to Mac OS X Snow Leopard and excluded from R&D expense, while R&D expense for 2007 excluded $75 million of capitalized software development costs related to Mac OS X Leopard and iPhone software. Although total R&D expense increased 42% during 2008, it remained relatively flat as a percentage of net sales given the 35% increase in revenue during 2008.

Selling, General and Administrative Expense ("SG&A")

SG&A expenditures increased $388 million or 10% to $4.1 billion in 2009 compared to 2008. These increases are due primarily to the Company's continued expansion of its Retail segment in both domestic and international markets, higher stock-based compensation expenses and higher spending on marketing and advertising.

Expenditures for SG&A increased $798 million or 27% to $3.8 billion in 2008 compared to 2007. These increases are due primarily to higher stock-based compensation expenses, higher variable selling expenses resulting from the significant year-over-year increase in total net sales and the Company's continued expansion of its Retail segment in both domestic and international markets. In addition, the Company incurred higher spending on marketing and advertising during 2008 compared to 2007.

Other Income and Expense

Other income and expense for the three years ended September 26, 2009, are as follows (in millions):

	2009	2008	2007
Interest income	$ 407	$ 653	$ 647
Other income (expense), net	(81)	(33)	(48)
Total other income and expense	$ 326	$ 620	$ 599

Total other income and expense decreased $294 million or 47% to $326 million during 2009 compared to $620 million and $599 million in 2008 and 2007, respectively. The overall decrease in other income and expense is attributable to the significant decline in interest rates during 2009 compared to 2008 and 2007, partially offset by the Company's higher cash, cash equivalents and marketable securities balances. The weighted average interest rate earned by the Company on its cash, cash equivalents and marketable securities was 1.43%, 3.44% and 5.27% during 2009, 2008 and 2007, respectively. During 2009, 2008 and 2007, the Company had no debt outstanding and accordingly did not incur any related interest expense.

The Company's investment portfolio had gross unrealized losses of $16 million and $121 million as of September 26, 2009 and September 27, 2008, respectively, which were offset by gross unrealized gains of $73 million and $4 million as of September 26, 2009 and September 27, 2008, respectively. The net unrealized gains

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as of September 26, 2009 and the net unrealized losses as of September 27, 2008 related primarily to long-term marketable securities. The Company considers the declines in market value of its marketable securities investment portfolio to be temporary in nature. The unrealized losses on the Company's marketable securities were caused primarily by changes in market interest rates, specifically widening credit spreads. The Company does not have the intent to sell, nor is it more likely than not the Company will be required to sell, any investment before recovery of its amortized cost basis. Accordingly, no material declines in fair value were recognized in the Company's Consolidated Statements of Operations during 2009, 2008 and 2007. The Company may sell certain of its marketable securities prior to their stated maturities for strategic purposes, in anticipation of credit deterioration, or for duration management. The Company recognized no material net gains or losses during 2009, 2008 and 2007 related to such sales.

Provision for Income Taxes

The Company's effective tax rates were 29%, 30% and 30% for 2009, 2008 and 2007, respectively. The Company's effective rates for these periods differ from the statutory federal income tax rate of 35% due primarily to certain undistributed foreign earnings for which no U.S. taxes are provided because such earnings are intended to be indefinitely reinvested outside the U.S.

As of September 26, 2009, the Company had deferred tax assets arising from deductible temporary differences, tax losses, and tax credits of $3.2 billion before being offset against certain deferred liabilities of $1.8 billion for presentation on the Company's Consolidated Balance Sheet. Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets. The Company will continue to evaluate the realizability of deferred tax assets quarterly by assessing the need for and amount of the valuation allowance.

The Internal Revenue Service (the "IRS") has completed its field audit of the Company's federal income tax returns for the years 2002 through 2003 and proposed certain adjustments. The Company has contested certain of these adjustments through the IRS Appeals Office. All IRS audit issues for years prior to 2002 have been resolved. In addition, the Company is subject to audits by state, local, and foreign tax authorities. Management believes that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs.

Recent Accounting Pronouncements

In September 2009, the Financial Accounting Standards Boards ("FASB") amended the Accounting Standards Codification ("ASC") as summarized in Accounting Standards Update ("ASU") 2009-14, *Software (Topic 985): Certain Revenue Arrangements That Include Software Elements*, and ASU 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements*. As summarized in ASU 2009-14, ASC Topic 985 has been amended to remove from the scope of industry specific revenue accounting guidance for software and software related transactions, tangible products containing software components and non-software components that function together to deliver the product's essential functionality. As summarized in ASU 2009-13, ASC Topic 605 has been amended (1) to provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and the consideration allocated; (2) to require an entity to allocate revenue in an arrangement using estimated selling prices of deliverables if a vendor does not have vendor-specific objective evidence ("VSOE") or third-party evidence of selling price; and (3) to eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method. The accounting changes summarized in ASU 2009-14 and ASU 2009-13 are both effective for fiscal years beginning on or after June 15, 2010, with early adoption permitted. Adoption may either be on a prospective basis or by retrospective application.

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The Company is currently assessing the impact of these amendments to the ASC on its accounting and reporting systems and processes; however, at this time the Company is unable to quantify the impact on its financial statements of its adoption or determine the timing and method of its adoption. As of September 26, 2009, total iPhone and Apple TV deferred revenue and deferred costs were $12.1 billion and $5.2 billion, respectively. The Company believes that application of these amendments will result in a substantial portion of the revenue associated with the sale of iPhone and Apple TV and all related cost of sales being recognized at the time of sale. Currently revenue and associated cost of sales for these products are deferred at the time of sale and recognized ratably on a straight-line basis over the currently estimated 24-month economic life of the products.

During the first quarter of 2009, the Company adopted FASB ASC 820, *Fair Value Measurements and Disclosures* (formerly referenced as Statement of Financial Accounting Standards ("SFAS") No. 157, *Fair Value Measurements*), which defines fair value, provides a framework for measuring fair value, and expands the disclosures required for fair value measurements. In February 2008, the FASB issued supplemental guidance that delays the effective date of this new fair value accounting standard to fiscal years beginning after November 15, 2008 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) and will be adopted by the Company beginning in the first quarter of 2010. Although the Company will continue to evaluate the application of this accounting standard, management does not currently believe adoption of this accounting pronouncement will have a material impact on the Company's financial condition or operating results.

In December 2007, the FASB issued FASB ASC 805, *Business Combinations* (formerly referenced as SFAS No. 141 (revised 2007), *Business Combinations*), which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree in a business combination. This new accounting standard also establishes principles regarding how goodwill acquired in a business combination or a gain from a bargain purchase should be recognized and measured, as well as provides guidelines on the disclosure requirements on the nature and financial impact of the business combination. In April 2009, the FASB amended this new accounting standard to require that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value, if the fair value can be determined during the measurement period. This new business combination accounting standard is effective for fiscal years beginning on or after December 15, 2008 and will be adopted by the Company beginning in the first quarter of 2010 and will apply prospectively to any business combinations completed on or after that date. The effect of adoption of this new accounting pronouncement on the Company's financial condition or operating results will depend on the nature of acquisitions completed after the date of adoption.

Liquidity and Capital Resources

The following table presents selected financial information and statistics as of and for the three years ended September 26, 2009 (in millions):

	2009	2008	2007
Cash, cash equivalents and marketable securities	$33,992	$24,490	$15,386
Accounts receivable, net	$ 3,361	$ 2,422	$ 1,637
Inventories	$ 455	$ 509	$ 346
Working capital	$16,983	$18,219	$10,728
Annual operating cash flow	$10,159	$ 9,596	$ 5,470

As of September 26, 2009, the Company had $34.0 billion in cash, cash equivalents and marketable securities, an increase of $9.5 billion from September 27, 2008. The principal component of this net increase was the cash generated by operating activities of $10.2 billion, which was partially offset by payments for acquisitions of property, plant and equipment of $1.1 billion. The Company's cash generated by operating activities significantly exceeded its net income due primarily to the increase in deferred revenue, net of deferred costs, associated with subscription accounting for iPhone.

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The Company's marketable securities investment portfolio is invested primarily in highly rated securities, generally with a minimum rating of single-A or equivalent. As of September 26, 2009 and September 27, 2008, $17.4 billion and $11.3 billion, respectively, of the Company's cash, cash equivalents and marketable securities were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. The Company believes its existing balances of cash, cash equivalents and marketable securities will be sufficient to satisfy its working capital needs, capital asset purchases, outstanding commitments and other liquidity requirements associated with its existing operations over the next 12 months.

Capital Assets

The Company's cash payments for capital asset purchases were $1.1 billion during 2009, consisting of $369 million for retail store facilities and $775 million for real estate acquisitions and corporate infrastructure including information systems enhancements. The Company anticipates utilizing approximately $1.9 billion for capital asset purchases during 2010, including approximately $400 million for Retail facilities and approximately $1.5 billion for corporate facilities, infrastructure, and product tooling and manufacturing process equipment.

Historically the Company has opened between 25 and 50 new retail stores per year. During 2010, the Company expects to open a number of new stores near the upper end of this range, over half of which are expected to be located outside of the U.S.

Off-Balance Sheet Arrangements and Contractual Obligations

The Company has not entered into any transactions with unconsolidated entities whereby the Company has financial guarantees, subordinated retained interests, derivative instruments, or other contingent arrangements that expose the Company to material continuing risks, contingent liabilities, or any other obligation under a variable interest in an unconsolidated entity that provides financing, liquidity, market risk, or credit risk support to the Company.

The following table presents certain payments due by the Company under contractual obligations with minimum firm commitments as of September 26, 2009 and excludes amounts already recorded on the Consolidated Balance Sheet as current liabilities (in millions):

	Total	Payments Due in Less Than 1 Year	Payments Due in 1-3 Years	Payments Due in 4-5 Years	Payments Due in More Than 5 Years
Operating leases	$ 1,922	$ 222	$ 462	$ 413	$ 825
Purchase obligations	4,783	4,783	—	—	—
Asset retirement obligations	32	4	8	4	16
Other obligations	356	175	129	52	—
Total	$ 7,093	$ 5,184	$ 599	$ 469	$ 841

Lease Commitments

As of September 26, 2009, the Company had total outstanding commitments on noncancelable operating leases of $1.9 billion, $1.5 billion of which related to the lease of retail space and related facilities. The Company's major facility leases are generally for terms of one to 20 years and generally provide renewal options for terms of one to five additional years. Leases for retail space are for terms of five to 20 years, the majority of which are for ten years, and often contain multi-year renewal options.

Purchase Commitments with Contract Manufacturers and Component Suppliers

The Company utilizes several contract manufacturers to manufacture sub-assemblies for the Company's products and to perform final assembly and test of finished products. These contract manufacturers acquire components

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and build product based on demand information supplied by the Company, which typically covers periods ranging from 30 to 150 days. The Company also obtains individual components for its products from a wide variety of individual suppliers. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. Such purchase commitments typically cover the Company's forecasted component and manufacturing requirements for periods ranging from 30 to 150 days. In addition, the Company has an off-balance sheet warranty obligation for products accounted for under subscription accounting whereby the Company recognizes warranty expense as incurred. As of September 26, 2009, the Company had outstanding off-balance sheet third-party manufacturing commitments, component purchase commitments and estimated warranty commitments of $4.8 billion.

The Company has entered into prepaid long-term supply agreements to secure the supply of certain inventory components. During the first quarter of 2009, a long-term supply agreement with Intel Corporation was terminated and the remaining prepaid balance of $167 million was repaid to the Company. During the second and fourth quarters of 2009, the Company made a prepayment of $500 million to LG Display for the purchase of LCD panels and a prepayment of $500 million to Toshiba to purchase NAND flash memory, respectively. As of September 26, 2009, the Company had a total of $1.2 billion of inventory component prepayments outstanding.

Asset Retirement Obligations

The Company's asset retirement obligations are associated with commitments to return property subject to operating leases to original condition upon lease termination. As of September 26, 2009, the Company estimated that gross expected future cash flows of $32 million would be required to fulfill these obligations.

Other Obligations

Other outstanding obligations were $356 million as of September 26, 2009, which related to advertising, research and development, Internet and telecommunications services and other obligations.

As of September 26, 2009, the Company had gross unrecognized tax benefits of $971 million and an additional $291 million for gross interest and penalties classified as non-current liabilities in the Consolidated Balance Sheet. The Company believes it is reasonably possible that tax audit resolutions could reduce its unrecognized tax benefits by between $105 million and $145 million in the next 12 months. At this time, the Company is unable to make a reasonably reliable estimate of the timing of payments in individual years due to uncertainties in the timing of tax audit outcomes; therefore, such amounts are not included in the above contractual obligation table.

Indemnifications

The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against it or an indemnified third-party and, in the opinion of management, does not have a liability related to unresolved infringement claims subject to indemnification that would materially adversely affect its financial condition or operating results. Therefore, the Company did not record a liability for infringement costs as of either September 26, 2009 or September 27, 2008.

The Company has entered into indemnification agreements with its directors and executive officers. Under these agreements, the Company has agreed to indemnify such individuals to the fullest extent permitted by law against liabilities that arise by reason of their status as directors or officers and to advance expenses incurred by such

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individuals in connection with related legal proceedings. It is not possible to determine the maximum potential amount of payments the Company could be required to make under these agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each claim. However, the Company maintains directors and officers liability insurance coverage to reduce its exposure to such obligations, and payments made under these agreements historically have not materially adversely affected the Company's financial condition or operating results.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate and Foreign Currency Risk Management

The Company regularly reviews its foreign exchange forward and option positions, both on a stand-alone basis and in conjunction with its underlying foreign currency and interest rate related exposures. However, given the effective horizons of the Company's risk management activities and the anticipatory nature of the exposures, there can be no assurance the hedges will offset more than a portion of the financial impact resulting from movements in either foreign exchange or interest rates. In addition, the timing of the accounting for recognition of gains and losses related to mark-to-market instruments for any given period may not coincide with the timing of gains and losses related to the underlying economic exposures and, therefore, may adversely affect the Company's financial condition and operating results.

Interest Rate Risk

While the Company is exposed to interest rate fluctuations in many of the world's leading industrialized countries, the Company's interest income and expense is most sensitive to fluctuations in the general level of U.S. interest rates. As such, changes in U.S. interest rates affect the interest earned on the Company's cash, cash equivalents and marketable securities, the fair value of those investments, as well as costs associated with foreign currency hedges.

The Company's investment policy and strategy are focused on preservation of capital and supporting the liquidity requirements of the Company. A portion of the Company's cash is managed by external managers within the guidelines of the Company's investment policy and to objective market benchmarks. The Company's internal portfolio is benchmarked against external manager performance.

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's investment portfolio. The Company typically invests in highly rated securities and its policy generally limits the amount of credit exposure to any one issuer. The Company's investment policy requires investments to be investment grade, primarily rated single-A or better with the objective of minimizing the potential risk of principal loss. All highly liquid investments with initial maturities of three months or less at the date of purchase are classified as cash equivalents. The Company classifies its marketable securities as either short-term or long-term based on each instrument's underlying contractual maturity date. All short-term marketable securities have maturities less than 12 months, while all long-term marketable securities have maturities ranging from one to five years. The Company may sell its investments prior to their stated maturities for strategic purposes, in anticipation of credit deterioration, or for duration management. The Company recognized no material net gains or losses during 2009, 2008 and 2007 related to such sales.

To provide a meaningful assessment of the interest rate risk associated with the Company's investment portfolio, the Company performed a sensitivity analysis to determine the impact a change in interest rates would have on the value of the investment portfolio assuming a 100 basis point parallel shift in the yield curve. Based on investment positions as of September 26, 2009, a hypothetical 100 basis point increase in interest rates across all maturities would result in a $176 million incremental decline in the fair market value of the portfolio. As of September 27, 2008, a similar 100 basis point shift in the yield curve would have resulted in a $46 million incremental decline in the fair market value of the portfolio. Such losses would only be realized if the Company sold the investments prior to maturity.

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Foreign Currency Risk

In general, the Company is a net receiver of currencies other than the U.S. dollar. Accordingly, changes in exchange rates, and in particular a strengthening of the U.S. dollar, will negatively affect the Company's net sales and gross margins as expressed in U.S. dollars. There is also a risk that the Company will have to adjust local currency product pricing due to competitive pressures when there has been significant volatility in foreign currency exchange rates.

The Company may enter into foreign currency forward and option contracts with financial institutions to protect against foreign exchange risks associated with certain existing assets and liabilities, certain firmly committed transactions, forecasted future cash flows, and net investments in foreign subsidiaries. Generally, the Company's practice is to hedge a majority of its material foreign exchange exposures, typically for three to six months. However, the Company may choose not to hedge certain foreign exchange exposures for a variety of reasons, including but not limited to immateriality, accounting considerations and the prohibitive economic cost of hedging particular exposures.

To provide a meaningful assessment of the foreign currency risk associated with certain of the Company's foreign currency derivative positions, the Company performed a sensitivity analysis using a value-at-risk ("VAR") model to assess the potential impact of fluctuations in exchange rates. The VAR model consisted of using a Monte Carlo simulation to generate 3,000 random market price paths. The VAR is the maximum expected loss in fair value, for a given confidence interval, to the Company's foreign exchange portfolio due to adverse movements in rates. The VAR model is not intended to represent actual losses but is used as a risk estimation and management tool. The model assumes normal market conditions. Forecasted transactions, firm commitments, and assets and liabilities denominated in foreign currencies were excluded from the model. Based on the results of the model, the Company estimates with 95% confidence a maximum one-day loss in fair value of $44 million as of September 26, 2009 compared to a maximum one-day loss in fair value of $60 million as of September 27, 2008. Because the Company uses foreign currency instruments for hedging purposes, losses incurred on those instruments are generally offset by increases in the fair value of the underlying exposures.

Actual future gains and losses associated with the Company's investment portfolio and derivative positions may differ materially from the sensitivity analyses performed as of September 26, 2009 due to the inherent limitations associated with predicting the changes in the timing and amount of interest rates, foreign currency exchanges rates and the Company's actual exposures and positions.

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Item 8. Financial Statements and Supplementary Data

All financial statement schedules have been omitted, since the required information is not applicable or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements and notes thereto.

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CONSOLIDATED BALANCE SHEETS
(In millions, except share amounts)

	September 26, 2009	September 27, 2008
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 5,263	$ 11,875
Short-term marketable securities	18,201	10,236
Accounts receivable, less allowances of $52 and $47, respectively	3,361	2,422
Inventories	455	509
Deferred tax assets	2,101	1,447
Other current assets	6,884	5,822
Total current assets	36,265	32,311
Long-term marketable securities	10,528	2,379
Property, plant and equipment, net	2,954	2,455
Goodwill	206	207
Acquired intangible assets, net	247	285
Other assets	3,651	1,935
Total assets	$ 53,851	$ 39,572
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	$ 5,601	$ 5,520
Accrued expenses	3,376	3,719
Deferred revenue	10,305	4,853
Total current liabilities	19,282	14,092
Deferred revenue - non-current	4,485	3,029
Other non-current liabilities	2,252	1,421
Total liabilities	26,019	18,542
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value; 1,800,000,000 shares authorized; 899,805,500 and 888,325,973 shares issued and outstanding, respectively	8,210	7,177
Retained earnings	19,538	13,845
Accumulated other comprehensive income	84	8
Total shareholders' equity	27,832	21,030
Total liabilities and shareholders' equity	$ 53,851	$ 39,572

See accompanying Notes to Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except share amounts which are reflected in thousands and per share amounts)

Three years ended September 26, 2009	2009	2008	2007
Net sales	$ 36,537	$ 32,479	$ 24,006
Cost of sales	23,397	21,334	15,852
Gross margin	13,140	11,145	8,154
Operating expenses:			
Research and development	1,333	1,109	782
Selling, general and administrative	4,149	3,761	2,963
Total operating expenses	5,482	4,870	3,745
Operating income	7,658	6,275	4,409
Other income and expense	326	620	599
Income before provision for income taxes	7,984	6,895	5,008
Provision for income taxes	2,280	2,061	1,512
Net income	$ 5,704	$ 4,834	$ 3,496
Earnings per common share:			
Basic	$ 6.39	$ 5.48	$ 4.04
Diluted	$ 6.29	$ 5.36	$ 3.93
Shares used in computing earnings per share:			
Basic	893,016	881,592	864,595
Diluted	907,005	902,139	889,292

See accompanying Notes to Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(In millions, except share amounts which are reflected in thousands)

	Common Stock			Accumulated Other Comprehensive Income	Total Shareholders' Equity
	Shares	Amount	Retained Earnings		
Balances as of September 30, 2006	855,263	$ 4,355	$ 5,607	$ 22	$ 9,984
Components of comprehensive income:					
Net income	—	—	3,496	—	3,496
Change in foreign currency translation	—	—	—	51	51
Change in unrealized loss on available-for-sale securities, net of tax	—	—	—	(7)	(7)
Change in unrealized gain on derivative instruments, net of tax	—	—	—	(3)	(3)
Total comprehensive income					3,537
Stock-based compensation	—	251	—	—	251
Common stock issued under stock plans, net of shares withheld for employee taxes	17,066	364	(2)	—	362
Tax benefit from employee stock plan awards	—	398	—	—	398
Balances as of September 29, 2007	872,329	5,368	9,101	63	14,532
Cumulative effect of change in accounting principle	—	45	11	—	56
Components of comprehensive income:					
Net income	—	—	4,834		4,834
Change in foreign currency translation	—	—	—	(11)	(11)
Change in unrealized loss on available-for-sale securities, net of tax	—	—	—	(63)	(63)
Change in unrealized gain on derivative instruments, net of tax	—	—	—	19	19
Total comprehensive income					4,779
Stock-based compensation	—	513	—	—	513
Common stock issued under stock plans, net of shares withheld for employee taxes	15,888	460	(101)	—	359
Issuance of common stock in connection with an asset acquisition	109	21	—	—	21
Tax benefit from employee stock plan awards	—	770	—	—	770
Balances as of September 27, 2008	888,326	7,177	13,845	8	21,030
Components of comprehensive income:					
Net income	—	—	5,704	—	5,704
Change in foreign currency translation	—	—	—	(54)	(54)
Change in unrealized loss on available-for-sale securities, net of tax	—	—	—	118	118
Change in unrealized gain on derivative instruments, net of tax	—	—	—	12	12
Total comprehensive income					5,780
Stock-based compensation	—	707	—	—	707
Common stock issued under stock plans, net of shares withheld for employee taxes	11,480	404	(11)	—	393
Tax benefit from employee stock plan awards, including transfer pricing adjustments	—	(78)	—	—	(78)
Balances as of September 26, 2009	899,806	$ 8,210	$19,538	$ 84	$27,832

See accompanying Notes to Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)

Three years ended September 26, 2009	2009	2008	2007
Cash and cash equivalents, beginning of the year	$ 11,875	$ 9,352	$ 6,392
Operating Activities:			
Net income	5,704	4,834	3,496
Adjustments to reconcile net income to cash generated by operating activities:			
Depreciation, amortization and accretion	703	473	317
Stock-based compensation expense	710	516	242
Deferred income tax (benefit)/expense	(519)	(368)	78
Loss on disposition of property, plant and equipment	26	22	12
Changes in operating assets and liabilities:			
Accounts receivable, net	(939)	(785)	(385)
Inventories	54	(163)	(76)
Other current assets	(1,050)	(1,958)	(1,540)
Other assets	(1,346)	(492)	81
Accounts payable	92	596	1,494
Deferred revenue	6,908	5,642	1,139
Other liabilities	(184)	1,279	612
Cash generated by operating activities	10,159	9,596	5,470
Investing Activities:			
Purchases of marketable securities	(46,724)	(22,965)	(11,719)
Proceeds from maturities of marketable securities	19,790	11,804	6,483
Proceeds from sales of marketable securities	10,888	4,439	2,941
Purchases of other long-term investments	(101)	(38)	(17)
Payments made in connection with business acquisitions, net of cash acquired	—	(220)	—
Payment for acquisition of property, plant and equipment	(1,144)	(1,091)	(735)
Payment for acquisition of intangible assets	(69)	(108)	(251)
Other	(74)	(10)	49
Cash used in investing activities	(17,434)	(8,189)	(3,249)
Financing Activities:			
Proceeds from issuance of common stock	475	483	365
Excess tax benefits from stock-based compensation	270	757	377
Cash used to net share settle equity awards	(82)	(124)	(3)
Cash generated by financing activities	663	1,116	739
(Decrease)/increase in cash and cash equivalents	(6,612)	2,523	2,960
Cash and cash equivalents, end of the year	$ 5,263	$ 11,875	$ 9,352
Supplemental cash flow disclosures:			
Cash paid for income taxes, net	$ 2,997	$ 1,267	$ 863

See accompanying Notes to Consolidated Financial Statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Summary of Significant Accounting Policies

Apple Inc. and its wholly-owned subsidiaries (collectively "Apple" or the "Company") design, manufacture, and market personal computers, mobile communication devices, and portable digital music and video players and sell a variety of related software, third-party digital content and applications, services, peripherals, and networking solutions. The Company sells its products worldwide through its online stores, its retail stores, its direct sales force, and third-party wholesalers, resellers and value-added resellers. In addition, the Company sells a variety of third-party Macintosh ("Mac"), iPhone and iPod compatible products including application software, printers, storage devices, speakers, headphones, and various other accessories and supplies through its online and retail stores. The Company sells to consumer, small and mid-sized business ("SMB"), education, enterprise, government and creative customers.

Basis of Presentation and Preparation

The accompanying consolidated financial statements include the accounts of the Company. Intercompany accounts and transactions have been eliminated. The preparation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the amounts reported in these consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates.

Certain prior year amounts in the consolidated financial statements and notes thereto have been reclassified to conform to the current year's presentation. During the first quarter of 2009, the Company reclassified $2.4 billion of certain fixed-income securities from short-term marketable securities to long-term marketable securities in the September 27, 2008 Consolidated Balance Sheet. The reclassification resulted from a change in accounting presentation for certain investments based on contractual maturity dates, which more closely reflects the Company's assessment of the timing of when such securities will be converted to cash. As a result of this change, marketable securities with maturities less than 12 months are classified as short-term and marketable securities with maturities greater than 12 months are classified as long-term. There have been no changes in the Company's investment policies or practices associated with this change in accounting presentation. See Note 2, "Financial Instruments" of this Form 10-K for additional information.

The Company's fiscal year is the 52 or 53-week period that ends on the last Saturday of September. The Company's fiscal years 2009, 2008 and 2007 ended on September 26, 2009, September 27, 2008 and September 29, 2007, respectively, and included 52 weeks each. An additional week is included in the first fiscal quarter approximately every six years to realign fiscal quarters with calendar quarters. Unless otherwise stated, references to particular years or quarters refer to the Company's fiscal years ended in September and the associated quarters of those fiscal years.

In May 2009, the Financial Accounting Standards Board ("FASB") established general accounting standards and disclosure for subsequent events. The Company adopted FASB Accounting Standards Codification ("ASC") 855, *Subsequent Events* (formerly referenced as Statement of Financial Accounting Standards ("SFAS") No. 165, *Subsequent Events*), during the third quarter of 2009. The Company has evaluated subsequent events through the date and time the financial statements were issued on October 27, 2009.

Financial Instruments

Cash Equivalents and Marketable Securities

All highly liquid investments with maturities of three months or less at the date of purchase are classified as cash equivalents. The Company's debt and marketable equity securities have been classified and accounted for as available-for-sale. Management determines the appropriate classification of its investments in debt securities at

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the time of purchase and reevaluates the available-for-sale designations as of each balance sheet date. The Company classifies its marketable debt securities as either short-term or long-term based on each instrument's underlying contractual maturity date. Marketable securities with maturities of less than 12 months are classified as short-term and marketable securities with maturities greater than 12 months are classified as long-term. These securities are carried at fair value, with the unrealized gains and losses, net of taxes, reported as a component of shareholders' equity. The cost of securities sold is based upon the specific identification method.

Derivative Financial Instruments

During the second quarter of 2009, the Company adopted FASB ASC 815, *Derivatives and Hedging* (formerly referenced as SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133*), which requires additional disclosures about the Company's objectives and strategies for using derivative instruments, how the derivative instruments and related hedged items are accounted for, and how the derivative instruments and related hedged item affect the financial statements.

The Company accounts for its derivative instruments as either assets or liabilities and carries them at fair value. Derivatives that are not defined as hedges must be adjusted to fair value through earnings.

For derivative instruments that hedge the exposure to variability in expected future cash flows that are designated as cash flow hedges, the effective portion of the gain or loss on the derivative instrument is reported as a component of accumulated other comprehensive income in shareholders' equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of the gain or loss on the derivative instrument is recognized in current earnings. To receive hedge accounting treatment, cash flow hedges must be highly effective in offsetting changes to expected future cash flows on hedged transactions. For options designated as cash flow hedges, changes in the time value are excluded from the assessment of hedge effectiveness and are recognized in earnings. For derivative instruments that hedge the exposure to changes in the fair value of an asset or a liability and that are designated as fair value hedges, the net gain or loss on the derivative instrument as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in earnings in the current period. The Company did not have a net gain or loss on these derivative instruments during 2009, 2008 and 2007. The net gain or loss on the effective portion of a derivative instrument that is designated as an economic hedge of the foreign currency translation exposure of the net investment in a foreign operation is reported in the same manner as a foreign currency translation adjustment. For forward exchange contracts designated as net investment hedges, the Company excludes changes in fair value relating to changes in the forward carry component from its definition of effectiveness. Accordingly, any gains or losses related to this component are recognized in current earnings.

Fair Value Measurements

During the first quarter of 2009, the Company adopted FASB ASC 820, *Fair Value Measurements and Disclosures* (formerly referenced as SFAS No. 157, *Fair Value Measurements*), which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. This new accounting standard does not require any new fair value measurements. The Company applies fair value accounting for all financial assets and liabilities and non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. The Company defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities, which are required to be recorded at fair value, the Company considers the principal or most advantageous market in which the Company would transact and the market-based risk measurements or assumptions that market participants would use in pricing the asset or liability, such as inherent risk, transfer restrictions and credit risk.

During the first quarter of 2009, the Company adopted FASB ASC 825, *Financial Instruments* (formerly referenced as SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including*

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an amendment of FASB Statement No. 115), which allows companies to choose to measure eligible financial instruments and certain other items at fair value that are not required to be measured at fair value. The Company has not elected the fair value option for any eligible financial instruments.

Inventories

Inventories are stated at the lower of cost, computed using the first-in, first-out method, or market. If the cost of the inventories exceeds their market value, provisions are made currently for the difference between the cost and the market value. The Company's inventories consist primarily of finished goods for all periods presented.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation is computed by use of the straight-line method over the estimated useful lives of the assets, which for buildings is the lesser of 30 years or the remaining life of the underlying building, up to five years for equipment, and the shorter of lease terms or ten years for leasehold improvements. The Company capitalizes eligible costs to acquire or develop internal-use software that are incurred subsequent to the preliminary project stage. Capitalized costs related to internal-use software are amortized using the straight-line method over the estimated useful lives of the assets, which range from three to five years. Depreciation and amortization expense on property and equipment was $577 million, $363 million and $249 million during 2009, 2008 and 2007, respectively.

Asset Retirement Obligations

The Company records obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The Company reviews legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the assets. If it is determined that a legal obligation exists, the fair value of the liability for an asset retirement obligation is recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset and this additional carrying amount is depreciated over the life of the asset. The difference between the gross expected future cash flow and its present value is accreted over the life of the related lease as an operating expense. All of the Company's existing asset retirement obligations are associated with commitments to return property subject to operating leases to original condition upon lease termination. The Company's asset retirement liability was $25 million and $21 million as of September 26, 2009 and September 27, 2008, respectively.

Long-Lived Assets Including Goodwill and Other Acquired Intangible Assets

The Company reviews property, plant and equipment and certain identifiable intangibles, excluding goodwill, for impairment. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of these assets is measured by comparison of their carrying amounts to future undiscounted cash flows the assets are expected to generate. If property, plant and equipment and certain identifiable intangibles are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the assets exceeds its fair market value. The Company did not record any material impairments during 2009, 2008 and 2007.

The Company does not amortize goodwill and intangible assets with indefinite useful lives, rather such assets are required to be tested for impairment at least annually or sooner whenever events or changes in circumstances indicate that the assets may be impaired. The Company performs its goodwill and intangible asset impairment tests on or about August 31 of each year. The Company did not recognize any goodwill or intangible asset impairment charges in 2009, 2008 and 2007. The Company established reporting units based on its current reporting structure. For purposes of testing goodwill for impairment, goodwill has been allocated to these reporting units to the extent it relates to each reporting unit.

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The Company amortizes its intangible assets with definite lives over their estimated useful lives and reviews these assets for impairment. The Company is currently amortizing its acquired intangible assets with definite lives over periods ranging from one to ten years.

Foreign Currency Translation and Remeasurement

The Company translates the assets and liabilities of its non-U.S. dollar functional currency subsidiaries into U.S. dollars using exchange rates in effect at the end of each period. Revenue and expenses for these subsidiaries are translated using rates that approximate those in effect during the period. Gains and losses from these translations are credited or charged to foreign currency translation included in accumulated other comprehensive income in shareholders' equity. The Company's subsidiaries that use the U.S. dollar as their functional currency remeasure monetary assets and liabilities at exchange rates in effect at the end of each period, and inventories, property, and nonmonetary assets and liabilities at historical rates. Gains and losses from these remeasurements were insignificant and have been included in the Company's results of operations.

Revenue Recognition

Net sales consist primarily of revenue from the sale of hardware, software, digital content and applications, peripherals, and service and support contracts. For any product within these groups that either is software, or is considered software-related (e.g., Mac computers, iPhones and iPod portable digital music and video players), the Company accounts for such products in accordance with the specific industry accounting guidance for software and software related transactions. The Company applies various revenue-related GAAP for products that are not software or software-related, such as digital content sold on the iTunes Store and certain Mac, iPhone and iPod supplies and accessories, which is described below.

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection is probable. Product is considered delivered to the customer once it has been shipped and title and risk of loss have been transferred. For most of the Company's product sales, these criteria are met at the time the product is shipped. For online sales to individuals, for some sales to education customers in the U.S., and for certain other sales, the Company defers revenue until the customer receives the product because the Company legally retains a portion of the risk of loss on these sales during transit. If at the outset of an arrangement the Company determines the arrangement fee is not, or is presumed not to be, fixed or determinable, revenue is deferred and subsequently recognized as amounts become due and payable and all other criteria for revenue recognition have been met.

Revenue from service and support contracts is deferred and recognized ratably over the service coverage periods. These contracts typically include extended phone support, repair services, web-based support resources, diagnostic tools, and extend the service coverage offered under the Company's standard limited warranty.

The Company sells software and peripheral products obtained from other companies. The Company generally establishes its own pricing and retains related inventory risk, is the primary obligor in sales transactions with its customers, and assumes the credit risk for amounts billed to its customers. Accordingly, the Company generally recognizes revenue for the sale of products obtained from other companies based on the gross amount billed.

The Company accounts for multiple element arrangements that consist only of software or software-related products in accordance with industry specific accounting guidance for software and software related transactions. If a multiple-element arrangement includes deliverables that are neither software nor software-related, the Company applies various revenue-related GAAP to determine if those deliverables constitute separate units of accounting from the software or software-related deliverables. If the Company can separate the deliverables, the Company applies the industry specific accounting guidance to the software and software-related deliverables and applies other appropriate guidance to the non-software related deliverables. Revenue on arrangements that include multiple elements such as hardware, software and services is allocated to each element based on the

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relative fair value of each element. Each element's allocated revenue is recognized when the revenue recognition criteria for that element have been met. Fair value is generally determined by vendor specific objective evidence ("VSOE"), which is based on the price charged when each element is sold separately. If the Company cannot objectively determine the fair value of any undelivered element included in a multiple-element arrangement, the Company defers revenue until all elements are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered elements. When the fair value of a delivered element has not been established, but fair value exists for the undelivered elements, the Company uses the residual method to recognize revenue if the fair value of all undelivered elements is determinable. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is allocated to the delivered elements and is recognized as revenue.

For both iPhone and Apple TV, the Company has indicated it may from time-to-time provide future unspecified features and additional software products free of charge to customers. Accordingly, iPhone handsets and Apple TV sales are accounted for under subscription accounting in accordance with GAAP. As such, the revenue and associated cost of sales are deferred at the time of sale, and are both recognized on a straight-line basis over the currently estimated 24-month economic life of these products, with any loss recognized at the time of sale. Costs incurred by the Company for engineering, sales, marketing and warranty are expensed as incurred.

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end-user rebates, and other sales programs and volume-based incentives. The estimated cost of these programs is accrued as a reduction to revenue in the period the Company has sold the product and committed to a plan. The Company also records reductions to revenue for expected future product returns based on the Company's historical experience. Revenue is recorded net of taxes collected from customers that are remitted to governmental authorities, with the collected taxes recorded as current liabilities until remitted to the relevant government authority.

Generally, the Company does not offer specified or unspecified upgrade rights to its customers in connection with software sales or the sale of extended warranty and support contracts. When the Company does offer specified upgrade rights, the Company defers revenue for the fair value of the specified upgrade right until the future obligation is fulfilled or the right to the specified upgrade expires. A limited number of the Company's software products are available with maintenance agreements that grant customers rights to unspecified future upgrades over the maintenance term on a when and if available basis. Revenue associated with such maintenance is recognized ratably over the maintenance term.

Allowance for Doubtful Accounts

The Company records its allowance for doubtful accounts based upon its assessment of various factors. The Company considers historical experience, the age of the accounts receivable balances, credit quality of the Company's customers, current economic conditions, and other factors that may affect customers' ability to pay.

Shipping Costs

For all periods presented, amounts billed to customers related to shipping and handling are classified as revenue, and the Company's shipping and handling costs are included in cost of sales.

Warranty Expense

The Company generally provides for the estimated cost of hardware and software warranties at the time the related revenue is recognized. The Company assesses the adequacy of its preexisting warranty liabilities and adjusts the amounts as necessary based on actual experience and changes in future estimates. For products accounted for under subscription accounting, the Company recognizes warranty expense as incurred.

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Software Development Costs

Research and development costs are expensed as incurred. Development costs of computer software to be sold, leased, or otherwise marketed are subject to capitalization beginning when a product's technological feasibility has been established and ending when a product is available for general release to customers. In most instances, the Company's products are released soon after technological feasibility has been established. Therefore, costs incurred subsequent to achievement of technological feasibility are usually not significant, and generally most software development costs have been expensed.

In 2009 and 2008, the Company capitalized $71 million and $11 million, respectively, of costs associated with the development of Mac OS X Version 10.6 Snow Leopard ("Mac OS X Snow Leopard"), which was released during the fourth quarter of 2009. During 2007, the Company capitalized $75 million of costs associated with the development of Mac OS X Version 10.5 Leopard ("Mac OS X Leopard") and iPhone software. The capitalized costs are being amortized to cost of sales on a straight-line basis over a three year estimated useful life of the underlying technology.

Total amortization related to capitalized software development costs was $25 million, $27 million and $13 million in 2009, 2008 and 2007, respectively.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expense was $501 million, $486 million and $467 million for 2009, 2008 and 2007, respectively.

Stock-Based Compensation

The Company accounts for stock-based payment transactions in which the Company receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. Stock-based compensation cost for restricted stock units ("RSUs") is measured based on the closing fair market value of the Company's common stock on the date of grant. Stock-based compensation cost for stock options is estimated at the grant date based on each option's fair-value as calculated by the Black-Scholes-Merton ("BSM") option-pricing model. The Company recognizes stock-based compensation cost as expense ratably on a straight-line basis over the requisite service period. The Company will recognize a benefit from stock-based compensation in equity if an incremental tax benefit is realized by following the ordering provisions of the tax law. In addition, the Company accounts for the indirect effects of stock-based compensation on the research tax credit, the foreign tax credit and the domestic manufacturing deduction through the income statement. Further information regarding stock-based compensation can be found in Note 7, "Shareholders' Equity and Stock-Based Compensation."

Income Taxes

The provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. The Company records a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized.

During 2008, the Company adopted FASB Accounting Standards Codification ("ASC") 740, *Income Taxes* (formerly referenced as FASB Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an*

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interpretation of FASB Statement No. 109), which changed the framework for accounting for uncertainty in income taxes. The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon settlement. See Note 6, "Income Taxes" for additional information, including the effects of adoption on the Company's consolidated financial statements.

Earnings Per Common Share

Basic earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the potentially dilutive securities had been issued. Potentially dilutive securities include outstanding stock options, shares to be purchased under the employee stock purchase plan and unvested RSUs. The dilutive effect of potentially dilutive securities is reflected in diluted earnings per common share by application of the treasury stock method. Under the treasury stock method, an increase in the fair market value of the Company's common stock can result in a greater dilutive effect from potentially dilutive securities.

The following table sets forth the computation of basic and diluted earnings per common share for the three years ended September 26, 2009 (in thousands, except net income in millions and per share amounts):

	2009	2008	2007
Numerator:			
Net income	$ 5,704	$ 4,834	$ 3,496
Denominator:			
Weighted-average shares outstanding	893,016	881,592	864,595
Effect of dilutive securities	13,989	20,547	24,697
Weighted-average shares diluted	907,005	902,139	889,292
Basic earnings per common share	$ 6.39	$ 5.48	$ 4.04
Diluted earnings per common share	$ 6.29	$ 5.36	$ 3.93

Potentially dilutive securities representing 12.6 million, 10.3 million and 13.7 million shares of common stock for 2009, 2008 and 2007, respectively, were excluded from the computation of diluted earnings per common share for these periods because their effect would have been antidilutive.

Comprehensive Income

Comprehensive income consists of two components, net income and other comprehensive income. Other comprehensive income refers to revenue, expenses, gains and losses that under GAAP are recorded as an element of shareholders' equity but are excluded from net income. The Company's other comprehensive income consists of foreign currency translation adjustments from those subsidiaries not using the U.S. dollar as their functional currency, unrealized gains and losses on marketable securities categorized as available-for-sale, and net deferred gains and losses on certain derivative instruments accounted for as cash flow hedges.

Segment Information

The Company reports segment information based on the "management" approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of the Company's reportable segments. Information about the Company's products, major customers and geographic areas on a company-wide basis is also disclosed.

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Note 2 – Financial Instruments

Cash, Cash Equivalents and Marketable Securities

The following table summarizes the fair value of the Company's cash and available-for-sale securities held in its marketable securities investment portfolio, recorded as cash and cash equivalents or short-term or long-term marketable securities as of September 26, 2009 and September 27, 2008 (in millions):

	September 26, 2009	September 27, 2008
Cash	$ 1,139	$ 368
Money market funds	1,608	1,536
U.S. Treasury securities	289	118
U.S. agency securities	273	2,798
Certificates of deposit and time deposits	572	2,560
Commercial paper	1,381	4,429
Corporate securities	—	66
Municipal securities	1	—
Total cash equivalents	4,124	11,507
U.S. Treasury securities	2,843	343
U.S. agency securities	8,582	5,823
Non-U.S. government securities	219	83
Certificates of deposit and time deposits	1,142	486
Commercial paper	2,816	1,254
Corporate securities	2,466	2,247
Municipal securities	133	—
Total short-term marketable securities	18,201	10,236
U.S. Treasury securities	484	100
U.S. agency securities	2,252	751
Non-U.S. government securities	102	—
Certificates of deposit and time deposits	—	32
Corporate securities	7,320	1,496
Municipal securities	370	—
Total long-term marketable securities	10,528	2,379
Total cash, cash equivalents and marketable securities	$ 33,992	$ 24,490

During the first quarter of 2009, the Company changed its accounting presentation for certain fixed-income investments, which resulted in the reclassification of certain investments from short-term marketable securities to long-term marketable securities. As a result, prior year balances have been reclassified to conform to the current year's presentation. The Company classifies its marketable securities as either short-term or long-term based on each instrument's underlying contractual maturity date, while its prior classifications were based on the nature of the securities and their availability for use in current operations. As a result of this change, marketable securities with maturities of less than 12 months are classified as short-term and marketable securities with maturities greater than 12 months are classified as long-term. The Company's long-term marketable securities' maturities range from one year to five years. The Company believes this new presentation is preferable as it more closely reflects the Company's assessment of the timing of when such securities will be converted to cash. Accordingly, certain fixed-income investments totaling $2.4 billion have been reclassified from short-term marketable securities to long-term marketable securities in the September 27, 2008 Consolidated Balance Sheet to conform to the current year's financial statement presentation. There have been no changes in the Company's investment policies or practices associated with this change in accounting presentation.

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The following tables summarize the Company's available-for-sale securities' adjusted cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category as of September 26, 2009 and September 27, 2008 (in millions):

	September 26, 2009			
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value
Money market funds	$ 1,608	$ —	$ —	$ 1,608
U.S. Treasury securities	3,610	6	—	3,616
U.S. agency securities	11,085	22	—	11,107
Non-U.S. government securities	320	1	—	321
Certificates of deposit and time deposits	1,714	—	—	1,714
Commercial paper	4,197	—	—	4,197
Corporate securities	9,760	42	(16)	9,786
Municipal securities	502	2	—	504
Total cash equivalents and marketable securities	$ 32,796	$ 73	$ (16)	$ 32,853

	September 27, 2008			
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value
Money market funds	$ 1,536	$ —	$ —	$ 1,536
U.S. Treasury securities	559	2	—	561
U.S. agency securities	9,383	2	(13)	9,372
Non-U.S. government securities	83	—	—	83
Certificates of deposit and time deposits	3,078	—	—	3,078
Commercial paper	5,683	—	—	5,683
Corporate securities	3,917	—	(108)	3,809
Total cash equivalents and marketable securities	$ 24,239	$ 4	$ (121)	$ 24,122

The Company had net unrealized gains on its investment portfolio of $57 million as of September 26, 2009 and net unrealized losses on its investment portfolio of $117 million as of September 27, 2008. The net unrealized gains as of September 26, 2009 and the net unrealized losses as of September 27, 2008 related primarily to long-term marketable securities. The Company may sell certain of its marketable securities prior to their stated maturities for strategic purposes, in anticipation of credit deterioration, or for duration management. The Company recognized no material net gains or losses during 2009, 2008 and 2007 related to such sales.

The following table shows the gross unrealized losses and fair value for investments in an unrealized loss position as of September 26, 2009 and September 27, 2008, aggregated by investment category and the length of time that individual securities have been in a continuous loss position (in millions):

	September 26, 2009					
	Less than 12 Months		12 Months or Greater		Total	
Security Description	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Loss
Corporate securities	$ 1,667	$ (3)	$ 719	$ (13)	$ 2,386	$ (16)
Total	$ 1,667	$ (3)	$ 719	$ (13)	$ 2,386	$ (16)

	September 27, 2008					
	Less than 12 Months		12 Months or Greater		Total	
Security Description	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Loss
U.S. agency securities	$ 6,822	$ (13)	$ —	$ —	$ 6,822	$ (13)
Corporate securities	2,147	(31)	1,148	(77)	3,295	(108)
Total	$ 8,969	$ (44)	$ 1,148	$ (77)	$ 10,117	$ (121)

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The Company considers the declines in market value of its marketable securities investment portfolio to be temporary in nature. The unrealized losses on the Company's marketable securities were caused primarily by changes in market interest rates, specifically, widening credit spreads. The Company typically invests in highly-rated securities, and its policy generally limits the amount of credit exposure to any one issuer. The Company's investment policy requires investments to be investment grade, primarily rated single-A or better, with the objective of minimizing the potential risk of principal loss. Fair values were determined for each individual security in the investment portfolio. When evaluating the investments for other-than-temporary impairment, the Company reviews factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer and any changes thereto, and the Company's intent to sell, or whether it is more likely than not it will be required to sell, the investment before recovery of the investment's amortized cost basis. During the years ended September 26, 2009 and September 27, 2008, the Company did not recognize any material impairment charges. As of September 26, 2009, the Company does not consider any of its investments to be other-than-temporarily impaired.

Derivative Financial Instruments

The Company uses derivatives to partially offset its business exposure to foreign currency exchange risk. The Company may enter into foreign currency forward and option contracts to offset some of the foreign exchange risk of expected future cash flows on certain forecasted revenue and cost of sales, of net investments in certain foreign subsidiaries, and on certain existing assets and liabilities. To help protect gross margins from fluctuations in foreign currency exchange rates, certain of the Company's subsidiaries whose functional currency is the U.S. dollar, hedge a portion of forecasted foreign currency revenue. The Company's subsidiaries whose functional currency is not the U.S. dollar and who sell in local currencies, may hedge a portion of forecasted inventory purchases not denominated in the subsidiaries' functional currencies. The Company typically hedges portions of its forecasted foreign currency exposure associated with revenue and inventory purchases for three to six months. To help protect the net investment in a foreign operation from adverse changes in foreign currency exchange rates, the Company may enter into foreign currency forward and option contracts to offset the changes in the carrying amounts of these investments due to fluctuations in foreign currency exchange rates. The Company may also enter into foreign currency forward and option contracts to partially offset the foreign currency exchange gains and losses generated by the re-measurement of certain assets and liabilities denominated in non-functional currencies. However, the Company may choose not to hedge certain foreign currency exchange exposures for a variety of reasons, including but not limited to immateriality, accounting considerations and the prohibitive economic cost of hedging particular exposures. There can be no assurance the hedges will offset more than a portion of the financial impact resulting from movements in foreign currency exchange rates.

The Company's accounting policies for these instruments are based on whether the instruments are designated as hedge or non-hedge instruments. The Company records all derivatives on the Consolidated Balance Sheets at fair value. The effective portions of cash flow hedges are recorded in other comprehensive income until the hedged item is recognized in earnings. The effective portions of net investment hedges are recorded in other comprehensive income as a part of the cumulative translation adjustment. Derivatives that are not designated as hedging instruments and the ineffective portions of cash flow hedges and net investment hedges are adjusted to fair value through earnings in other income and expense.

The Company had a net deferred gain associated with cash flow hedges of approximately $31 million and $19 million, net of taxes, recorded in other comprehensive income as of September 26, 2009 and September 27, 2008, respectively. Other comprehensive income associated with cash flow hedges of foreign currency revenue is recognized as a component of net sales in the same period as the related revenue is recognized, and other comprehensive income related to cash flow hedges of inventory purchases is recognized as a component of cost of sales in the same period as the related costs are recognized. The portion of the Company's net deferred gain related to products under subscription accounting is expected to be recorded in earnings ratably over the related products' estimated economic lives beginning when the hedged transactions occur, while the portion of the net deferred gain related to other products is expected to be recorded in earnings at the time the hedged transactions occur. As of September 26, 2009, the hedged transactions are expected to occur within six months.

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Derivative instruments designated as cash flow hedges must be de-designated as hedges when it is probable the forecasted hedged transaction will not occur in the initially identified time period or within a subsequent two month time period. Deferred gains and losses in other comprehensive income associated with such derivative instruments are reclassified immediately into earnings through other income and expense. Any subsequent changes in fair value of such derivative instruments also are reflected in current earnings unless they are re-designated as hedges of other transactions. The Company did not recognize any material net gains or losses related to the loss of hedge designation on discontinued cash flow hedges during 2009, 2008 and 2007.

The Company had an unrealized net loss on net investment hedges of $2 million and $1 million, net of taxes, included in the cumulative translation adjustment account of accumulated other comprehensive income ("AOCI") as of September 26, 2009 and September 27, 2008, respectively. The ineffective portions and amounts excluded from the effectiveness test of net investment hedges are recorded in current earnings in other income and expense.

The Company recognized in earnings a net gain of $133 million on foreign currency forward and option contracts not designated as hedging instruments during the year ended September 26, 2009.

The following table shows the notional principal and credit risk amounts of the Company's derivative instruments outstanding as of September 26, 2009 and September 27, 2008 (in millions):

	2009		2008	
	Notional Principal	Credit Risk Amounts	Notional Principal	Credit Risk Amounts
Instruments qualifying as accounting hedges:				
Foreign exchange contracts	$ 4,422	$ 31	$ 5,902	$ 107
Instruments other than accounting hedges:				
Foreign exchange contracts	$ 3,416	$ 10	$ 2,868	$ 8

The notional principal amounts for derivative instruments provide one measure of the transaction volume outstanding as of September 26, 2009, and do not represent the amount of the Company's exposure to credit or market loss. The credit risk amounts represent the Company's gross exposure to potential accounting loss on these transactions if all counterparties failed to perform according to the terms of the contract, based on then-current currency exchange rates at each respective date. The Company's gross exposure on these transactions may be further mitigated by collateral received from certain counterparties. The Company's exposure to credit loss and market risk will vary over time as a function of currency exchange rates. Although the table above reflects the notional principal and credit risk amounts of the Company's foreign exchange instruments, it does not reflect the gains or losses associated with the exposures and transactions that the foreign exchange instruments are intended to hedge. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

The Company generally enters into master netting arrangements, which reduce credit risk by permitting net settlement of transactions with the same counterparty. To further limit credit risk, the Company generally enters into collateral security arrangements that provide for collateral to be received when the net fair value of certain financial instruments exceeds contractually established thresholds. The Company presents its derivative assets and derivative liabilities at their gross fair values. The Company did not record a material amount of cash collateral related to the derivative instruments under its master netting arrangements as of September 26, 2009. The Company did not have any derivative instruments with credit risk-related contingent features that would require it to post additional collateral as of September 26, 2009.

The estimates of fair value are based on applicable and commonly used pricing models and prevailing financial market information as of September 26, 2009. Refer to Note 3, "Fair Value Measurements" of this Form 10-K,

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for additional information on the fair value measurements for all financial assets and liabilities, including derivative assets and derivative liabilities, that are measured at fair value in the consolidated financial statements on a recurring basis. The following tables shows the Company's derivative instruments measured at gross fair value as reflected in the Consolidated Balance Sheets as of September 26, 2009 and September 27, 2008 (in millions):

	September 26, 2009		
	Fair Value of Derivatives Designated as Hedge Instruments	Fair Value of Derivatives Not Designated as Hedge Instruments	Total Fair Value
Derivative assets (a):			
Foreign exchange contracts	$ 27	$ 10	$ 37
Derivative liabilities (b):			
Foreign exchange contracts	$ 24	$ 1	$ 25

	September 27, 2008		
	Fair Value of Derivatives Designated as Hedge Instruments	Fair Value of Derivatives Not Designated as Hedge Instruments	Total Fair Value
Derivative assets (a):			
Foreign exchange contracts	$ 107	$ 8	$ 115
Derivative liabilities (b):			
Foreign exchange contracts	$ 68	$ 2	$ 70

(a) All derivative assets are recorded as other current assets in the Consolidated Balance Sheets.
(b) All derivative liabilities are recorded as accrued expenses in the Consolidated Balance Sheets.

The following table shows the effect of the Company's derivative instruments designated as cash flow and net investment hedges in the Consolidated Statements of Operations for the year ended September 26, 2009 (in millions):

	Year Ended September 26, 2009				
	Gain or (Loss) Recognized in AOCI - Effective Portion (a)	Location of Gain or (Loss) Reclassified from AOCI into Income - Effective Portion	Gain or (Loss) Reclassified from AOCI into Income - Effective Portion (a)	Location of Gain or (Loss) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing	Gain or (Loss) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing
Cash flow hedges:					
Foreign exchange contracts	$ 283	Net sales	$ 251	Other income and expense	$ (83)
Foreign exchange contracts	55	Cost of sales	72	Other income and expense	(14)
Net investment hedges:					
Foreign exchange contracts	(44)	Other income and expense	—	Other income and expense	3
Total	$ 294		$ 323		$ (94)

(a) Refer to Note 7, "Shareholders' Equity and Stock-Based Compensation" of this Form 10-K, which summarizes the activity in accumulated other comprehensive income related to derivatives.

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Accounts Receivable

Trade Receivables

The Company distributes its products through third-party distributors, cellular network carriers, and resellers and directly to certain education, consumer and enterprise customers. The Company generally does not require collateral from its customers; however, the Company will require collateral in certain instances to limit credit risk. In addition, when possible, the Company attempts to limit credit risk on trade receivables with credit insurance for certain customers in Latin America, Europe, Asia, and Australia, or by requiring third-party financing, loans or leases to support credit exposure. These credit-financing arrangements are directly between the third-party financing company and the end customer. As such, the Company generally does not assume any recourse or credit risk sharing related to any of these arrangements. However, considerable trade receivables not covered by collateral, third-party financing arrangements, or credit insurance are outstanding with the Company's distribution and retail channel partners. Trade receivables from one of the Company's customers accounted for 16% of trade receivables as of September 26, 2009 and two of the Company's customers accounted for 15% and 10%, respectively, of trade receivables as of September 27, 2008.

The following table summarizes the activity in the allowance for doubtful accounts for the three years ended September 26, 2009 (in millions):

	2009	2008	2007
Beginning allowance balance	$ 47	$ 47	$ 52
Charged to costs and expenses	25	3	12
Deductions	(20)	(3)	(17)
Ending allowance balance	$ 52	$ 47	$ 47

Vendor Non-Trade Receivables

The Company has non-trade receivables from certain of its manufacturing vendors resulting from the sale of raw material components to these manufacturing vendors who manufacture sub-assemblies or assemble final products for the Company. The Company purchases these raw material components directly from suppliers. These non-trade receivables, which are included in the Consolidated Balance Sheets in other current assets, totaled $1.7 billion and $2.3 billion as of September 26, 2009 and September 27, 2008, respectively. Vendor non-trade receivables from two of the Company's vendors accounted for 40% and 36%, respectively, of non-trade receivables as of September 26, 2009 and two of the Company's vendors accounted for 47% and 38%, respectively, of non-trade receivables as of September 27, 2008. The Company does not reflect the sale of these components in net sales and does not recognize any profits on these sales until the related products are sold by the Company, at which time any profit is recognized as a reduction of cost of sales.

Note 3 – Fair Value Measurements

The Company defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities, which are required to be recorded at fair value, the Company considers the principal or most advantageous market in which the Company would transact and the market-based risk measurements or assumptions that market participants would use in pricing the asset or liability, such as inherent risk, transfer restrictions and credit risk.

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The Company applies the following fair value hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Inputs that are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability.

The Company's valuation techniques used to measure the fair value of money market funds and certain marketable equity securities were derived from quoted prices in active markets for identical assets or liabilities. The valuation techniques used to measure the fair value of all other financial instruments, all of which have counterparties with high credit ratings, were valued based on quoted market prices or model driven valuations using significant inputs derived from or corroborated by observable market data.

Assets/Liabilities Measured at Fair Value on a Recurring Basis

The following table presents the Company's assets and liabilities measured at fair value on a recurring basis as of September 26, 2009 (in millions):

	September 26, 2009			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total (a)
Assets:				
Money market funds	$ 1,608	$ —	$ —	$ 1,608
U.S. Treasury securities	—	3,616	—	3,616
U.S. agency securities	—	11,107	—	11,107
Non-U.S. government securities	—	321	—	321
Certificates of deposit and time deposits	—	1,714	—	1,714
Commercial paper	—	4,197	—	4,197
Corporate securities	—	9,786	—	9,786
Municipal securities	—	504	—	504
Marketable equity securities	61	—	—	61
Derivative assets	—	37	—	37
Total assets measured at fair value	$ 1,669	$ 31,282	$ —	$32,951
Liabilities:				
Derivative liabilities	$ —	$ 25	$ —	$ 25
Total liabilities measured at fair value	$ —	$ 25	$ —	$ 25

(a) The total fair value amounts for assets and liabilities also represent the related carrying amounts.

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The following table summarizes the Company's assets and liabilities measured at fair value on a recurring basis as presented in the Company's Consolidated Balance Sheet as of September 26, 2009 (in millions):

	September 26, 2009			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total (a)
Assets:				
Cash equivalents	$ 1,608	$ 2,516	$ —	$ 4,124
Short-term marketable securities	—	18,201	—	18,201
Long-term marketable securities	—	10,528	—	10,528
Other current assets	—	37	—	37
Other assets	61	—	—	61
Total assets measured at fair value	$ 1,669	$ 31,282	$ —	$32,951
Liabilities:				
Other current liabilities	$ —	$ 25	$ —	$ 25
Total liabilities measured at fair value	$ —	$ 25	$ —	$ 25

(a) The total fair value amounts for assets and liabilities also represent the related carrying amounts.

Note 4 – Consolidated Financial Statement Details

The following tables show the Company's consolidated financial statement details as of September 26, 2009 and September 27, 2008 (in millions):

Other Current Assets

	2009	2008
Deferred costs under subscription accounting - current	$ 3,703	$ 1,931
Vendor non-trade receivables	1,696	2,282
Inventory component prepayments - current	309	475
Other current assets	1,176	1,134
Total other current assets	$ 6,884	$ 5,822

Property, Plant and Equipment

	2009	2008
Land and buildings	$ 955	$ 810
Machinery, equipment and internal-use software	1,932	1,491
Office furniture and equipment	115	122
Leasehold improvements	1,665	1,324
Gross property, plant and equipment	4,667	3,747
Accumulated depreciation and amortization	(1,713)	(1,292)
Net property, plant and equipment	$ 2,954	$ 2,455

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Other Assets

	2009	2008
Deferred costs under subscription accounting - non-current	$1,468	$1,089
Inventory component prepayments - non-current	844	208
Deferred tax assets - non-current	259	138
Capitalized software development costs, net	106	67
Other assets	974	433
Total other assets	$3,651	$1,935

Accrued Expenses

	2009	2008
Income taxes payable	$ 439	$ 502
Accrued marketing and distribution	359	329
Accrued compensation and employee benefits	357	320
Deferred margin on component sales	225	681
Accrued warranty and related costs	210	267
Other current liabilities	1,786	1,620
Total accrued expenses	$3,376	$3,719

Non-Current Liabilities

	2009	2008
Deferred tax liabilities	$ 966	$ 675
Other non-current liabilities	1,286	746
Total other non-current liabilities	$2,252	$1,421

Note 5 – Goodwill and Other Intangible Assets

The Company is currently amortizing its acquired intangible assets with definite lives over periods ranging from one to ten years. The following table summarizes the components of gross and net intangible asset balances as of September 26, 2009 and September 27, 2008 (in millions):

	2009			2008		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Definite lived and amortizable acquired technology	$ 323	$ (176)	$ 147	$ 308	$ (123)	$ 185
Indefinite lived and unamortizable trademarks	100	—	100	100	—	100
Total acquired intangible assets	$ 423	$ (176)	$ 247	$ 408	$ (123)	$ 285
Goodwill	$ 206	$ —	$ 206	$ 207	$ —	$ 207

In 2008, the Company completed an acquisition of a business for total cash consideration, net of cash acquired, of $220 million, of which $169 million has been allocated to goodwill, $51 million to deferred tax assets and $7 million to acquired intangible assets.

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The Company's goodwill is allocated primarily to the America's reportable operating segment. Amortization expense related to acquired intangible assets was $53 million, $46 million and $35 million in 2009, 2008 and 2007, respectively. As of September 26, 2009 and September 27, 2008, the remaining weighted-average amortization period for acquired technology was 7.2 years and 7.0 years, respectively.

Expected annual amortization expense related to acquired technology as of September 26, 2009, is as follows (in millions):

Years	
2010	$ 40
2011	37
2012	28
2013	13
2014	10
Thereafter	19
Total	$147

Note 6 – Income Taxes

The provision for income taxes for the three years ended September 26, 2009, consisted of the following (in millions):

	2009	2008	2007
Federal:			
Current	$2,162	$1,942	$1,219
Deferred	(207)	(155)	85
	1,955	1,787	1,304
State:			
Current	279	210	112
Deferred	(113)	(82)	9
	166	128	121
Foreign:			
Current	358	277	103
Deferred	(199)	(131)	(16)
	159	146	87
Provision for income taxes	$2,280	$2,061	$1,512

The foreign provision for income taxes is based on foreign pretax earnings of $4.4 billion, $3.5 billion and $2.2 billion in 2009, 2008 and 2007, respectively. As of September 26, 2009 and September 27, 2008, $17.4 billion and $11.3 billion, respectively, of the Company's cash, cash equivalents and marketable securities were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S. The Company's consolidated financial statements provide for any related tax liability on amounts that may be repatriated, aside from undistributed earnings of certain of the Company's foreign subsidiaries that are intended to be indefinitely reinvested in operations outside the U.S. U.S. income taxes have not been provided on a cumulative total of $5.1 billion of such earnings. It is not practicable to determine the income tax liability that might be incurred if these earnings were to be distributed.

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Deferred tax assets and liabilities reflect the effects of tax losses, credits, and the future income tax effects of temporary differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases and are measured using enacted tax rates that apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

As of September 26, 2009 and September 27, 2008, the significant components of the Company's deferred tax assets and liabilities were (in millions):

	2009	2008
Deferred tax assets:		
Accrued liabilities and other reserves	$2,133	$1,295
Basis of capital assets and investments	180	173
Accounts receivable and inventory reserves	172	126
Other	683	550
Total deferred tax assets	3,168	2,144
Less valuation allowance	—	—
Deferred tax assets, net of valuation allowance	3,168	2,144
Deferred tax liabilities - Unremitted earnings of foreign subsidiaries	1,778	1,234
Net deferred tax assets	$1,390	$ 910

A reconciliation of the provision for income taxes, with the amount computed by applying the statutory federal income tax rate (35% in 2009, 2008 and 2007) to income before provision for income taxes for the three years ended September 26, 2009, is as follows (in millions):

	2009	2008	2007
Computed expected tax	$2,795	$2,414	$1,753
State taxes, net of federal effect	228	159	140
Indefinitely invested earnings of foreign subsidiaries	(658)	(492)	(297)
Nondeductible executive compensation	13	6	6
Research and development credit, net	(84)	(21)	(54)
Other	(14)	(5)	(36)
Provision for income taxes	$2,280	$2,061	$1,512
Effective tax rate	29%	30%	30%

The Company's income taxes payable have been reduced by the tax benefits from employee stock plan awards. For stock options, the Company receives an income tax benefit calculated as the difference between the fair market value of the stock issued at the time of the exercise and the option price, tax effected. The Company had net tax benefits from employee stock plan awards of $246 million, $770 million and $398 million in 2009, 2008 and 2007, respectively, which were reflected as increases to common stock.

On October 3, 2008, the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 was signed into law. This bill, among other things, retroactively extended the expired research and development tax credit. As a result, the Company recorded a tax benefit of $42 million in the first quarter of 2009 to account for the retroactive effects of the research credit extension.

Uncertain Tax Positions

As discussed in Note 1, "Summary of Significant Accounting Policies" the Company adopted new accounting principles on accounting for uncertain tax positions in 2008. Under these new principles, tax positions are evaluated in a two-step process. The Company first determines whether it is more likely than not that a tax

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position will be sustained upon examination. If a tax position meets the more-likely-than-not recognition threshold it is then measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Upon adoption of these new principles, the Company's cumulative effect of a change in accounting principle resulted in an increase to retained earnings of $11 million. The Company had historically classified interest and penalties and unrecognized tax benefits as current liabilities. Beginning with the adoption of these new principles, the Company classifies gross interest and penalties and unrecognized tax benefits that are not expected to result in payment or receipt of cash within one year as non-current liabilities in the Consolidated Balance Sheets. The total amount of gross unrecognized tax benefits as of the date of adoption was $475 million, of which $209 million, if recognized, would affect the Company's effective tax rate.

The Company's total gross unrecognized tax benefits are classified as non-current liabilities in the Consolidated Balance Sheets. As of September 26, 2009, the total amount of gross unrecognized tax benefits was $971 million, of which $307 million, if recognized, would affect the Company's effective tax rate. As of September 27, 2008, the total amount of gross unrecognized tax benefits was $506 million, of which $253 million, if recognized, would affect the Company's effective tax rate.

On May 27, 2009, the United States Court of Appeals for the Ninth Circuit issued its ruling in the case of *Xilinx, Inc. v. Commissioner*, holding that stock-based compensation is required to be included in certain transfer pricing arrangements between a U.S. company and its offshore subsidiary. As a result of the ruling in this case, the Company increased its liability for unrecognized tax benefits by approximately $86 million and decreased shareholders' equity by approximately $78 million in the year ended September 26, 2009.

The aggregate changes in the balance of gross unrecognized tax benefits, which excludes interest and penalties, for the two years ended September 26, 2009, is as follows (in millions):

Balance as of September 30, 2007	$475
Increases related to tax positions taken during a prior period	27
Decreases related to tax positions taken during a prior period	(70)
Increases related to tax positions taken during the current period	85
Decreases related to settlements with taxing authorities	—
Decreases related to expiration of statute of limitations	(11)
Balance as of September 27, 2008	506
Increases related to tax positions taken during a prior period	341
Decreases related to tax positions taken during a prior period	(24)
Increases related to tax positions taken during the current period	151
Decreases related to settlements with taxing authorities	—
Decreases related to expiration of statute of limitations	(3)
Balance as of September 26, 2009	$971

The Company's policy to include interest and penalties related to unrecognized tax benefits within the provision for income taxes did not change as a result of adopting the new accounting principles on accounting for uncertain tax positions in 2008. As of the date of adoption, the Company had accrued $203 million for the gross interest and penalties relating to unrecognized tax benefits. As of September 26, 2009 and September 27, 2008, the total amount of gross interest and penalties accrued was $291 million and $219 million, respectively, which is classified as non-current liabilities in the Consolidated Balance Sheets. In 2009 and 2008, the Company recognized interest expense in connection with tax matters of $64 million and $16 million, respectively.

The Company is subject to taxation and files income tax returns in the U.S. federal jurisdiction and in many state and foreign jurisdictions. For U.S. federal income tax purposes, all years prior to 2002 are closed. The years 2002-2003 have been examined by the Internal Revenue Service (the "IRS") and disputed issues have been taken

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to administrative appeals. The IRS is currently examining the 2004-2006 years. In addition, the Company is also subject to audits by state, local and foreign tax authorities. In major states and major foreign jurisdictions, the years subsequent to 1988 and 2000, respectively, generally remain open and could be subject to examination by the taxing authorities.

Management believes that an adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs. Although timing of the resolution and/or closure of audits is highly uncertain, the Company believes it is reasonably possible that tax audit resolutions could reduce its unrecognized tax benefits by between $105 million and $145 million in the next 12 months.

Note 7 – Shareholders' Equity and Stock-Based Compensation

Preferred Stock

The Company has five million shares of authorized preferred stock, none of which is issued or outstanding. Under the terms of the Company's Restated Articles of Incorporation, the Board of Directors is authorized to determine or alter the rights, preferences, privileges and restrictions of the Company's authorized but unissued shares of preferred stock.

Comprehensive Income

Comprehensive income consists of two components, net income and other comprehensive income. Other comprehensive income refers to revenue, expenses, gains and losses that under GAAP are recorded as an element of shareholders' equity but are excluded from net income. The Company's other comprehensive income consists of foreign currency translation adjustments from those subsidiaries not using the U.S. dollar as their functional currency, unrealized gains and losses on marketable securities categorized as available-for-sale, and net deferred gains and losses on certain derivative instruments accounted for as cash flow hedges.

The following table summarizes the components of accumulated other comprehensive income, net of taxes, as of the three years ended September 26, 2009 (in millions):

	2009	2008	2007
Net unrealized gains/losses on available-for-sale securities	$ 48	$(70)	$ (7)
Net unrecognized gains on derivative instruments	31	19	—
Cumulative foreign currency translation	5	59	70
Accumulated other comprehensive income	$ 84	$ 8	$ 63

The change in fair value of available-for-sale securities included in other comprehensive income was $118 million, $(63) million and $(7) million, net of taxes in 2009, 2008 and 2007, respectively. The tax effect related to the change in unrealized gain/loss on available-for-sale securities was $(78) million, $42 million and $4 million for 2009, 2008 and 2007, respectively.

The following table summarizes activity in other comprehensive income related to derivatives, net of taxes, held by the Company during the three years ended September 26, 2009 (in millions):

	2009	2008	2007
Changes in fair value of derivatives	$ 90	$ 7	$ (1)
Adjustment for net gains/losses realized and included in net income	(78)	12	(2)
Change in unrecognized gains/losses on derivative instruments	$ 12	$ 19	$ (3)

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The tax effect related to the changes in fair value of derivatives was $(60) million, $(5) million and $1 million for 2009, 2008 and 2007, respectively. The tax effect related to derivative gains/losses reclassified from other comprehensive income to net income was $54 million, $(9) million and $2 million for 2009, 2008 and 2007, respectively.

Employee Benefit Plans

2003 Employee Stock Plan

The 2003 Employee Stock Plan (the "2003 Plan") is a shareholder approved plan that provides for broad-based equity grants to employees, including executive officers. The 2003 Plan permits the granting of incentive stock options, nonstatutory stock options, RSUs, stock appreciation rights, stock purchase rights and performance-based awards. Based on the terms of individual option grants, options granted under the 2003 Plan generally expire seven to ten years after the grant date and generally become exercisable over a period of four years, based on continued employment, with either annual, semi-annual or quarterly vesting. In general, RSUs granted under the 2003 Plan vest over two to four years, are subject to the employees' continued employment and do not have an expiration date. As of September 26, 2009, approximately 37 million shares were reserved for future issuance under the 2003 Plan.

1997 Employee Stock Option Plan

In August 1997, the Company's Board of Directors approved the 1997 Employee Stock Option Plan (the "1997 Plan"), a non-shareholder approved plan for grants of stock options to employees who are not officers of the Company. Based on the terms of individual option grants, options granted under the 1997 Plan generally expire seven to ten years after the grant date. All stock options granted under the 1997 Plan are fully vested. In October 2003, the Company terminated the 1997 Plan, and no new options can be granted from this plan.

1997 Director Stock Option Plan

In August 1997, the Company's Board of Directors adopted a Director Stock Option Plan (the "Director Plan") for non-employee directors of the Company, which was approved by shareholders in 1998. Pursuant to the Director Plan, the Company's non-employee directors are granted an option to acquire 30,000 shares of common stock upon their initial election to the Board ("Initial Options"). The Initial Options vest and become exercisable in three equal annual installments on each of the first through third anniversaries of the grant date. On the fourth anniversary of a non-employee director's initial election to the Board and on each subsequent anniversary thereafter, the director will be entitled to receive an option to acquire 10,000 shares of common stock ("Annual Options"). Annual Options are fully vested and immediately exercisable on their date of grant. Options granted under the Director Plan expire ten years after the grant date. As of September 26, 2009, approximately 240,000 shares were reserved for future issuance under the Director Plan.

Rule 10b5-1 Trading Plans

As of October 16, 2009, executive officers Timothy D. Cook, Ronald B. Johnson, Peter Oppenheimer, Philip W. Schiller and Bertrand Serlet have entered into trading plans pursuant to Rule 10b5-1(c)(1) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). A trading plan is a written document that pre-establishes the amounts, prices and dates (or formula for determining the amounts, prices and dates) of future purchases or sales of the Company's stock including the exercise and sale of employee stock options and shares acquired pursuant to the Company's employee stock purchase plan and upon vesting of RSUs.

Employee Stock Purchase Plan

The Company has a shareholder approved employee stock purchase plan (the "Purchase Plan"), under which substantially all employees may purchase common stock through payroll deductions at a price equal to 85% of the lower of the fair market values as of the beginning and end of six-month offering periods. Stock purchases

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under the Purchase Plan are limited to 10% of an employee's compensation, up to a maximum of $25,000 in any calendar year. The number of shares authorized to be purchased in any calendar year is limited to a total of 3 million shares. As of September 26, 2009, approximately 4.7 million shares were reserved for future issuance under the Purchase Plan.

Employee Savings Plan

The Company has an employee savings plan (the "Savings Plan") qualifying as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code. Under the Savings Plan, participating U.S. employees may defer a portion of their pre-tax earnings, up to the IRS annual contribution limit ($16,500 for calendar year 2009). The Company matches 50% to 100% of each employee's contributions, depending on length of service, up to a maximum 6% of the employee's eligible earnings. The Company's matching contributions to the Savings Plan were $59 million, $50 million and $39 million in 2009, 2008 and 2007, respectively.

Restricted Stock Units

Historically, the Company used equity awards in the form of stock options as one of the means for recruiting and retaining highly skilled talent. In conjunction with the Company's 2009 equity compensation program changes, it began issuing primarily RSUs rather than stock options for eligible employees as the primary type of long-term equity-based award. A summary of the Company's RSU activity and related information for the three years ended September 26, 2009, is as follows (in thousands, except per share amounts):

	Number of Shares	Weighted-Average Grant Date Fair Value	Aggregate Intrinsic Value
Balance at September 30, 2006	3,410	$ 39.62	
Restricted stock units granted	1,320	$ 88.51	
Restricted stock units vested	(45)	$ 46.57	
Restricted stock units cancelled	(10)	$ 86.14	
Balance at September 29, 2007	4,675	$ 52.98	
Restricted stock units granted	4,917	$ 162.61	
Restricted stock units vested	(2,195)	$ 25.63	
Restricted stock units cancelled	(357)	$ 119.12	
Balance at September 27, 2008	7,040	$ 134.91	
Restricted stock units granted	7,786	$ 111.80	
Restricted stock units vested	(1,935)	$ 124.87	
Restricted stock units cancelled	(628)	$ 121.28	
Balance at September 26, 2009	12,263	$ 122.52	$2,236,305

The fair value as of the vesting date of RSUs that vested was $221 million, $320 million and $6 million for 2009, 2008 and 2007, respectively. Upon vesting, the RSUs are generally net share-settled to cover the required withholding tax and the remaining amount is converted into an equivalent number of shares of common stock. The majority of RSUs vested in 2009, 2008 and 2007, were net-share settled such that the Company withheld shares with value equivalent to the employees' minimum statutory obligation for the applicable income and other employment taxes, and remitted the cash to the appropriate taxing authorities. The total shares withheld were approximately 707,000, 857,000 and 20,000 for 2009, 2008 and 2007, respectively, and were based on the value of the RSUs on their vesting date as determined by the Company's closing stock price. Total payments for the employees' tax obligations to the taxing authorities were $82 million, $124 million and $3 million in 2009, 2008 and 2007, respectively, and are reflected as a financing activity within the Consolidated Statements of Cash Flows. These net-share settlements had the effect of share repurchases by the Company as they reduced and retired the number of shares that would have otherwise been issued as a result of the vesting and did not represent an expense to the Company.

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Stock Option Activity

A summary of the Company's stock option and RSU activity and related information for the three years ended September 26, 2009, is as follows (in thousands, except per share amounts and contractual term in years):

		Outstanding Options			
	Shares Available for Grant	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance at September 30, 2006	54,994	52,982	$ 23.23		
Additional shares authorized	28,000	—	$ —		
Restricted stock units granted	(2,640)	—	$ —		
Options granted	(14,010)	14,010	$ 94.52		
Options cancelled	1,471	(1,471)	$ 55.38		
Restricted stock units cancelled	20	—	$ —		
Options exercised	—	(15,770)	$ 18.32		
Plan shares expired	(8)	—	$ —		
Balance at September 29, 2007	67,827	49,751	$ 43.91		
Restricted stock units granted	(9,834)	—	$ —		
Options granted	(9,359)	9,359	$ 171.36		
Options cancelled	1,236	(1,236)	$ 98.40		
Restricted stock units cancelled	714	—	$ —		
Options exercised	—	(13,728)	$ 27.88		
Plan shares expired	(12)	—	$ —		
Balance at September 27, 2008	50,572	44,146	$ 74.39		
Restricted stock units granted	(15,572)	—	$ —		
Options granted	(234)	234	$ 106.84		
Options cancelled	1,241	(1,241)	$ 122.98		
Restricted stock units cancelled	1,256	—	$ —		
Options exercised	—	(8,764)	$ 41.78		
Plan shares expired	(2)	—	$ —		
Balance at September 26, 2009	37,261	34,375	$ 81.17	3.52	$3,482,530
Exercisable at September 26, 2009		24,685	$ 60.62	3.01	$3,006,829
Expected to Vest after September 26, 2009		9,479	$ 133.28	4.82	$ 465,321

Aggregate intrinsic value represents the value of the Company's closing stock price on the last trading day of the fiscal period in excess of the weighted-average exercise price multiplied by the number of options outstanding or exercisable. The aggregate intrinsic value excludes the effect of stock options that have a zero or negative intrinsic value. Total intrinsic value of options at time of exercise was $827 million, $2.0 billion and $1.3 billion for 2009, 2008 and 2007, respectively.

RSUs granted are deducted from the shares available for grant under the Company's stock option plans utilizing a factor of two times the number of RSUs granted. Similarly, RSUs cancelled are added back to the shares available for grant under the Company's stock option plans utilizing a factor of two times the number of RSUs cancelled. Outstanding RSU balances are not included in the outstanding options balances in the stock option activity table.

Stock-Based Compensation

Stock-based compensation cost for RSUs is measured based on the closing fair market value of the Company's common stock on the date of grant. Stock-based compensation cost for stock options is estimated at the grant

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date based on each option's fair-value as calculated by the BSM option-pricing model. The BSM option-pricing model incorporates various assumptions including expected volatility, expected life and interest rates. The expected volatility is based on the historical volatility of the Company's common stock over the most recent period commensurate with the estimated expected life of the Company's stock options and other relevant factors including implied volatility in market traded options on the Company's common stock. The Company bases its expected life assumption on its historical experience and on the terms and conditions of the stock awards it grants to employees. The Company recognizes stock-based compensation cost as expense ratably on a straight-line basis over the requisite service period.

The weighted-average assumptions used for the three years ended September 26, 2009, and the resulting estimates of weighted-average fair value per share of options granted and of employee stock purchase plan rights ("stock purchase rights") during those periods are as follows:

	2009	2008	2007
Expected life of stock options	4.54 years (a)	3.41 years	3.46 years
Expected life of stock purchase rights	6 months	6 months	6 months
Interest rate - stock options	2.04%(a)	3.40%	4.61%
Interest rate - stock purchase rights	0.58%	3.48%	5.13%
Volatility - stock options	50.98% (a)	45.64%	38.13%
Volatility - stock purchase rights	52.16%	38.51%	39.22%
Dividend yields	—	—	—
Weighted-average fair value of stock options granted during the year	$46.71	$62.73	$31.86
Weighted-average fair value of employee stock purchase plan rights during the year	$30.62	$42.27	$20.90

(a) In conjunction with the Company's 2009 equity compensation program changes, it began issuing primarily RSUs rather than stock options to employees, although the Company continues to grant stock options to non-employee directors. Accordingly the weighted average expected life of stock options was influenced by non-employee director stock option grants, which had a ten-year expected life. The weighted average expected life of stock options also affects the resulting interest rate and expected volatility assumptions.

The following table provides a summary of the stock-based compensation expense included in the Consolidated Statements of Operations for the three years ended September 26, 2009 (in millions):

	2009	2008	2007
Cost of sales	$114	$ 80	$ 35
Research and development	258	185	77
Selling, general and administrative	338	251	130
Total stock-based compensation expense	$710	$516	$242

Stock-based compensation expense capitalized as software development costs was not significant as of September 26, 2009 or September 27, 2008. The income tax benefit related to stock-based compensation expense was $266 million, $169 million and $81 million for 2009, 2008 and 2007, respectively. The total unrecognized compensation cost related to stock options and RSUs expected to vest was $1.4 billion as of September 26, 2009, which is expected to be recognized over a weighted-average period of 2.53 years.

Note 8 – Commitments and Contingencies

Lease Commitments

The Company leases various equipment and facilities, including retail space, under noncancelable operating lease arrangements. The Company does not currently utilize any other off-balance sheet financing arrangements. The

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major facility leases are generally for terms of one to 20 years and generally provide renewal options for terms of one to five additional years. Leases for retail space are for terms of five to 20 years, the majority of which are for ten years, and often contain multi-year renewal options. As of September 26, 2009, the Company's total future minimum lease payments under noncancelable operating leases were $1.9 billion, of which $1.5 billion related to leases for retail space.

Rent expense under all operating leases, including both cancelable and noncancelable leases, was $231 million, $207 million and $151 million in 2009, 2008 and 2007, respectively. Future minimum lease payments under noncancelable operating leases having remaining terms in excess of one year as of September 26, 2009, are as follows (in millions):

Years	
2010	$ 222
2011	234
2012	228
2013	214
2014	199
Thereafter	825
Total minimum lease payments	$1,922

Accrued Warranty and Indemnifications

The Company offers a basic limited parts and labor warranty on its hardware products. The basic warranty period for hardware products is typically one year from the date of purchase by the end-user. The Company also offers a 90-day basic warranty for its service parts used to repair the Company's hardware products. The Company provides currently for the estimated cost that may be incurred under its basic limited product warranties at the time related revenue is recognized. Factors considered in determining appropriate accruals for product warranty obligations include the size of the installed base of products subject to warranty protection, historical and projected warranty claim rates, historical and projected cost-per-claim, and knowledge of specific product failures that are outside of the Company's typical experience. The Company assesses the adequacy of its preexisting warranty liabilities and adjusts the amounts as necessary based on actual experience and changes in future estimates. For products accounted for under subscription accounting, the Company recognizes warranty expense as incurred.

The Company periodically provides updates to its applications and system software to maintain the software's compliance with published specifications. The estimated cost to develop such updates is accounted for as warranty costs that are recognized at the time related software revenue is recognized. Factors considered in determining appropriate accruals related to such updates include the number of units delivered, the number of updates expected to occur, and the historical cost and estimated future cost of the resources necessary to develop these updates.

The following table reconciles changes in the Company's accrued warranties and related costs for the three years ended September 26, 2009 (in millions):

	2009	2008	2007
Beginning accrued warranty and related costs	$ 267	$ 230	$ 284
Cost of warranty claims	(294)	(319)	(281)
Accruals for product warranties	237	356	227
Ending accrued warranty and related costs	$ 210	$ 267	$ 230

The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party.

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However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against it or an indemnified third-party and, in the opinion of management, does not have a potential liability related to unresolved infringement claims subject to indemnification that would materially adversely affect its financial condition or operating results. Therefore, the Company did not record a liability for infringement costs as of either September 26, 2009 or September 27, 2008.

The Company has entered into indemnification agreements with its directors and executive officers. Under these agreements, the Company has agreed to indemnify such individuals to the fullest extent permitted by law against liabilities that arise by reason of their status as directors or officers and to advance expenses incurred by such individuals in connection with related legal proceedings. It is not possible to determine the maximum potential amount of payments the Company could be required to make under these agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each claim. However, the Company maintains directors and officers liability insurance coverage to reduce its exposure to such obligations, and payments made under these agreements historically have not materially adversely affected the Company's financial condition or operating results.

Concentrations in the Available Sources of Supply of Materials and Product

Although most components essential to the Company's business are generally available from multiple sources, certain key components including but not limited to microprocessors, enclosures, certain liquid crystal displays ("LCDs"), certain optical drives and application-specific integrated circuits ("ASICs") are currently obtained by the Company from single or limited sources, which subjects the Company to significant supply and pricing risks. Many of these and other key components that are available from multiple sources including but not limited to NAND flash memory, dynamic random access memory ("DRAM") and certain LCDs, are subject at times to industry-wide shortages and significant commodity pricing fluctuations. In addition, the Company has entered into certain agreements for the supply of key components including but not limited to microprocessors, NAND flash memory, DRAM and LCDs at favorable pricing, but there is no guarantee that the Company will be able to extend or renew these agreements on similar favorable terms, or at all, upon expiration or otherwise obtain favorable pricing in the future. Therefore, the Company remains subject to significant risks of supply shortages and/or price increases that can materially adversely affect its financial condition and operating results.

The Company and other participants in the personal computer, mobile communication and consumer electronics industries also compete for various components with other industries that have experienced increased demand for their products. In addition, the Company uses some custom components that are not common to the rest of the personal computer, mobile communication and consumer electronics industries, and new products introduced by the Company often utilize custom components available from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. When a component or product uses new technologies, initial capacity constraints may exist until the suppliers' yields have matured or manufacturing capacity has increased. If the Company's supply of a key single-sourced component for a new or existing product were delayed or constrained, if such components were available only at significantly higher prices, or if a key manufacturing vendor delayed shipments of completed products to the Company, the Company's financial condition and operating results could be materially adversely affected. The Company's business and financial performance could also be adversely affected depending on the time required to obtain sufficient quantities from the original source, or to identify and obtain sufficient quantities from an alternative source. Continued availability of these components at acceptable prices, or at all, may be affected if those suppliers decided to concentrate on the production of common components instead of components customized to meet the Company's requirements.

Significant portions of the Company's Mac computers, iPhones, iPods, logic boards and other assembled products are now manufactured by outsourcing partners, primarily in various parts of Asia. A significant concentration of this outsourced manufacturing is currently performed by only a few of the Company's outsourcing partners, often in single locations. Certain of these outsourcing partners are the sole-sourced supplier of components and manufacturing outsourcing for many of the Company's key products including but not limited to final assembly of substantially all of the Company's portable Mac computers, iPhones, iPods and most of the Company's desktop products. Although

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the Company works closely with its outsourcing partners on manufacturing schedules, the Company's operating results could be adversely affected if its outsourcing partners were unable to meet their production commitments. The Company's purchase commitments typically cover its requirements for periods ranging from 30 to 150 days.

Long-Term Supply Agreements

The Company has entered into prepaid long-term supply agreements to secure the supply of certain inventory components. During the first quarter of 2009, a long-term supply agreement with Intel Corporation was terminated and the remaining prepaid balance of $167 million was repaid to the Company. During the second and fourth quarters of 2009, the Company made a prepayment of $500 million to LG Display for the purchase of LCD panels and a prepayment of $500 million to Toshiba to purchase NAND flash memory, respectively. As of September 26, 2009, the Company had a total of $1.2 billion of inventory component prepayments outstanding.

Contingencies

The Company is subject to certain other legal proceedings and claims that have arisen in the ordinary course of business and have not been fully adjudicated, which are discussed in Part I, Item 3 of this Form 10-K under the heading "Legal Proceedings." In the opinion of management, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate materially adversely affect its financial condition or operating results. However, the results of legal proceedings cannot be predicted with certainty. If the Company failed to prevail in any of these legal matters or if several of these legal matters were resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

Production and marketing of products in certain states and countries may subject the Company to environmental, product safety and other regulations including, in some instances, the requirement to provide customers the ability to return product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have been passed in several jurisdictions in which the Company operates, including various countries within Europe and Asia and certain states and provinces within North America. Although the Company does not anticipate any material adverse effects in the future based on the nature of its operations and the thrust of such laws, there is no assurance that such existing laws or future laws will not materially adversely affect the Company's financial condition or operating results.

Note 9 – Segment Information and Geographic Data

The Company reports segment information based on the "management" approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of the Company's reportable segments.

The Company manages its business primarily on a geographic basis. Accordingly, the Company determined its operating segments, which are generally based on the nature and location of its customers, to be the Americas, Europe, Japan, Asia-Pacific, Retail and FileMaker operations. The Company's reportable operating segments consist of Americas, Europe, Japan and Retail operations. Other operating segments include Asia Pacific, which encompasses Australia and Asia except for Japan and the Company's FileMaker, Inc. subsidiary. The Americas, Europe, Japan and Asia Pacific segments exclude activities related to the Retail segment. The Americas segment includes both North and South America. The Europe segment includes European countries, as well as the Middle East and Africa. The Retail segment operates Apple-owned retail stores in the U.S. and in international markets. Each reportable operating segment provides similar hardware and software products and similar services to the same types of customers. The accounting policies of the various segments are the same as those described in Note 1, "Summary of Significant Accounting Policies."

The Company evaluates the performance of its operating segments based on net sales and operating income. Net sales for geographic segments are generally based on the location of customers, while Retail segment net sales are based on sales from the Company's retail stores. Operating income for each segment includes net sales to

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third parties, related cost of sales and operating expenses directly attributable to the segment. Advertising expenses are generally included in the geographic segment in which the expenditures are incurred. Operating income for each segment excludes other income and expense and certain expenses managed outside the operating segments. Costs excluded from segment operating income include various corporate expenses, such as manufacturing costs and variances not included in standard costs, research and development, corporate marketing expenses, stock-based compensation expense, income taxes, various nonrecurring charges, and other separately managed general and administrative costs. The Company does not include intercompany transfers between segments for management reporting purposes. Segment assets exclude corporate assets, such as cash, short-term and long-term investments, manufacturing and corporate facilities, miscellaneous corporate infrastructure, goodwill and other acquired intangible assets. Except for the Retail segment, capital asset purchases for long-lived assets are not reported to management by segment. Cash payments for capital asset purchases by the Retail segment were $369 million, $389 million and $294 million for 2009, 2008 and 2007, respectively.

The Company has certain retail stores that have been designed and built to serve as high-profile venues to promote brand awareness and serve as vehicles for corporate sales and marketing activities. Because of their unique design elements, locations and size, these stores require substantially more investment than the Company's more typical retail stores. The Company allocates certain operating expenses associated with its high-profile stores to corporate marketing expense to reflect the estimated Company-wide benefit. The allocation of these operating costs to corporate expense is based on the amount incurred for a high-profile store in excess of that incurred by a more typical Company retail location. The Company had opened a total of 11 high-profile stores as of September 26, 2009. Expenses allocated to corporate marketing resulting from the operations of high-profile stores were $65 million, $53 million and $39 million for 2009, 2008 and 2007, respectively.

Summary information by operating segment for the three years ended September 26, 2009 is as follows (in millions):

	2009	2008	2007
Americas:			
Net sales	$16,142	$14,573	$11,596
Operating income	$ 4,772	$ 4,051	$ 2,949
Depreciation, amortization and accretion	$ 11	$ 9	$ 9
Segment assets (a)	$ 4,290	$ 3,039	$ 1,497
Europe:			
Net sales	$ 9,365	$ 7,622	$ 5,460
Operating income	$ 2,913	$ 2,313	$ 1,348
Depreciation, amortization and accretion	$ 7	$ 6	$ 6
Segment assets	$ 2,994	$ 1,775	$ 595
Japan:			
Net sales	$ 1,831	$ 1,509	$ 1,082
Operating income	$ 657	$ 440	$ 232
Depreciation, amortization and accretion	$ 2	$ 2	$ 3
Segment assets	$ 638	$ 302	$ 159
Retail:			
Net sales	$ 6,574	$ 6,315	$ 4,115
Operating income	$ 1,392	$ 1,337	$ 875
Depreciation, amortization and accretion (b)	$ 146	$ 108	$ 88
Segment assets (b)	$ 1,929	$ 1,869	$ 1,085
Other Segments (c):			
Net sales	$ 2,625	$ 2,460	$ 1,753
Operating income	$ 748	$ 615	$ 388
Depreciation, amortization and accretion	$ 4	$ 4	$ 3
Segment assets	$ 953	$ 534	$ 252

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(a) The Americas asset figures do not include fixed assets held in the U.S. Such fixed assets are not allocated specifically to the Americas segment and are included in the corporate assets figures below.
(b) Retail segment depreciation and asset figures reflect the cost and related depreciation of its retail stores and related infrastructure.
(c) Other Segments include Asia-Pacific and FileMaker.

A reconciliation of the Company's segment operating income and assets to the consolidated financial statements for the three years ended September 26, 2009 is as follows (in millions):

	2009	2008	2007
Segment operating income	$10,482	$ 8,756	$ 5,792
Other corporate expenses, net (a)	(2,114)	(1,965)	(1,141)
Stock-based compensation expense	(710)	(516)	(242)
Total operating income	$ 7,658	$ 6,275	$ 4,409
Segment assets	$10,804	$ 7,519	$ 3,588
Corporate assets	43,047	32,053	21,759
Consolidated assets	$53,851	$39,572	$25,347
Segment depreciation, amortization and accretion	$ 170	$ 129	$ 109
Corporate depreciation, amortization and accretion	533	344	208
Consolidated depreciation, amortization and accretion	$ 703	$ 473	$ 317

(a) Other corporate expenses include research and development, corporate marketing expenses, manufacturing costs and variances not included in standard costs, and other separately managed general and administrative expenses, including certain corporate expenses associated with support of the Retail segment.

No single customer or single country outside of the U.S. accounted for more than 10% of net sales in 2009, 2008 or 2007. Net sales and long-lived assets related to the U.S. and international operations for the three years ended September 26, 2009, are as follows (in millions):

	2009	2008	2007
Net sales:			
U.S.	$19,870	$18,469	$14,128
International	16,667	14,010	9,878
Total net sales	$36,537	$32,479	$24,006
Long-lived assets:			
U.S.	$ 2,698	$ 2,269	$ 1,752
International	495	410	260
Total long-lived assets	$ 3,193	$ 2,679	$ 2,012

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Information regarding net sales by product for the three years ended September 26, 2009, is as follows (in millions):

	2009	2008	2007
Net sales:			
Desktops (a)	$ 4,308	$ 5,603	$ 4,020
Portables (b)	9,472	8,673	6,294
Total Mac net sales	13,780	14,276	10,314
iPod	8,091	9,153	8,305
Other music related products and services (c)	4,036	3,340	2,496
iPhone and related products and services (d)	6,754	1,844	123
Peripherals and other hardware (e)	1,470	1,659	1,260
Software, service and other net sales (f)	2,406	2,207	1,508
Total net sales	$36,537	$32,479	$24,006

(a) Includes iMac, Mac mini, Mac Pro and Xserve product lines.
(b) Includes MacBook, MacBook Air and MacBook Pro product lines.
(c) Consists of iTunes Store sales and iPod services, and Apple-branded and third-party iPod accessories.
(d) Derived from handset sales, carrier agreements, and Apple-branded and third-party iPhone accessories.
(e) Includes sales of displays, wireless connectivity and networking solutions, and other hardware accessories.
(f) Includes sales of Apple-branded operating system and application software, third-party software, AppleCare and Internet services.

Note 10 – Related Party Transactions and Certain Other Transactions

The Company entered into a Reimbursement Agreement with its CEO, Steve Jobs, for the reimbursement of expenses incurred by Mr. Jobs in the operation of his private plane when used for Apple business. The Company recognized a total of approximately $4,000, $871,000 and $776,000 in expenses pursuant to the Reimbursement Agreement during 2009, 2008 and 2007, respectively. All expenses recognized pursuant to the Reimbursement Agreement have been included in selling, general and administrative expenses in the Consolidated Statements of Operations.

Note 11 – Selected Quarterly Financial Information (Unaudited)

The following tables set forth a summary of the Company's quarterly financial information for each of the four quarters ended September 26, 2009 and September 27, 2008 (in millions, except per share amounts):

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
2009				
Net sales	$ 9,870	$ 8,337	$ 8,163	$ 10,167
Gross margin	$ 3,614	$ 3,023	$ 2,971	$ 3,532
Net income	$ 1,665	$ 1,229	$ 1,205	$ 1,605
Earnings per common share:				
Basic	$ 1.85	$ 1.38	$ 1.35	$ 1.81
Diluted	$ 1.82	$ 1.35	$ 1.33	$ 1.78
2008				
Net sales	$ 7,895	$ 7,464	$ 7,512	$ 9,608
Gross margin	$ 2,739	$ 2,600	$ 2,474	$ 3,332
Net income	$ 1,136	$ 1,072	$ 1,045	$ 1,581
Earnings per common share:				
Basic	$ 1.28	$ 1.21	$ 1.19	$ 1.81
Diluted	$ 1.26	$ 1.19	$ 1.16	$ 1.76

Basic and diluted earnings per share are computed independently for each of the quarters presented. Therefore, the sum of quarterly basic and diluted per share information may not equal annual basic and diluted earnings per share.

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Report of Ernst & Young LLP, Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of Apple Inc.

We have audited the accompanying consolidated balance sheet of Apple Inc. as of September 26, 2009, and the related consolidated statements of operations, shareholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Apple Inc. at September 26, 2009, and the consolidated results of its operations and its cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Apple Inc.'s internal control over financial reporting as of September 26, 2009, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated October 27, 2009 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Jose, California
October 27, 2009

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Report of Ernst & Young LLP, Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of Apple Inc.

We have audited Apple Inc.'s internal control over financial reporting as of September 26, 2009, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("the COSO criteria"). Apple Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Apple Inc. maintained, in all material respects, effective internal control over financial reporting as of September 26, 2009, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of Apple Inc. as of and for the year ended September 26, 2009 and our report dated October 27, 2009 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Jose, California
October 27, 2009

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Report of KPMG LLP, Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Apple Inc.:

We have audited the accompanying consolidated balance sheet of Apple Inc. and subsidiaries (the Company) as of September 27, 2008, and the related consolidated statements of operations, shareholders' equity, and cash flows for the years ended September 27, 2008 and September 29, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Apple Inc. and subsidiaries as of September 27, 2008 and the results of their operations and their cash flows for the years ended September 27, 2008 and September 29, 2007 in conformity with U.S. generally accepted accounting principles.

As discussed in note 1 to the Consolidated Financial Statements, effective September 30, 2007, the Company adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109.*

/s/ KPMG LLP

Mountain View, California
November 4, 2008

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on an evaluation under the supervision and with the participation of the Company's management, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act were effective as of September 26, 2009 to provide reasonable assurance that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Inherent Limitations Over Internal Controls

The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. The Company's internal control over financial reporting includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the Company's assets;

(ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that the Company's receipts and expenditures are being made only in accordance with authorizations of the Company's management and directors; and

(iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Management, including the Company's Chief Executive Officer and Chief Financial Officer, does not expect that the Company's internal controls will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of internal controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Also, any evaluation of the effectiveness of controls in future periods are subject to the risk that those internal controls may become inadequate because of changes in business conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management's Annual Report on Internal Control Over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act. Management conducted an evaluation of the effectiveness of the Company's internal control over financial reporting based on the criteria set forth in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on the Company's assessment, management has concluded that its internal control over financial reporting was effective as of September 26, 2009 to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with U.S. generally accepted accounting principles. The Company's independent registered public accounting firm, Ernst & Young LLP, has issued an audit report on the Company's internal control over financial reporting. The report on the audit of internal control over financial reporting appears on page 90 of this Form 10-K.

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Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the fourth quarter of fiscal 2009, which were identified in connection with management's evaluation required by paragraph (d) of rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information

None.

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PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this Item under the heading "Directors, Executive Officers and Corporate Governance" is incorporated herein by reference from the information to be contained in the Company's 2010 Proxy Statement to be filed with the U.S. Securities and Exchange Commission ("SEC") in connection with the solicitation of proxies for the Company's 2010 Annual Meeting of Shareholders ("2010 Proxy Statement"). Such Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year to which this report relates.

Item 11. Executive Compensation

The information required by this Item under the headings "Executive Compensation" and "Compensation Discussion and Analysis" is incorporated herein by reference from the information to be contained in the Company's 2010 Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item under the headings "Security Ownership of Certain Beneficial Owners and Management" and "Equity Compensation Plan Information" is incorporated herein by reference from the information to be contained in the Company's 2010 Proxy Statement.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this Item under the heading "Review, Approval or Ratification of Transactions with Related Persons" is incorporated herein by reference from the information to be contained in the Company's 2010 Proxy Statement.

Item 14. Principal Accountant Fees and Services

The information required by this Item under the heading "Fees Paid to Auditors" is incorporated herein by reference from the information to be contained in the Company's 2010 Proxy Statement.

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PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) Documents filed as part of this report

(1) All financial statements

(2) Financial Statement Schedules

All financial statement schedules have been omitted, since the required information is not applicable or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements and notes thereto.

(b) Exhibits required by Item 601 of Regulation S-K

The information required by this Item is set forth on the exhibit index that follows the signature page of this report.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, this 27th day of October 2009.

APPLE INC.

By: /s/ Peter Oppenheimer
Peter Oppenheimer
Senior Vice President and
Chief Financial Officer

Power of Attorney

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Steven P. Jobs and Peter Oppenheimer, jointly and severally, his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this Annual Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Name	Title	Date
/s/ Steven P. Jobs STEVEN P. JOBS	Chief Executive Officer and Director (Principal Executive Officer)	October 27, 2009
/s/ Peter Oppenheimer PETER OPPENHEIMER	Senior Vice President and Chief Financial Officer (Principal Financial Officer)	October 27, 2009
/s/ Betsy Rafael BETSY RAFAEL	Vice President Corporate Controller (Principal Accounting Officer)	October 27, 2009
/s/ William V. Campbell WILLIAM V. CAMPBELL	Director	October 27, 2009
/s/ Millard S. Drexler MILLARD S. DREXLER	Director	October 27, 2009
/s/ Albert Gore, Jr. ALBERT GORE, JR.	Director	October 27, 2009
/s/ Andrea Jung ANDREA JUNG	Director	October 27, 2009
/s/ Arthur D. Levinson ARTHUR D. LEVINSON	Director	October 27, 2009
/s/ Jerome B. York JEROME B. YORK	Director	October 27, 2009

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EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference Form	Filing Date/ Period End Date
3.1	Restated Articles of Incorporation, filed with the Secretary of State of the State of California on July 10, 2009.	10-Q	6/27/09
3.2	By-Laws of the Registrant, as amended through May 27, 2009.	8-K	6/2/09
4.1	Form of Stock Certificate of the Registrant.	10-Q	12/30/06
10.1*	Employee Stock Purchase Plan, as amended through May 10, 2007.	8-K	5/16/07
10.2*	Form of Indemnification Agreement between the Registrant and each director and executive officer of the Registrant.	10-Q	6/27/09
10.3*	1997 Employee Stock Option Plan, as amended through October 19, 2001.	10-K	9/28/02
10.4*	1997 Director Stock Option Plan, as amended through May 10, 2007.	8-K	5/16/07
10.5*	2003 Employee Stock Plan, as amended through May 10, 2007.	8-K	5/16/07
10.6*	Reimbursement Agreement dated as of May 25, 2001 by and between the Registrant and Steven P. Jobs.	10-Q	6/29/02
10.7*	Form of Option Agreement.	10-K	9/24/05
10.8*	Form of Restricted Stock Unit Award Agreement effective as of August 28, 2007.	10-K	9/29/07
10.9*	Form of Restricted Stock Unit Award Agreement effective as of November 11, 2008.	10-Q	12/27/08
10.10*	Transition Agreement and Settlement Agreement and Release dated as of November 3, 2008 by and between the Registrant and Anthony Fadell.	10-Q	12/27/08
14.1	Business Conduct Policy of the Registrant dated February 2009.	10-Q	3/28/09
21.1**	Subsidiaries of the Registrant.		
23.1**	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.		
23.2**	Consent of KPMG LLP, Independent Registered Public Accounting Firm.		
24.1**	Power of Attorney (included on the Signature Page of this Annual Report on Form 10-K).		
31.1**	Rule 13a-14(a) / 15d-14(a) Certification of Chief Executive Officer.		
31.2**	Rule 13a-14(a) / 15d-14(a) Certification of Chief Financial Officer.		
32.1***	Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer.		
101.INS****	XBRL Instance Document		
101.SCH****	XBRL Taxonomy Extension Schema Document		
101.CAL****	XBRL Taxonomy Extension Calculation Linkbase Document		
101.DEF****	XBRL Taxonomy Extension Definition Linkbase Document		
101.LAB****	XBRL Taxonomy Extension Label Linkbase Document		
101.PRE****	XBRL Taxonomy Extension Presentation Linkbase Document		

* Indicates management contract or compensatory plan or arrangement.

** Filed herewith.

*** Furnished herewith.

**** Pursuant to applicable securities laws and regulations, the Company is deemed to have complied with the reporting obligation relating to the submission of interactive data files in such exhibits and is not subject to liability under any anti-fraud provisions of the federal securities laws as long as the Company has made a good faith attempt to comply with the submission requirements and promptly amends the interactive data files after becoming aware that the interactive data files fails to comply with the submission requirements. Users of this data are advised that, pursuant to Rule 406T, these interactive data files are deemed not filed and otherwise are not subject to liability.

EXHIBIT 7

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(MarkOne)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended September 27, 2008

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission file number: 000-10030

APPLE INC.

(Exact name of registrant as specified in its charter)

California (State or other jurisdiction of incorporation or organization)	**94-2404110** (I.R.S. Employer Identification No.)
1 Infinite Loop **Cupertino, California** (Address of principal executive offices)	**95014** (Zip Code)

Registrant's telephone number, including area code: **(408) 996-1010**

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, no par value (Title of class)	The NASDAQ Global Select Market (Name of exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒	Accelerated filer ☐
Non-accelerated filer ☐ (Do not check if smaller reporting company)	Smaller Reporting Company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

The aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant, as of March 29, 2008, was approximately $118,441,000,000 based upon the closing price reported for such date on the NASDAQ Global Select Market. For purposes of this disclosure, shares of common stock held by persons who hold more than 5% of the outstanding shares of common stock and shares held by executive officers and directors of the registrant have been excluded because such persons may be deemed to be affiliates. This determination of executive officer or affiliate status is not necessarily a conclusive determination for other purposes.

888,935,123 shares of Common Stock Issued and Outstanding as of October 24, 2008

DOCUMENTS INCORPORATED BY REFERENCE

(1) Portions of the registrant's definitive Proxy Statement relating to its 2009 Annual Meeting of Shareholders, to be held on February 25, 2009, are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated.

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The Business section and other parts of this Annual Report on Form 10-K ("Form 10-K") contain forward-looking statements that involve risks and uncertainties. Many of the forward-looking statements are located in "Management's Discussion and Analysis of Financial Condition and Results of Operations." Forward-looking statements provide current expectations of future events based on certain assumptions and include any statement that does not directly relate to any historical or current fact. Forward-looking statements can also be identified by words such as "anticipates," "believes," "estimates," "expects," "intends," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and the Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Risk Factors" under Part I, Item 1A of this Form 10-K, which are incorporated herein by reference. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

PART I

Item 1. Business

Company Background
Apple Inc. and its wholly-owned subsidiaries (collectively "Apple" or the "Company") design, manufacture, and market personal computers, portable digital music players, and mobile communication devices and sell a variety of related software, services, peripherals, and networking solutions. The Company sells its products worldwide through its online stores, its retail stores, its direct sales force, and third-party wholesalers, resellers, and value-added resellers. In addition, the Company sells a variety of third-party Macintosh® ("Mac"), iPod® and iPhone™ compatible products, including application software, printers, storage devices, speakers, headphones, and various other accessories and peripherals through its online and retail stores, and digital content through the iTunes Store®. The Company sells to consumer, small and mid-sized business ("SMB"), education, enterprise, government, and creative customers. The Company's fiscal year is the 52 or 53-week period that ends on the last Saturday of September. Unless otherwise stated, all information presented in this Form 10-K is based on the Company's fiscal calendar.

Business Strategy
The Company is committed to bringing the best personal computing, portable digital music and mobile communication experience to consumers, students, educators, businesses, and government agencies through its innovative hardware, software, peripherals, services, and Internet offerings. The Company's business strategy leverages its unique ability to design and develop its own operating system, hardware, application software, and services to provide its customers new products and solutions with superior ease-of-use, seamless integration, and innovative industrial design. The Company believes continual investment in research and development is critical to the development and enhancement of innovative products and technologies. In addition to evolving its personal computers and related solutions, the Company continues to capitalize on the convergence of the personal computer, digital consumer electronics and mobile communications by creating and refining innovations, such as the iPod, iPhone, iTunes Store, and Apple TV®. The Company desires to support a community for the development of third-party products that complement the Company's offerings through its developer programs. The Company offers various third-party software applications and hardware accessories for Mac® computers, iPods and iPhones through its retail and online stores, as well as software applications for the iPhone platform through its iTunes® App Store. The Company's strategy also includes expanding its distribution network to effectively reach more of its targeted customers and provide them with a high-quality sales and post-sales support experience.

Consumer and Small and Mid-Sized Business
The Company believes a high-quality buying experience with knowledgeable salespersons who can convey the value of the Company's products and services greatly enhances its ability to attract and retain customers. The Company sells many of its products and resells certain third-party products in most of its major markets directly to consumers and businesses through its retail and online stores. The Company has also invested in programs to

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enhance reseller sales, including the Apple Sales Consultant Program, which places Apple employees and contractors at selected third-party reseller locations. The Company believes providing direct contact with its targeted customers is an efficient way to demonstrate the advantages of its Mac computers and other products over those of its competitors.

At the end of fiscal 2008, the Company had opened a total of 247 retail stores, including 205 stores in the U.S. and a total of 42 stores internationally. The Company has typically located its stores at high-traffic locations in quality shopping malls and urban shopping districts.

A goal of the Company's retail business is to expand its installed base through sales to customers who currently do not already own the Company's products. By operating its own stores and locating them in desirable high-traffic locations, the Company is better positioned to control the customer buying experience and attract new customers. The stores are designed to simplify and enhance the presentation and marketing of the Company's products and related solutions. To that end, retail store configurations have evolved into various sizes in order to accommodate market-specific demands. The stores employ experienced and knowledgeable personnel who provide product advice, service, and training. The stores offer a wide selection of third-party hardware, software, and various other accessory products and peripherals selected to complement the Company's own products.

Education
Throughout its history, the Company has focused on the use of technology in education and has been committed to delivering tools to help educators teach and students learn. The Company believes effective integration of technology into classroom instruction can result in higher levels of student achievement, especially when used to support collaboration, information access, and the expression and representation of student thoughts and ideas. The Company has designed a range of products and services to address the needs of education customers. These products and services include the Company's Mac computers, iPods, and iTunes, in addition to various solutions for video creation and editing, wireless networking, professional development, and one-to-one ("1:1") learning. A 1:1 learning solution typically consists of a portable computer for every student and teacher along with the installation of a wireless network.

Enterprise, Government and Creative
The Company also sells its hardware and software products to enterprise, government, and creative customers in each of its geographic segments. These markets are also important to many third-party developers who provide Mac-compatible hardware and software solutions. These customers utilize the Company's products for their high-powered computing performance and expansion capabilities, networking functionality, and seamless integration with complementary products. The Company designs its high-end hardware solutions, including desktops such as Mac Pro, portable Mac systems such as MacBook® Pro and MacBook Air™, and servers to incorporate the power, expandability, and other features desired by these professionals. The Company's operating system, Mac OS® X, incorporates powerful graphics and audio technologies and features developer tools to optimize system and application performance.

Other
In addition to consumer, SMB, education, enterprise, government and creative markets, the Company provides hardware and software products and solutions for customers in the information technology and scientific markets.

Business Organization
The Company manages its business primarily on a geographic basis. The Company's reportable operating segments consist of the Americas, Europe, Japan, and Retail. The Americas, Europe, and Japan reportable segments do not include activities related to the Retail segment. The Americas segment includes both North and South America. The Europe segment includes European countries as well as the Middle East and Africa. The Retail segment operates Apple-owned retail stores in the U.S. and in international markets. Each reportable geographic operating segment and the Retail operating segment provide similar hardware and software products and similar services. Further information regarding the Company's operating segments may be found in Part II,

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Item 7 of this Form 10-K under the heading "Segment Operating Performance," and in Part II, Item 8 of this Form 10-K in Notes to Consolidated Financial Statements at Note 9, "Segment Information and Geographic Data."

Products

The Company offers a range of personal computing products including desktop and portable personal computers, related devices and peripherals, and various third-party hardware and software products. In addition, the Company offers its own software products, including Mac OS X, the Company's proprietary operating system software for the Mac; server software and related solutions; professional application software; and consumer, education, and business oriented application software. The Company also designs, develops, and markets to Mac and Windows users its family of iPod digital music players and its iPhone mobile communication device, along with related accessories and services, including the online distribution of third-party content through the Company's iTunes Store. The Company's primary products are discussed below.

Hardware Products

The Company offers a range of personal computing products including desktop and notebook computers, server and storage products, related devices and peripherals, and various third-party hardware products. The Company's Mac desktop and portable systems feature Intel microprocessors, the Company's Mac OS X Version 10.5 Leopard® ("Mac OS X Leopard") operating system and iLife® suite of software for creation and management of digital photography, music, movies, DVDs, and website.

MacBook® Pro

The MacBook Pro family of notebook computers is designed for professionals and advanced consumer users. First introduced in January 2006, the MacBook Pro includes a 15-inch or 17-inch widescreen display, a built-in iSight® video camera, and the MagSafe® magnetic power adapter. In October 2008, the Company redesigned its 15-inch MacBook Pro models to include a widescreen light-emitting diode ("LED") display, the latest Intel Core 2 Duo processors running at up to 2.8GHz, and a new Nvidia GeForce 9600M graphics processor. The 15-inch MacBook Pro includes up to 4GB of 1066MHz synchronous dynamic random access memory ("SDRAM") with a 1066MHz frontside bus, up to a 320GB hard drive, a slot-loading double-layer SuperDrive®, a glass trackpad with Multi-Touch™ gesture support, AirPort Extreme® 802.11n wireless networking, and Bluetooth 2.1. In addition, the Company updated its 17-inch MacBook Pro models to include larger hard drives of up to 320GB, as well as an optional 128GB solid state drive.

MacBook®

The MacBook is designed for consumer and education users. First introduced in May 2006, the MacBook includes a 13-inch widescreen display, a built-in iSight video camera, and the MagSafe magnetic power adapter. In October 2008, the Company introduced new MacBook models with all-metal unibody enclosures, LED-backlit glossy widescreen displays, Intel Core 2 Duo processors running at up to 2.4GHz, NVIDIA GeForce 9400M graphics processor, support for up to 4GB of 1066MHz SDRAM memory, up to 320GB Serial ATA hard drive, a double-layer SuperDrive, a glass trackpad with Multi-Touch™ gesture support, and built-in AirPort Extreme 802.11n wireless networking and Bluetooth 2.1.

MacBook Air™

In October 2008, the Company updated its MacBook Air, an ultra-slim notebook computer that measures 0.16-inches at its thinnest point and 0.76-inches at its maximum height. The new MacBook Air includes an Intel Core 2 Duo processor running at up to 1.86GHz with 6MB of Level 2 cache, an NVIDIA GeForce 9400M graphics processor, 2GB of memory, and a 120GB hard drive. The MacBook Air includes a 13.3-inch LED-backlit widescreen display, a full-size backlit keyboard, a built-in iSight video camera, a trackpad with Multi-Touch gesture support, and built-in AirPort Extreme 802.11n wireless networking and Bluetooth 2.1.

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Mac® Pro
The Mac Pro desktop computer is targeted at business and professional users and is designed to meet the performance, expansion, and networking needs of the most demanding Mac user. In January 2008, the Company introduced the new Mac Pro featuring up to two Intel Quad-Core Xeon processors running at up to 3.2GHz, 12MB of Level 2 cache per processor and dual-independent 1.6GHz front-side buses, and up to 32GB of 800MHz fully buffered memory. The Mac Pro also features a direct attach storage solution for snap-in installation of up to four 1TB hard drives for a total of 4TB of internal storage and optional AirPort Extreme 802.11n wireless networking and Bluetooth 2.0.

iMac®
The iMac desktop computer is targeted at consumer, education and business customers. In April 2008, the Company updated the iMac to include Intel Core 2 Duo processors running at up to 3.06GHz, up to 4GB of 800MHz SDRAM memory, a faster graphics card option using NVIDIA GeForce 8800 GS graphics, and a slot-loading double-layer SuperDrive. All iMac models also include a built-in iSight video camera, AirPort Extreme 802.11n wireless networking, and Bluetooth 2.1.

Mac® mini
The Mac mini is an Intel-based desktop computer that includes 1GB of 667MHz memory that is expandable to 2GB and either a 1.83GHz or 2.0GHz Intel Core 2 Duo processor. All Mac mini models include built-in Gigabit Ethernet, AirPort Extreme 802.11g wireless networking, Bluetooth 2.0, a total of four USB 2.0 ports, and one FireWire 400 port. Mac mini includes a full-size digital video interface and a video graphics array output adapter to connect to a variety of displays.

Xserve®
Xserve is a 1U rack-mount server powered by up to two Quad-Core 128-bit Intel Xeon processors running at up to 3.0GHz and features Mac OS X Server 10.5 Leopard, which became available in October 2007. Xserve supports up to 32GB of random access memory, remote management, storage drives of up to 3TB, and an optional internal Xserve RAID card.

Music Products and Services
The Company offers its iPod line of portable digital music players and related accessories to Mac and Windows users. All iPods work with the Company's iTunes digital music management software ("iTunes software") available for both Mac and Windows-based computers. The Company also provides an online service to distribute third-party music, audio books, music videos, short films, television shows, movies, podcasts, and applications through its iTunes Store. In July 2008, the Company launched the iTunes App Store that allows a user to browse, search for, or purchase third-party applications through either a Mac or Windows-based computer or wirelessly download them directly onto an iPhone or iPod touch. In addition to the Company's own iPod accessories, thousands of third-party iPod compatible products are available, either through the Company's online and retail stores or from third parties, including portable and desktop speaker systems, headphones, car radio solutions, voice recorders, cables and docks, power supplies and chargers, and carrying cases and armbands.

iPod® shuffle
The iPod shuffle weighs half an ounce and features an aluminum design and a built-in clip. The iPod shuffle is available in 1GB or 2GB flash memory configurations and is capable of holding up to 240 or 500 songs, respectively. The iPod shuffle is available in a variety of colors and provides up to 12 hours of battery life. The iPod shuffle includes a shuffle switch feature that allows users to listen to their music in random order or in the order of their playlists synced through iTunes. iPod shuffle works with iTunes' patent-pending AutoFill option that automatically selects songs to fill the iPod shuffle from a user's iTunes library.

iPod® nano
In September 2008, the Company introduced the new iPod nano, a flash-memory-based iPod featuring the thinnest iPod design ever. The iPod nano incorporates a two-inch display with 204 pixels per inch, a built-in

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accelerometer, and an updated user interface featuring Cover Flow® and Shake to Shuffle mode. The new iPod nano also features "Genius" technology allowing users to automatically create playlists from songs in their music libraries. The new iPod nano provides up to 24 hours of audio playback or up to four hours of video playback and is available in 8GB and 16GB configurations in a variety of colors.

iPod® classic

The iPod classic is an upgraded version of the original iPod, the Company's hard-drive based portable digital music player. In September 2008, the Company introduced the new iPod classic, which has 120GB of storage and is capable of holding up to 30,000 songs, 150 hours of video, or 25,000 photos. The iPod classic provides up to 36 hours of audio playback or up to six hours of video playback, features "Genius" technology, and includes a 2.5-inch color screen that can display album artwork, photos, and video content including music videos, video and audio podcasts, short films, television shows, movies, and games.

iPod® touch

In September 2008, the Company introduced the new iPod touch, a flash-memory-based iPod that is 8.5 mm thin and features a 3.5-inch widescreen display, "Genius" technology, a built-in speaker, and an accelerometer. The iPod touch's user interface is based on the Company's Multi-Touch display allowing users to control the device with a touchscreen. It also includes Wi-Fi wireless networking, which allows users to access the iTunes Wi-Fi Music Store and iTunes App Store to purchase and/or download audio and video files, as well as a variety of other applications. The iPod touch is available in 8GB, 16GB and 32GB configurations and features up to 36 hours of audio playback and up to six hours of video playback.

iTunes® 8

iTunes is an application for playing, downloading, and organizing digital audio and video files and is available for both Mac and Windows-based computers. iTunes is integrated with the iTunes Store, a service that allows customers to find, purchase, rent, and download third-party digital music, audio books, music videos, short films, television shows, movies, games, and other applications. Originally introduced in the U.S. in April 2003, the iTunes Store now serves customers in 22 countries. In September 2008, the Company announced iTunes 8, which includes the new "Genius" technology and features new ways of viewing music and video libraries and allows the purchase of high definition television programs from the iTunes Store. In July 2008, the Company launched the iTunes App Store that allows users to browse, search, purchase, and wirelessly download third-party applications directly onto their iPhone or iPod touch. In January 2008, the Company announced iTunes Movie Rentals, a service allowing customers to rent movies from the iTunes Store that can be watched on Macs, Windows-based computers, current generation video-enabled iPods, iPhones, and digitally enabled televisions using Apple TV.

iPhone™

In June 2008, the Company announced iPhone™ 3G, the second-generation iPhone that combines in a single handheld product a mobile phone, a widescreen iPod with touch controls, and an Internet communications device. iPhone features desktop-class email, web browsing, searching, and maps and is compatible with both Macs and Windows-based computers. iPhone automatically syncs content from users' iTunes libraries, as well as contacts, bookmarks, and email accounts. Its user interface is based on the Company's Multi-Touch display allowing users to control the device with a touchscreen. iPhone 3G combines the features of the original iPhone, which was released in June 2007, with 3G networking, a built-in global positioning system ("GPS"), and iPhone 2.0 software. iPhone 2.0 software incorporates new enterprise features, including support for Microsoft Exchange ActiveSync and Cisco IPsec virtual private network ("VPN"). iPhone 3G is a quad-band GSM phone featuring 3G, EDGE and Wi-Fi wireless technologies for data networking, Bluetooth 2.0, a built-in 2.0 megapixel camera, and a 3.5-inch touch widescreen with 480-by-320 resolution at 163 pixels per inch. iPhone 3G provides up to 10 hours of talk time on 2G networks and five hours using 3G networks, up to five to six hours of web browsing, up to seven hours of video playback, or up to 24 hours of audio playback. It is available in 8GB and 16GB configurations.

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In July 2008, the Company began shipping iPhone 3G in certain countries and made iPhone 2.0 software available to all iPhone customers. The Company has signed multi-year agreements with various cellular network carriers authorizing them to distribute and provide cellular network services for iPhone 3G in over 70 countries. These agreements are generally not exclusive with a specific carrier, except in the U.S., U.K., France, Germany, Spain, Ireland, and certain other countries. The Company expects to ship iPhone 3G in over 70 countries by the end of calendar year 2008.

In addition to the Company's own iPhone accessories, third-party iPhone compatible products, including headsets, cables and docks, power supplies, and carrying cases, are available through the Company's online and retail stores or from third parties.

Peripheral Products
The Company sells a variety of Apple-branded and third-party Mac-compatible peripheral products directly to end-users through its retail and online stores, including printers, storage devices, computer memory, digital video and still cameras, and various other computing products and supplies.

Displays
The Company manufactures a family of widescreen flat panel displays including the 23-inch and 30-inch Apple Cinema High Definition ("HD") Displays™, and the 20-inch Apple Cinema Display®. In October 2008, the Company introduced a 24-inch LED Cinema Display that features a built-in iSight camera, microphone, built-in 2.1 speaker system, and MagSafe charger.

Apple TV®
Apple TV is a device that permits users to wirelessly play iTunes content on a widescreen television. Compatible with a Mac or Windows-based computer, Apple TV includes either a 40GB or 160GB hard drive capable of storing up to 200 hours of video, 36,000 songs, 25,000 photos, or a combination of each and is capable of displaying content in high definition resolution up to 720p. Apple TV connects to a broad range of widescreen televisions and home theater systems and comes standard with high-definition multimedia interface, component video, and both analog and digital optical audio ports. Using high-speed AirPort Extreme 802.11n wireless networking, Apple TV can auto-sync content from one computer or stream content from up to five additional computers directly to a television.

Software Products and Computer Technologies
The Company offers a range of software products for consumer, SMB, education, enterprise, government, and creative customers, including the Company's proprietary operating system software; server software and related solutions; professional application software; and consumer, education, and business oriented application software.

Operating System Software
Mac OS® X is built on an open-source UNIX-based foundation. Mac OS X Leopard is the sixth major release of Mac OS X and became available in October 2007. Leopard includes 300 additional features and introduces an updated desktop with Stacks, a means of easily accessing files from the Dock; a redesigned Finder™ that lets users quickly browse and share files between multiple Macs; Quick Look, a way to instantly see files without opening an application; Spaces®, a feature used to create groups of applications and instantly switch between them; and Time Machine™, a way to automatically back up all of the contents of a Mac.

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Application Software

iLife® '08
In August 2007, the Company introduced iLife '08, the latest release of its consumer-oriented digital lifestyle application suite, which features iPhoto®, iDVD®, GarageBand®, iWeb™, and iMovie® '08. All of these applications are Universal, meaning that they run natively on both Intel and PowerPC-based Mac computers ("Universal").

iPhoto® is the Company's consumer-oriented digital photo software application. iPhoto '08 adds new features for organizing and browsing photos, including event-based grouping, new professional quality image editing tools, and enables publishing to the MobileMe™ Web Gallery. The MobileMe Web Gallery, is fully integrated with iPhoto '08 and iMovie '08, allowing MobileMe users to share photos and movies over the web. iPhoto '08 features print, photo book, greeting card, and calendar layout tools and integrated online ordering services.

iMovie® '08 is the latest version of the Company's consumer-oriented digital video editing software application. iMovie '08 provides new tools for quick movie creation and video enhancements, including transitions, titles, music and sound effects. Projects in iMovie '08 can also be published to the MobileMe Web Gallery.

iDVD® is the Company's consumer-oriented software application that enables users to turn iMovie files, QuickTime® files, and digital pictures into interactive DVDs that can be played on most consumer DVD players. iDVD '08 features 10 new Apple-designed menu themes in both widescreen (16:9) and standard (4:3) formats.

GarageBand® is the Company's consumer-oriented music creation software application that allows users to play, record and create music using a simple interface. With GarageBand, software instruments, digital audio recordings and looping tracks can be arranged and edited to create songs. GarageBand '08 allows users to export finished songs to their iTunes library, or publish a podcast through iWeb and MobileMe that includes artwork, sound effects, and music jingles.

iWeb™ allows users to create online photo albums, blogs and podcasts, and to customize websites using editing tools. iWeb'08 offers new features to make websites more interactive by adding live web widgets, which are snippets of live content from other websites, such as Google Maps, targeted ads using Google AdSense, and photos or movies from the MobileMe Web Galleries.

iWork® '08
In August 2007, the Company introduced iWork '08, the latest version of the Company's integrated productivity suite designed to help users create, present, and publish documents, presentations, and spreadsheets. iWork '08 includes updates to Pages® '08 for word processing and page layout, Keynote® '08 for presentations, and introduces Numbers® '08 for spreadsheets. All of these programs are Universal and feature advanced image tools, including enhanced photo masking, resizable picture frames and edges, and Instant Alpha, which easily removes the background of a photo.

Final Cut Studio® 2
In April 2007, the Company introduced Final Cut Studio® 2, an upgraded version of the Company's video production suite designed for professionals. Final Cut Studio 2 features Final Cut Pro® 6 for video editing, DVD Studio Pro® 4 for DVD authoring, Motion 3 for real-time motion graphics, Soundtrack® Pro 2 for audio editing and sound design, Color for color grading and finishing, and Compressor 3 for encoding media in multiple formats. All of these applications are Universal. The Company also offers Final Cut Express HD 3.5, a consumer version of the Company's movie making software.

Logic® Studio
In September 2007, the Company introduced Logic Studio, a comprehensive suite of professional tools used by musicians and professionals to create, perform, and record music. Logic Studio features Logic Pro 8, an upgraded

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version of the Company's music creation and audio production software; MainStage®, a new live performance application; Soundtrack Pro 2, a professional audio post production software; Studio Instruments, made up of 40 instrument plug-ins; Studio Effects, with 80 professional effect plug-ins; and studio Sound Library. In addition, the Company offers Logic Express 8, a standalone version of the Logic Pro 8 application that provides an easy entry into professional music production. All of these applications are Universal.

FileMaker® Pro
The FileMaker Pro database software is Universal and offers relational databases and desktop-to-web publishing capabilities. In July 2007, the Company introduced FileMaker Pro 9 featuring a new Quick Start screen, which stores users' favorites and gives them access to the new videos in the FileMaker Learning Center; Conditional Formatting, which highlights data based on parameters the user sets; and the ability to email a link to other FileMaker users to instantly access a database.

Internet Software and Services
The Company is focused on delivering seamless integration with and access to the Internet throughout the Company's products and services. The Company's Internet solutions adhere to many industry standards to provide an optimized user experience.

Safari®
In March 2008, the Company made available Safari 3.1, a web browser compatible with Windows XP, Windows Vista, and Mac OS X. Safari 3.1 includes built-in Google search; SnapBack™ to instantly return to search results; a way to name, organize and present bookmarks; tabbed browsing; and automatic "pop-up" ad blocking. Safari 3.1 supports the new video and audio tags in HTML 5 and supports Cascading Style Sheets Animations and Web Fonts, which provide designers additional choices of fonts to create web sites.

QuickTime®
QuickTime, the Company's multimedia software for Mac or Windows-based computers, features streaming of live and stored video and audio over the Internet and playback of high-quality audio and video on computers. QuickTime 7 features H.264 encoding and can automatically determine a user's connection speed to ensure they are getting the highest-quality content stream possible. QuickTime 7 also delivers multi-channel audio and supports a wide range of industry standard audio formats.

The Company offers several other QuickTime products. QuickTime 7 Pro, a suite of software tools, allows creation and editing of Internet-ready audio and video files. QuickTime 7 Pro allows users to create H.264 video, capture audio and video, create multi-channel audio, and export multiple files while playing back or editing video.

MobileMe™
In June 2008, the Company introduced MobileMe, an annual subscription-based suite of Internet services that delivers email, contacts and calendars to and from native applications on iPhone, iPod touch, Macs, and Windows-based computers. MobileMe services include Internet message access protocol ("IMAP") mail, an ad-free email service; website hosting for publishing websites from iWeb; iDisk, a virtual hard drive accessible anywhere with Internet access; Web Gallery for viewing and sharing photos; MobileMe Sync, which keeps Safari bookmarks, iCal® calendars, Address Book information, Keychain®, and Mac OS X Mail preferences up-to-date across multiple computers, iPhones, and iPod touches. MobileMe provides combined email and file storage of 20GB for individuals and 40GB for families with additional storage options.

Product Support and Services
AppleCare® offers a range of support options for the Company's customers. These options include assistance that is built into software products, printed and electronic product manuals, online support including comprehensive product information as well as technical assistance, and the AppleCare Protection Plan. The AppleCare Protection Plan is a fee-based service that typically includes two to three years of phone support and hardware repairs, dedicated web-based support resources, and user diagnostic tools.

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Markets and Distribution

The Company's customers are primarily in the consumer, SMB, education, enterprise, government, and creative markets. The Company distributes its products through wholesalers, resellers, national and regional retailers, and cataloguers. No individual customer accounted for more than 10% of net sales in 2008, 2007, or 2006. The Company also sells many of its products and resells certain third-party products in most of its major markets directly to customers through its own sales force and retail and online stores.

Competition

The Company is confronted by aggressive competition in all areas of its business. The markets for consumer electronics, personal computers, related software and peripheral products, digital music devices and related services, and mobile communication devices are highly competitive. These markets are characterized by rapid technological advances in both hardware and software that have substantially increased the capabilities and use of personal computers, other digital electronic devices, and mobile communication devices that have resulted in the frequent introduction of new products with competitive price, feature, and performance characteristics. Over the past several years, price competition in these markets has been particularly intense. The Company's competitors who sell personal computers based on other operating systems have aggressively cut prices and lowered their product margins to gain or maintain market share. The Company's financial condition and operating results can be adversely affected by these and other industry-wide downward pressures on gross margins. The principal competitive factors include price, product features, relative price/performance, product quality and reliability, design innovation, availability of software and peripherals, marketing and distribution capability, service and support, and corporate reputation. Further, as the personal computer industry and its customers place more reliance on the Internet, an increasing number of Internet devices that are smaller, simpler, and less expensive than traditional personal computers may compete with the Company's products.

The Company's music products and services have faced significant competition from other companies promoting their own digital music and content products and services, including those offering free peer-to-peer music and video services. The Company believes it currently retains a competitive advantage by offering superior innovation and integration of the entire solution including the hardware (personal computer, iPod, and iPhone), software (iTunes), and distribution of content (iTunes Store and iTunes Wi-Fi Music Store). However, the Company expects competition in this space to intensify as competitors attempt to imitate the Company's approach to tightly integrating these elements within their own offerings or, alternatively, collaborate with each other to offer solutions that are more integrated than those they currently offer. Some of these current and potential competitors have substantial resources and may be able to provide such products and services at little or no profit or even at a loss to compete with the Company's offerings.

The Company is currently focused on market opportunities related to mobile communication devices including the iPhone. The mobile communications industry is highly competitive with several large, well-funded, and experienced competitors. The Company faces competition from mobile communication device companies that may attempt to imitate some of the iPhone's functions and applications within their own smart phones. This industry is characterized by aggressive pricing practices, frequent product introductions, evolving design approaches and technologies, rapid adoption of technological and product advancements by competitors, and price sensitivity on the part of consumers.

The Company's future financial condition and operating results are substantially dependent on the Company's ability to continue to develop and offer new innovative products and services in each of its markets.

Raw Materials

Although most components essential to the Company's business are generally available from multiple sources, certain key components including, but not limited to microprocessors, enclosures, certain LCDs, certain optical drives, and application-specific integrated circuits ("ASICs") are currently obtained by the Company from single or limited sources, which subjects the Company to significant supply and pricing risks. Many of these and other key components that are available from multiple sources including, but not limited to NAND flash memory, dynamic random access memory ("DRAM"), and certain LCDs, are subject at times to industry-wide shortages and significant commodity pricing fluctuations. In addition, the Company has entered into certain agreements for

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the supply of key components including, but not limited to microprocessors, NAND flash memory, DRAM and LCDs at favorable pricing, but there is no guarantee that the Company will be able to extend or renew these agreements on similar favorable terms, or at all, upon expiration or otherwise obtain favorable pricing in the future. Therefore, the Company remains subject to significant risks of supply shortages and/or price increases that can have a material adverse effect on its financial condition and operating results.

The Company and other participants in the personal computer, consumer electronics and mobile communication industries also compete for various components with other industries that have experienced increased demand for their products. In addition, the Company uses some custom components that are not common to the rest of the personal computer, consumer electronics and mobile communication industries, and new products introduced by the Company often utilize custom components available from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. When a component or product uses new technologies, initial capacity constraints may exist until the suppliers' yields have matured. If the Company's supply of a key single-sourced component for a new or existing product were delayed or constrained, if such components were available only at significantly higher prices, or if a key manufacturing vendor delayed shipments of completed products to the Company, the Company's financial condition and operating results could be materially adversely affected. The Company's business and financial performance could also be adversely affected depending on the time required to obtain sufficient quantities from the original source, or to identify and obtain sufficient quantities from an alternative source. Continued availability of these components at acceptable prices, or at all, may be affected if those suppliers decided to concentrate on the production of common components instead of components customized to meet the Company's requirements.

Significant portions of the Company's Mac computers, iPods, iPhones, logic boards, and other assembled products are manufactured by outsourcing partners, primarily in various parts of Asia. A significant concentration of this outsourced manufacturing is currently performed by only a few of the Company's outsourcing partners, often in single locations. Certain of these outsourcing partners are the sole-sourced suppliers of components and manufacturing outsourcing for many of the Company's key products, including but not limited to final assembly of substantially all of the Company's portable Mac computers, iPods, iPhones and most of the Company's iMacs. Although the Company works closely with its outsourcing partners on manufacturing schedules, the Company's operating results could be adversely affected if its outsourcing partners were unable to meet their production commitments. The Company's purchase commitments typically cover its requirements for periods ranging from 30 to 150 days.

The Company believes there are several component suppliers and manufacturing vendors whose loss to the Company could have a material adverse effect upon the Company's business and financial condition. At this time, such vendors include, without limitation, Amperex Technology Limited, ASUSTeK Corporation, ATI Technologies, Inc., Atheros Communications Inc., AU Optronics Corporation, Broadcom Corporation, Chi Mei Optoelectronics Corporation, Cypress Semiconductor Corporation, Hitachi Global Storage Technologies, Hon Hai Precision Industry Co., Ltd., Infineon Technologies AG, Intel Corporation, Inventec Appliances Corporation, LG Display, LSI Corporation, Matsushita, Murata Manufacturing Co., Ltd., National Semiconductor Corporation, NVIDIA Corp., Inc., Quanta Computer, Inc., Renesas Semiconductor Co. Ltd., Samsung Electronics, Sony Corporation, Synaptics, Inc., Texas Instruments, and Toshiba Corporation.

Research and Development

Because the personal computer, consumer electronics, and mobile communication industries are characterized by rapid technological advances, the Company's ability to compete successfully is heavily dependent upon its ability to ensure a continual and timely flow of competitive products, services, and technologies to the marketplace. The Company continues to develop new products and technologies and to enhance existing products in the areas of computer hardware and peripherals, consumer electronics products, mobile communication devices, system software, applications software, networking and communications software and solutions, and Internet services and solutions. The Company may expand the range of its product offerings and intellectual property through licensing and/or acquisition of third-party business and technology. The Company's research and development expenditures totaled $1.1 billion, $782 million, and $712 million in 2008, 2007, and 2006, respectively.

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Patents, Trademarks, Copyrights and Licenses

The Company currently holds rights to patents and copyrights relating to certain aspects of its computer systems, iPods, iPhone, peripherals, software, and services. In addition, the Company has registered, and/or has applied to register, trademarks and service marks in the U.S. and a number of foreign countries for "Apple," the Apple logo, "Macintosh," "Mac," "iPod," "iTunes," "iTunes Store," "iPhone," "Apple TV," "MobileMe" and numerous other trademarks and service marks. Although the Company believes the ownership of such patents, copyrights, trademarks and service marks is an important factor in its business and that its success does depend in part on the ownership thereof, the Company relies primarily on the innovative skills, technical competence, and marketing abilities of its personnel.

The Company regularly files patent applications to protect inventions arising from its research and development, and is currently pursuing thousands of patent applications around the world. Over time, the Company has accumulated a portfolio of several thousand issued patents in the U.S. and worldwide. In addition, the Company currently holds copyrights relating to certain aspects of its products and services. No single patent or copyright is solely responsible for protecting the Company's products. The Company believes the duration of the applicable patents that it has been granted is adequate relative to the expected lives of its products. Due to the fast pace of innovation and product development, the Company's products are often obsolete before the patents related to them expire, and sometimes are obsolete before the patents related to them are even granted.

Many of the Company's products are designed to include intellectual property obtained from third parties. While it may be necessary in the future to seek or renew licenses relating to various aspects of its products and business methods, the Company believes, based upon past experience and industry practice, such licenses generally could be obtained on commercially reasonable terms; however, there is no guarantee that such licenses could be obtained at all. Because of technological changes in the computer, digital music player and mobile communications industries, current extensive patent coverage, and the rapid rate of issuance of new patents, it is possible certain components of the Company's products and business methods may unknowingly infringe existing patents or intellectual property rights of others. From time to time, the Company has been notified that it may be infringing certain patents or other intellectual property rights of third parties.

Foreign and Domestic Operations and Geographic Data

The U.S. represents the Company's largest geographic marketplace. Approximately 57% of the Company's net sales in 2008 came from sales to customers inside the U.S. Final assembly of the Company's products is currently performed in the Company's manufacturing facility in Ireland, and by external vendors in California, the Republic of Korea ("Korea"), the People's Republic of China ("China") and the Czech Republic. Currently, the supply and manufacture of many critical components is performed by sole-sourced third-party vendors in the U.S., China, Japan, Korea, Malaysia, Philippines, Taiwan, Thailand, and Singapore. Sole-sourced third-party vendors in China perform final assembly of substantially all of the Company's portable products, including MacBook Pro, MacBook, MacBook Air, iPods, iPhone, and most of the Company's iMacs. Margins on sales of the Company's products in foreign countries, and on sales of products that include components obtained from foreign suppliers, can be adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including tariffs and antidumping penalties.

Information regarding financial data by geographic segment is set forth in Part II, Item 8 of this Form 10-K and in Notes to Consolidated Financial Statements at Note 9, "Segment Information and Geographic Data."

Seasonal Business

The Company has historically experienced increased net sales in its first and fourth fiscal quarters compared to other quarters in its fiscal year due to seasonal demand related to the holiday season and the beginning of the school year. This historical pattern should not be considered a reliable indicator of the Company's future net sales or financial performance.

Warranty

The Company offers a basic limited parts and labor warranty on most of its hardware products, including Mac computers, iPods and iPhones. The basic warranty period is typically one year from the date of purchase by the

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original end-user. The Company also offers a 90-day basic warranty for its service parts used to repair the Company's hardware products. In addition, consumers may purchase the AppleCare Protection Plan, which extends service coverage on many of the Company's hardware products in most of its major markets.

Backlog

In the Company's experience, the actual amount of product backlog at any particular time is not a meaningful indication of its future business prospects. In particular, backlog often increases in anticipation of or immediately following new product introductions as dealers anticipate shortages. Backlog is often reduced once dealers and customers believe they can obtain sufficient supply. Because of the foregoing, backlog should not be considered a reliable indicator of the Company's ability to achieve any particular level of revenue or financial performance.

Environmental Laws

Compliance with federal, state, local, and foreign laws enacted for the protection of the environment has to date had no material effect on the Company's capital expenditures, earnings, or competitive position. In the future, these laws could have a material adverse effect on the Company.

Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations including, in some instances, the requirement to provide customers the ability to return product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have been passed in several jurisdictions in which the Company operates including various countries within Europe and Asia, certain Canadian provinces, and certain states within the U.S. Although the Company does not anticipate any material adverse effects in the future based on the nature of its operations and the thrust of such laws, there is no assurance that such existing laws or future laws will not have a material adverse effect on the Company's financial condition or operating results.

Employees

As of September 27, 2008, the Company had approximately 32,000 full-time equivalent employees and an additional 3,100 temporary equivalent employees and contractors.

Available Information

The Company's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are filed with the U.S. Securities and Exchange Commission (the "SEC"). Such reports and other information filed by the Company with the SEC are available on the Company's website at http://www.apple.com/investor when such reports are available on the SEC website. The public may read and copy any materials filed by the Company with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy, and information statements and other information regarding issuers that file electronically with the SEC at http://www.sec.gov. The contents of these websites are not incorporated into this filing. Further, the Company's references to the URLs for these websites are intended to be inactive textual references only.

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Executive Officers of the Registrant

The following sets forth certain information regarding executive officers of the Company as of November 1, 2008.

Name	Position With the Company	Age
Timothy D. Cook	Chief Operating Officer	47
Daniel Cooperman	Senior Vice President, General Counsel and Secretary	57
Tony Fadell	Senior Vice President, iPod Division	39
Scott Forstall	Senior Vice President, iPhone Software Engineering and Platform Experience	39
Steven P. Jobs	Director and Chief Executive Officer	53
Ronald B. Johnson	Senior Vice President, Retail	50
Robert Mansfield	Senior Vice President, Hardware Engineering	47
Peter Oppenheimer	Senior Vice President and Chief Financial Officer	45
Philip W. Schiller	Senior Vice President, Worldwide Product Marketing	48
Bertrand Serlet	Senior Vice President, Software Engineering	47
Sina Tamaddon	Senior Vice President, Applications	51

Timothy D. Cook, Chief Operating Officer, joined the Company in March 1998. Mr. Cook also served as Executive Vice President, Worldwide Sales and Operations from 2002 to 2005. In 2004, his responsibilities were expanded to include the Company's Macintosh hardware engineering. From 2000 to 2002, Mr. Cook served as Senior Vice President, Worldwide Operations, Sales, Service and Support. From 1998 to 2000, Mr. Cook served as Senior Vice President, Worldwide Operations. Prior to joining the Company, Mr. Cook was Vice President, Corporate Materials for Compaq Computer Corporation ("Compaq"). Previous to his work at Compaq, Mr. Cook was the Chief Operating Officer of the Reseller Division at Intelligent Electronics. Mr. Cook also spent 12 years with IBM, most recently as Director of North American Fulfillment. Mr. Cook also serves as a member of the Board of Directors of Nike, Inc.

Daniel Cooperman, Senior Vice President, General Counsel and Secretary, joined the Company in November 2007. Prior to joining the Company, he served as Senior Vice President, General Counsel and Secretary of Oracle Corporation since February 1997. Prior to that, he had been associated with the law firm of McCutchen, Doyle, Brown & Enersen (which is now Bingham McCutchen LLP) since October 1977, and had served as a partner since June 1983. From September 1995 until February 1997, Mr. Cooperman was Chair of the law firm's Business and Transactions Group, and from April 1989 through September 1995 he served as Managing Partner of the law firm's San Jose office.

Tony Fadell, Senior Vice President, iPod Division, joined the Company in 2001. From 2004 to April 2006, Mr. Fadell was Vice President of iPod Engineering. From 2001 to 2004, Mr. Fadell was the Senior Director of the Company's iPod Engineering Team. Prior to joining Apple, Mr. Fadell was a co-founder, CTO, and director of engineering of the Mobile Computing Group at Philips Electronics where he was responsible for all aspects of business and product development for a variety of products. Mr. Fadell later became VP of Business Development for Philips U.S. Strategy & Ventures, focusing on building the company's digital media strategy and investment portfolio.

Scott Forstall, Senior Vice President of iPhone Software Engineering and Platform Experience, joined the Company in February 1997 upon the Company's acquisition of NeXT. Mr. Forstall also has served the Company as Vice President of Platform Experience while leading several releases of Mac OS X, and as Director of Application Frameworks. Prior to joining the Company, Mr. Forstall worked at NeXT developing core technologies.

Steven P. Jobs is one of the Company's co-founders and currently serves as its Chief Executive Officer. Mr. Jobs also is a director of The Walt Disney Company.

Ronald B. Johnson, Senior Vice President, Retail, joined the Company in January 2000. Prior to joining the Company, Mr. Johnson spent 16 years with Target Stores, most recently as Senior Merchandising Executive.

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Robert Mansfield, Senior Vice President of Hardware Engineering, joined the Company in November 1999 as Vice President of Development Engineering and assumed his current position in May 2008. Prior to joining the Company, Mr. Mansfield was Vice President of Engineering at Raycer Graphics and a Senior Director at Silicon Graphics, Inc.

Peter Oppenheimer, Senior Vice President and Chief Financial Officer, joined the Company in July 1996. Mr. Oppenheimer also served the Company as Vice President and Corporate Controller and as Senior Director of Finance for the Americas. Prior to joining the Company, Mr. Oppenheimer was Chief Financial Officer of one of the four business units for Automatic Data Processing, Inc. ("ADP"). Prior to joining ADP, Mr. Oppenheimer spent six years in the Information Technology Consulting Practice with Coopers and Lybrand.

Philip W. Schiller, Senior Vice President, Worldwide Product Marketing, rejoined the Company in 1997. Prior to rejoining the Company, Mr. Schiller was Vice President of Product Marketing at Macromedia, Inc. from December 1995 to March 1997 and Director of Product Marketing at FirePower Systems, Inc. from 1993 to December 1995. Prior to that, Mr. Schiller spent six years at the Company in various marketing positions.

Bertrand Serlet, Senior Vice President, Software Engineering, joined the Company in February 1997 upon the Company's acquisition of NeXT and also served the Company as Vice President of Platform Technology. At NeXT, Mr. Serlet held several engineering and managerial positions, including Director of Web Engineering. Prior to NeXT, Mr. Serlet worked as a research engineer at Xerox PARC from 1985 to 1989.

Sina Tamaddon, Senior Vice President, Applications, joined the Company in September 1997. Mr. Tamaddon has also served with the Company as Senior Vice President, Worldwide Service and Support, and Vice President and General Manager, Newton Group. Before joining the Company, Mr. Tamaddon held the position of Vice President, Europe with NeXT from September 1996 through March 1997. From August 1994 to August 1996, Mr. Tamaddon was Vice President, Professional Services with NeXT.

Item 1A. Risk Factors

Because of the following factors, as well as other factors affecting the Company's financial condition and operating results, past financial performance should not be considered to be a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

Economic conditions could materially adversely affect the Company.
The Company's operations and performance depend significantly on worldwide economic conditions. Uncertainty about current global economic conditions poses a risk as consumers and businesses may postpone spending in response to tighter credit, negative financial news and/or declines in income or asset values, which could have a material negative effect on the demand for the Company's products and services. Demand could also differ materially from the Company's expectations since the Company generally raises prices on goods and services sold outside the U.S. to offset the effect of the strengthening of the U.S. dollar, a trend which has been very pronounced recently. Other factors that could influence demand include continuing increases in fuel and other energy costs, conditions in the residential real estate and mortgage markets, labor and healthcare costs, access to credit, consumer confidence, and other macroeconomic factors affecting consumer spending behavior. These and other economic factors could have a material adverse effect on demand for the Company's products and services and on the Company's financial condition and operating results.

The current financial turmoil affecting the banking system and financial markets and the possibility that financial institutions may consolidate or go out of business have resulted in a tightening in the credit markets, a low level of liquidity in many financial markets, and extreme volatility in fixed income, credit, currency and equity markets. There could be a number of follow-on effects from the credit crisis on the Company's business, including insolvency of key suppliers resulting in product delays; inability of customers, including channel partners, to obtain credit to finance purchases of the Company's products and/or customer, including channel partner, insolvencies; and failure of derivative counterparties and other financial institutions negatively impacting the Company's treasury operations. Other income and expense could also vary materially from expectations depending on gains or losses realized on the sale or exchange of financial instruments; impairment charges

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related to debt securities as well as equity and other investments; interest rates; cash balances; and changes in fair value of derivative instruments. The current volatility in the financial markets and overall economic uncertainty increases the risk that the actual amounts realized in the future on the Company's financial instruments could differ significantly from the fair values currently assigned to them.

Uncertainty about current global economic conditions could also continue to increase the volatility of the Company's stock price.

The matters relating to the Company's past stock option practices and the restatement of the Company's consolidated financial statements may result in additional litigation.
The findings from the Company's investigation into its past stock option granting practices and the resulting restatement of prior financial statements in the Company's Annual Report on Form 10-K for the fiscal year September 30, 2006 (the "2006 Form 10-K") have exposed the Company to greater risks associated with litigation, regulatory proceedings and government enforcement actions. As described in Part I, Item 3, "Legal Proceedings," several derivative complaints and a class action complaint have been filed in state and federal courts against the Company and certain current and former directors and executive officers pertaining to allegations relating to past stock option grants. The Company has provided the results of its investigation to the Securities and Exchange Commission (the "SEC") and the United States Attorney's Office for the Northern District of California, and the Company has responded to their requests for documents and additional information. The Company intends to continue to provide its full cooperation.

On April 24, 2007, the SEC filed an enforcement action against two former officers of the Company. In announcing the lawsuit, the SEC stated that it would not bring an enforcement action against the Company based in part on the Company's "swift, extensive, and extraordinary cooperation in the Commission's investigation." According to the SEC's statement, the Company's "cooperation consisted of, among other things, prompt self-reporting, an independent internal investigation, the sharing of the results of that investigation with the government, and the implementation of new controls designed to prevent the recurrence of fraudulent conduct." The enforcement actions against each of these former officers have now been settled.

No assurance can be given regarding the outcomes from litigation relating to the Company's past stock option practices. These and related matters have required, and will continue to require, the Company to incur substantial expenses for legal, accounting, tax, and other professional services, and may divert management's attention from the Company's business. If the Company is subject to adverse findings, it could be required to pay damages and penalties and might face additional remedies that could harm its financial condition and operating results.

Global markets for personal computers, digital music devices, mobile communication devices, and related peripherals and services are highly competitive and subject to rapid technological change. If the Company is unable to compete effectively in these markets, its financial condition and operating results could be materially adversely affected.
The Company competes in global markets that are highly competitive and characterized by aggressive price cutting, with its resulting downward pressure on gross margins, frequent introduction of new products, short product life cycles, evolving industry standards, continual improvement in product price/performance characteristics, rapid adoption of technological and product advancements by competitors, and price sensitivity on the part of consumers.

The Company's ability to compete successfully depends heavily on its ability to ensure a continuing and timely introduction of new innovative products and technologies to the marketplace. The Company believes it is unique in that it designs and develops nearly the entire solution for its personal computers, consumer electronics, and mobile communication devices, including the hardware, operating system, several software applications, and related services. As a result, the Company must make significant investments in research and development and as such, the Company currently holds a significant number of patents and copyrights and has registered and/or has applied to register numerous patents, trademarks and service marks. By contrast, many of the Company's competitors seek to compete primarily through aggressive pricing and very low cost structures. If the Company is unable to continue to develop and sell innovative new products with attractive margins or if other companies

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infringe on the Company's intellectual property, the Company's ability to maintain a competitive advantage could be negatively affected and have a materially adverse affect on its financial condition and operating results.

In the market for personal computers and peripherals, the Company faces a significant number of competitors, many of which have broader product lines, lower priced products, and larger installed customer bases. Consolidation in this market has resulted in larger and potentially stronger competitors. Price competition has been particularly intense as competitors selling Windows-based personal computers have aggressively cut prices and lowered product margins. The Company also faces increased competition in key market segments, including consumer, SMB, education, enterprise, government, and creative markets. An increasing number of Internet devices that include software applications and are smaller and simpler than traditional personal computers compete for market share with the Company's existing products.

The Company is currently the only authorized maker of hardware using the Mac OS. The Mac OS has a minority market share in the personal computer market, which is dominated by makers of computers using competing operating systems, most notably Windows. The Company's financial condition and operating results depend substantially on the Company's ability to continually improve the Mac platform to maintain design and functional advantages. Use of unauthorized copies of the Mac OS on other companies' hardware products may result in decreased demand for the Company's hardware products, and could materially adversely affect the Company's financial condition and operating results.

The Company is currently focused on certain mobile communication devices, such as iPhone; consumer electronic devices, including the iPod family of digital music players, and digital content distribution. The Company faces substantial competition from companies that have significant technical, marketing, distribution, and other resources, as well as established hardware, software, and digital content supplier relationships. The Company has only recently entered the mobile communications market, and many of its competitors in the mobile communications market have significantly greater experience, product breadth, and distribution channels than the Company. The Company also competes with illegitimate ways to obtain digital content. Because some current and potential competitors have substantial resources and experience and a lower cost structure, they may be able to provide such products and services at little or no profit or even at a loss. The Company also expects competition to intensify as competitors attempt to imitate the Company's approach to providing these components seamlessly within their individual offerings or work collaboratively to offer integrated solutions.

There can be no assurance the Company will be able to continue to provide products and services that compete effectively.

To remain competitive and stimulate customer demand, the Company must successfully manage frequent product introductions and transitions.

Due to the highly volatile and competitive nature of the personal computer, consumer electronics and mobile communication industries, the Company must continually introduce new products and technologies, enhance existing products, and effectively stimulate customer demand for new and upgraded products. The success of new product introductions depends on a number of factors, including timely and successful product development, market acceptance, the Company's ability to manage the risks associated with new products and production ramp issues, the availability of application software for new products, the effective management of purchase commitments and inventory levels in line with anticipated product demand, the availability of products in appropriate quantities and costs to meet anticipated demand, and the risk that new products may have quality or other defects in the early stages of introduction. Accordingly, the Company cannot determine in advance the ultimate effect of new product introductions and transitions on its financial condition and operating results.

The Company faces substantial inventory and other asset risk.

The Company records a write-down for product and component inventories that have become obsolete or exceed anticipated demand or net realizable value and accrues necessary cancellation fee reserves for orders of excess products and components. The Company also reviews its long-lived assets for impairment whenever events or changed circumstances indicate the carrying amount of an asset may not be recoverable. If the Company determines that impairment has occurred, it records a write-down equal to the amount by which the carrying

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value of the assets exceeds its fair market value. Although the Company believes its inventory, asset, and related provisions are currently adequate, no assurance can be given that, given the rapid and unpredictable pace of product obsolescence in the global personal computer, consumer electronics, and mobile communication industries, the Company will not incur additional inventory or asset related charges. Such charges have had, and could have, a material adverse effect on the Company's financial condition and operating results.

The Company must order components for its products and build inventory in advance of product announcements and shipments. Consistent with industry practice, components are normally acquired through a combination of purchase orders, supplier contracts, and open orders based on projected demand. Such purchase commitments typically cover forecasted component and manufacturing requirements for 30 to 150 days. Because the Company's markets are volatile, competitive and subject to rapid technology and price changes, there is a risk the Company will forecast incorrectly and order or produce excess or insufficient inventories of components or products. The Company's financial condition and operating results have been in the past and could be in the future materially adversely affected by the Company's ability to manage its inventory levels and respond to short-term shifts in customer demand patterns.

Future operating results depend upon the Company's ability to obtain key components including, but not limited to microprocessors, NAND flash memory, DRAM and LCDs at favorable prices and in sufficient quantities.

Because the Company currently obtains certain key components including, but not limited to microprocessors, enclosures, certain LCDs, certain optical drives, and ASICs, from single or limited sources, the Company is subject to significant supply and pricing risks. Many of these and other key components that are available from multiple sources including, but not limited to NAND flash memory, DRAM and certain LCDs, are subject at times to industry-wide shortages and significant commodity pricing fluctuations. The Company has entered into certain agreements for the supply of key components including, but not limited to microprocessors, NAND flash memory, DRAM and LCDs at favorable pricing, but there is no guarantee that the Company will be able to extend or renew these agreements on similar favorable terms, or at all, upon expiration or otherwise obtain favorable pricing in the future. Therefore, the Company remains subject to significant risks of supply shortages and/or price increases that can have a material adverse effect on its financial condition and operating results. The Company expects to experience decreases in its gross margin percentage in future periods, as compared to levels achieved during 2008 and 2007, due largely to the anticipated impact of product transitions, flat or reduced pricing on new and innovative products that have higher cost structures, both expected and potential future cost increases for key components, and higher logistical costs. For additional information refer to Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," under the subheading "Gross Margin," which is incorporated herein by reference.

The Company and other participants in the personal computer, consumer electronics and mobile communication industries compete for various components with other industries that have experienced increased demand for their products. The Company uses some custom components that are not common to the rest of the personal computer, consumer electronics or mobile communication industries. The Company's new products often utilize custom components available from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. When a component or product uses new technologies, initial capacity constraints may exist until the suppliers' yields have matured. Continued availability of these components at acceptable prices, or at all, may be affected if those suppliers decided to concentrate on the production of common components instead of components customized to meet the Company's requirements. If the supply of a key single-sourced component for a new or existing product were delayed or constrained, if such components were available only at significantly higher prices, or if a key manufacturing vendor delayed shipments of completed products to the Company, the Company's financial condition and operating results could be materially adversely affected.

The Company depends on component and product manufacturing and logistical services provided by third parties, many of whom are located outside of the U.S.

Most of the Company's components and products are manufactured in whole or in part by a few third-party manufacturers. Many of these manufacturers are located outside of the U.S., and are geographically concentrated

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in single locations. The Company has also outsourced much of its transportation and logistics management. While these arrangements may lower operating costs, they also reduce the Company's direct control over production and distribution. It is uncertain what effect such diminished control will have on the quality or quantity of products or services, or the Company's flexibility to respond to changing conditions. In addition, the Company relies on third-party manufacturers to adhere to the Company's supplier code of conduct. Although arrangements with such manufacturers may contain provisions for warranty expense reimbursement, the Company may remain responsible to the consumer for warranty service in the event of product defects. Any unanticipated product defect or warranty liability, whether pursuant to arrangements with contract manufacturers or otherwise, could have a material adverse effect on the Company's reputation, financial condition and operating results.

Final assembly of the Company's products is currently performed in the Company's manufacturing facility in Ireland, and by external vendors in California, Korea, China and the Czech Republic. Currently, the supply and manufacture of many critical components is performed by sole-sourced third-party vendors in the U.S., China, Japan, Korea, Malaysia, Philippines, Taiwan, Thailand and Singapore. Sole-sourced third-party vendors in China perform final assembly of substantially all of the Company's portable products, including MacBook Pro, MacBook, MacBook Air, iPods, iPhones and most of the Company's iMacs. If manufacturing or logistics in these locations is disrupted for any reason, including natural disasters, information technology system failures, military actions or economic, business, labor, environmental, public health, or political issues, the Company's financial condition and operating results could be materially adversely affected.

The Company relies on third-party digital content, which may not be available to the Company on commercially reasonable terms or at all.

The Company contracts with certain third parties to offer their digital content through the Company's iTunes Store. The Company pays substantial fees to obtain the rights to audio and video content. The Company's licensing arrangements with these third parties are short-term and do not guarantee the continuation or renewal of these arrangements on reasonable terms, if at all. Some third-party content providers currently or in the future may offer competing products and services, and could take action to make it more difficult or impossible for the Company to license their content in the future. Other content owners, providers or distributors may seek to limit the Company's access to, or increase the total cost of, such content. If the Company is unable to continue to offer a wide variety of content at reasonable prices with acceptable usage rules, or continue to expand its geographic reach, the Company's financial condition and operating results may be materially adversely affected.

Many third-party content providers require that the Company provide certain digital rights management ("DRM") and other security solutions. If these requirements change, the Company may have to develop or license new technology to provide these solutions. There is no assurance the Company will be able to develop or license such solutions at a reasonable cost and in a timely manner. In addition, certain countries have passed or may propose legislation that would force the Company to license its DRM, which could lessen the protection of content and subject it to piracy and also could affect arrangements with the Company's content providers.

The Company relies on access to third-party patents and intellectual property, and the Company's future results could be materially adversely affected if it is alleged or found to have infringed intellectual property rights.

Many of the Company's products are designed to include third-party intellectual property, and in the future the Company may need to seek or renew licenses relating to various aspects of its products and business methods. Although the Company believes that, based on past experience and industry practice, such licenses generally could be obtained on reasonable terms, there is no assurance that the necessary licenses would be available on acceptable terms or at all.

Because of technological changes in the global personal computer, consumer electronics and mobile communication industries, current extensive patent coverage, and the rapid issuance of new patents, it is possible that certain components of the Company's products and business methods may unknowingly infringe the patents or other intellectual property rights of third parties. From time to time, the Company has been notified that it may be infringing such rights. Regardless of merit, responding to such claims can consume significant time and

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expense. At present, the Company is vigorously defending more than 21 patent infringement cases, 13 of which were filed during fiscal 2008, and several pending claims are in various stages of evaluation. In certain cases, the Company may consider the desirability of entering into licensing agreements, although no assurance can be given that such licenses can be obtained on acceptable terms or that litigation will not occur. If the Company is found to be infringing such rights, it may be required to pay substantial damages. If there is a temporary or permanent injunction prohibiting the Company from marketing or selling certain products or a successful claim of infringement against the Company requires it to pay royalties to a third party, the Company's financial condition and operating results could be materially adversely affected, regardless of whether it can develop non-infringing technology. While in management's opinion the Company does not have a potential liability for damages or royalties from any known current legal proceedings or claims related to the infringement of patent or other intellectual property rights that would individually or in the aggregate have a material adverse effect on its financial condition and operating results, the results of such legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of the matters related to infringement of patent or other intellectual property rights of others or should several of these matters be resolved against the Company in the same reporting period, the Company's financial condition and operating results could be materially adversely affected.

With the June 2007 introduction of iPhone, the Company has begun to compete with mobile communication device companies that hold significant patent portfolios. Regardless of the scope or validity of such patents or the merits of any potential patent claims by competitors, the Company may have to engage in protracted litigation, enter into expensive agreements or settlements and/or modify its products. Any of these events could have a material adverse impact on the Company's financial condition and operating results.

The Company's future performance depends on support from third-party software developers. If third-party software applications and services cease to be developed and maintained for the Company's products, customers may choose not to buy the Company's products.
The Company believes decisions by customers to purchase its hardware products, including its Macs, iPods and iPhones, are often based to a certain extent on the availability of third-party software applications and services. There is no assurance that third-party developers will continue to develop and maintain applications and services for the Company's products on a timely basis or at all, and discontinuance or delay of these applications and services could have a material adverse effect on the Company's financial condition and operating results.

With respect to its Mac products, the Company believes the availability of third-party software applications and services depends in part on the developers' perception and analysis of the relative benefits of developing, maintaining, and upgrading such software for the Company's products compared to Windows-based products. This analysis may be based on factors such as the perceived strength of the Company and its products, the anticipated revenue that may be generated, continued acceptance by customers of Mac OS X, and the costs of developing such applications and services. If the Company's minority share of the global personal computer market causes developers to question the Company's prospects, developers could be less inclined to develop or upgrade software for the Company's products and more inclined to devote their resources to developing and upgrading software for the larger Windows market. The Company's development of its own software applications and services may also negatively affect the decisions of third-party developers, such as Microsoft, Adobe, and Google, to develop, maintain, and upgrade similar or competitive software and services for the Company's products. Mac OS X Leopard, which became available in October 2007, includes a new feature that enables Intel-based Mac systems to run Microsoft Windows XP and Windows Vista operating systems. This feature may deter developers from creating software applications for Mac OS X if such applications are already available for the Windows platform.

With respect to iPhone and iPod touch, the Company relies on the continued availability and development of compelling and innovative software applications. As with applications for the Company's Mac products, the availability and development of these applications also depend on developers' perceptions and analysis of the relative benefits of developing software for the Company's products rather than its competitors', including devices that use competing platforms. If developers focus their efforts on these competing platforms, the availability and quality of applications for the Company's devices may suffer.

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The Company's products and services experience quality problems from time to time that can result in decreased sales and operating margin.
The Company sells highly complex hardware and software products and services that can contain defects in design and manufacture. Sophisticated operating system software and applications, such as those sold by the Company, often contain "bugs" that can unexpectedly interfere with the software's intended operation. Defects may also occur in components and products the Company purchases from third parties. There can be no assurance the Company will be able to detect and fix all defects in the hardware, software and services it sells. Failure to do so could result in lost revenue, harm to reputation, and significant warranty and other expenses, and could have a material adverse impact on the Company's financial condition and operating results.

The Company expects its quarterly revenue and operating results to fluctuate for a variety of reasons.
The Company's profit margins vary among its products and its distribution channels. The Company's software, accessories, and service and support contracts generally have higher gross margins than certain of the Company's other products. Gross margins on the Company's hardware products vary across product lines and can change over time as a result of product transitions, pricing and configuration changes, and component, warranty, and other cost fluctuations. The Company's direct sales generally have higher associated gross margins than its indirect sales through its channel partners. In addition, the Company's gross margin and operating margin percentages, as well as overall profitability, may be materially adversely impacted as a result of a shift in product, geographic or channel mix, new products, component cost increases, or price competition. The Company has typically experienced greater net sales in the first and fourth fiscal quarters compared to the second and third fiscal quarters due to seasonal demand related to the holiday season and the beginning of the school year, respectively. Furthermore, the Company sells more products from time-to-time during the third month of a quarter than it does during either of the first two months. Developments late in a quarter, such as lower-than-anticipated demand for the Company's products, an internal systems failure, or failure of one of the Company's key logistics, components supply, or manufacturing partners, could have a material adverse impact on the Company's financial condition and operating results.

In certain countries, including the U.S., the Company relies on a single cellular network carrier to provide service for iPhone.
In the U.S., U.K., France, Germany, Spain, Ireland, and certain other countries, the Company has contracted with a single carrier to provide cellular network services for iPhone on an exclusive basis. If these exclusive carriers cannot successfully compete with other carriers in their markets for any reason, including but not limited to the quality and coverage of wireless voice and data services, performance and timely build-out of advanced wireless networks, and pricing and other terms of conditions of end-user contracts, or if these exclusive carriers fail to promote iPhone aggressively or favor other handsets in their promotion and sales activities or service plans, sales may be materially adversely affected.

The Company is subject to risks associated with laws, regulations and industry-imposed standards related to mobile communications devices.
Laws and regulations related to mobile communications devices in the many jurisdictions in which the Company operates are extensive and subject to change. Such changes, which could include but are not limited to restrictions on production, manufacture, distribution, and use of the device, locking the device to a carrier's network, or mandating the use of the device on more than one carrier's network, could have a material adverse effect on the Company's financial condition and operating results.

Mobile communication devices, such as iPhone, are subject to certification and regulation by governmental and standardization bodies, as well as by cellular network carriers for use on their networks. These certification processes are extensive and time consuming, and could result in additional testing requirements, product modifications or delays in product shipment dates, which could have a material adverse effect on the Company's financial condition and operating results.

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The Company may be subject to information technology system failures, network disruptions and breaches in data security.
Information technology system failures, network disruptions and breaches of data security could disrupt the Company's operations by causing delays or cancellation of customer, including channel partner, orders, negatively affecting the Company's online offerings and services, impeding the manufacture or shipment of products, processing transactions and reporting financial results, resulting in the unintentional disclosure of customer or Company information, or damage to the Company's reputation. While management has taken steps to address these concerns by implementing sophisticated network security and internal control measures, there can be no assurance that a system failure or data security breach will not have a material adverse effect on the Company's financial condition and operating results.

The Company's stock price continues to be volatile.
The Company's stock has at times experienced substantial price volatility as a result of variations between its actual and anticipated financial results, announcements by the Company and its competitors, or uncertainty about current global economic conditions. The stock market as a whole also has experienced extreme price and volume fluctuations that have affected the market price of many technology companies in ways that may have been unrelated to these companies' operating performance. Furthermore, the Company believes its stock price reflects high future growth and profitability expectations. If the Company fails to meet these expectations its stock price may significantly decline.

Political events, war, terrorism, public health issues, natural disasters and other circumstances could materially adversely affect the Company.
War, terrorism, geopolitical uncertainties, public health issues, and other business interruptions have caused and could cause damage or disruption to international commerce and the global economy, and thus could have a strong negative effect on the Company, its suppliers, logistics providers, manufacturing vendors and customers, including channel partners. The Company's business operations are subject to interruption by natural disasters, fire, power shortages, terrorist attacks, and other hostile acts, labor disputes, public health issues, and other events beyond its control. Such events could decrease demand for the Company's products, make it difficult or impossible for the Company to make and deliver products to its customers, including channel partners, or to receive components from its suppliers, and create delays and inefficiencies in the Company's supply chain. Should major public health issues, including pandemics, arise, the Company could be negatively affected by more stringent employee travel restrictions, additional limitations in freight services, governmental actions limiting the movement of products between regions, delays in production ramps of new products, and disruptions in the operations of the Company's manufacturing vendors and component suppliers. The majority of the Company's research and development activities, its corporate headquarters, information technology systems, and other critical business operations, including certain component suppliers and manufacturing vendors, are located near major seismic faults. Because the Company does not carry earthquake insurance for direct quake-related losses and significant recovery time could be required to resume operations, the Company's financial condition and operating results could be materially adversely affected in the event of a major earthquake.

The Company's success depends largely on its ability to attract and retain key personnel.
Much of the Company's future success depends on the continued service and availability of skilled personnel, including its CEO, its executive team and key employees in technical, marketing and staff positions. Experienced personnel in the technology industry are in high demand and competition for their talents is intense, especially in the Silicon Valley, where most of the Company's key employees are located. The Company has relied on equity awards as one means for recruiting and retaining this highly skilled talent. Accounting regulations requiring the expensing of stock options have resulted in increased stock-based compensation expense, which has caused the Company to reduce the number of stock-based awards issued to employees and could negatively impact the Company's ability to attract and retain key personnel. Additionally, significant adverse volatility in the Company's stock price could result in a stock option's exercise price exceeding the underlying stock's market value or a significant deterioration in the value of restricted stock units ("RSUs") granted, thus lessening the

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effectiveness of retaining employees through stock-based awards. There can be no assurance that the Company will continue to successfully attract and retain key personnel.

Unfavorable results of legal proceedings could materially adversely affect the Company.
The Company is subject to various legal proceedings and claims that have arisen out of the ordinary conduct of its business and are not yet resolved and additional claims may arise in the future. Results of legal proceedings cannot be predicted with certainty. Regardless of its merit, litigation may be both time-consuming and disruptive to the Company's operations and cause significant expense and diversion of management attention. In recognition of these considerations, the Company may enter into material settlements. Should the Company fail to prevail in certain matters, or should several of these matters be resolved against the Company in the same reporting period, the Company may be faced with significant monetary damages or injunctive relief against it that would materially adversely affect a portion of its business and might materially affect the Company's financial condition and operating results.

The Company's business is subject to the risks of international operations.
The Company derives a large and growing portion of its revenue and earnings from its international operations. As a result, its financial condition and operating results could be significantly affected by risks associated with international activities, including economic and labor conditions, political instability, tax laws (including U.S. taxes on foreign subsidiaries), and changes in the value of the U.S. dollar versus local currencies. Margins on sales of the Company's products in foreign countries, and on sales of products that include components obtained from foreign suppliers, could be materially adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including tariffs and antidumping penalties.

The Company's primary exposure to movements in foreign currency exchange rates relate to non-U.S. dollar denominated sales in Europe, Japan, Australia, Canada, and certain parts of Asia, as well as non-U.S. dollar denominated operating expenses incurred throughout the world. Weakening of foreign currencies relative to the U.S. dollar will adversely affect the U.S. dollar value of the Company's foreign currency-denominated sales and earnings, and generally will lead the Company to raise international pricing, potentially reducing demand for the Company's products. In some circumstances, due to competition or other reasons, the Company may decide not to raise local prices to the full extent of the dollar's strengthening, or at all, which would adversely affect the U.S. dollar value of the Company's foreign currency denominated sales and earnings. Conversely, a strengthening of foreign currencies, while generally beneficial to the Company's foreign currency-denominated sales and earnings, could cause the Company to reduce international pricing, thereby limiting the benefit. As strengthening of foreign currencies may also increase the Company's cost of product components denominated in those currencies.

The Company has used derivative instruments, such as foreign exchange forward and option positions, to hedge certain exposures to fluctuations in foreign currency exchange rates. The use of such hedging activities may not offset any or more than a portion of the adverse financial effects of unfavorable movements in foreign exchange rates over the limited time the hedges are in place.

The Company's retail business has required and will continue to require a substantial investment and commitment of resources and is subject to numerous risks and uncertainties.
Through September 27, 2008, the Company had opened 247 retail stores. The Company's retail stores have required substantial fixed investment in equipment and leasehold improvements, information systems, inventory, and personnel. The Company also has entered into substantial operating lease commitments for retail space with terms ranging from 5 to 20 years, the majority of which are for 10 years. Certain stores have been designed and built to serve as high-profile venues to promote brand awareness and serve as vehicles for corporate sales and marketing activities. Because of their unique design elements, locations and size, these stores require substantially more investment than the Company's more typical retail stores. Due to the high fixed cost structure associated with the Retail segment, a decline in sales or the closure or poor performance of individual or multiple stores could result in significant lease termination costs, write-offs of equipment and leasehold improvements, and severance costs that could have a material adverse effect on the Company's financial condition and operating results.

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Many factors unique to retail operations, some of which are beyond the Company's control, pose risks and uncertainties that could have a material adverse effect on the Retail segment's future results, cause its actual results to differ from anticipated results and have a material adverse effect on the Company's financial condition and operating results. These risks and uncertainties include, among other things, macro-economic factors that could have a negative effect on general retail activity, as well as the Company's inability to manage costs associated with store construction and operation, inability to sell third-party products at adequate margins, failure to manage relationships with existing retail channel partners, more challenging environment in managing retail operations outside the U.S., costs associated with unanticipated fluctuations in the value of retail inventory, and inability to obtain and renew leases in quality retail locations at a reasonable cost.

Investment in new business strategies and initiatives could disrupt the Company's ongoing business and present risks not originally contemplated.
The Company has invested, and in the future may invest, in new business strategies or acquisitions. Such endeavors may involve significant risks and uncertainties, including distraction of management from current operations, insufficient revenue to offset liabilities assumed and expenses associated with the strategy, inadequate return of capital, and unidentified issues not discovered in the Company's due diligence. Because these new ventures are inherently risky, no assurance can be given that such strategies and initiatives will be successful and will not have a material adverse effect on the Company's financial condition and operating results.

The Company's future operating performance depends on the performance of distributors, carriers, and other resellers.
The Company distributes its products through wholesalers, resellers, national and regional retailers, value-added resellers, and cataloguers, many of whom distribute products from competing manufacturers. The Company also sells many of its products and resells third-party products in most of its major markets directly to end-users, certain education customers, and certain resellers through its online and retail stores. iPhone is distributed through the Company, its cellular network carriers' distribution channels, and certain third-party resellers.

Many resellers operate on narrow product margins and have been negatively affected in the past by weak economic conditions. Some resellers have perceived the expansion of the Company's direct sales as conflicting with their business interests as distributors and resellers of the Company's products. Such a perception could discourage resellers from investing resources in the distribution and sale of the Company's products or lead them to limit or cease distribution of those products. The Company's financial condition and operating results could be materially adversely affected if the financial condition of these resellers weakens, if resellers stopped distributing the Company's products, or if uncertainty regarding demand for the Company's products caused resellers to reduce their ordering and marketing of the Company's products. The Company has invested and will continue to invest in programs to enhance reseller sales, including staffing selected resellers' stores with Company employees and contractors and improving product placement displays. These programs could require a substantial investment while providing no assurance of return or incremental revenue.

The Company is exposed to credit risk and fluctuations in the market values of its investment portfolio.
Although the Company has not recognized any material losses on its cash, cash equivalents and short-term investments, future declines in their market values could have a material adverse effect on the Company's financial condition and operating results. Given the global nature of its business, the Company has investments both domestically and internationally. Additionally, the Company's overall investment portfolio is often concentrated in the financial sector, which has been negatively impacted by the recent market liquidity conditions. Credit ratings and pricing of these investments can be negatively impacted by liquidity, credit deterioration or losses, financial results, or other factors. As a result, the value or liquidity of the Company's cash, cash equivalents and short-term investments could decline and result in a material impairment, which could have a material adverse effect on the Company's financial condition and operating results.

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The Company is exposed to credit risk on its accounts receivable and prepayments related to long-term supply agreements. This risk is heightened during periods when economic conditions worsen.

A substantial majority of the Company's outstanding trade receivables are not covered by collateral or credit insurance. The Company also has unsecured non-trade receivables resulting from the sale by the Company of components to vendors who manufacture sub-assemblies or assemble final products for the Company. In addition, the Company has made prepayments associated with long-term supply agreements to secure supply of NAND flash memory. While the Company has procedures to monitor and limit exposure to credit risk on its trade and non-trade receivables as well as long-term prepayments, there can be no assurance such procedures will effectively limit its credit risk and avoid losses, which could have a material adverse effect on the Company's financial condition and operating results.

The Company is subject to risks associated with laws and regulations related to health, safety and environmental protection.

The Company's products and services, and the production and distribution of those goods and services, are subject to a variety of laws and regulations. These may require the Company to offer customers the ability to return a product at the end of its useful life and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have been passed in several jurisdictions in which the Company operates, including various countries within Europe and Asia, certain Canadian provinces and certain states within the U.S. Although the Company does not anticipate any material adverse effects based on the nature of its operations and the thrust of such laws, there is no assurance such existing laws or future laws will not have a material adverse effect on the Company's financial condition and operating results.

Changes in the Company's tax rates could affect its future results.

The Company's future effective tax rates could be affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, or changes in tax laws or their interpretation. The Company is subject to the continuous examination of its income tax returns by the Internal Revenue Service and other tax authorities. The Company regularly assesses the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of its provision for taxes. There can be no assurance that the outcomes from these examinations will not have a material adverse effect on the Company's financial condition and operating results.

The Company is subject to risks associated with the availability and coverage of insurance.

For certain risks, the Company does not maintain insurance coverage because of cost and/or availability. Because the Company retains some portion of its insurable risks, and in some cases self-insures completely, unforeseen or catastrophic losses in excess of insured limits could have a material adverse effect on the Company's financial condition and operating results.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Company's headquarters are located in Cupertino, California. The Company has a manufacturing facility in Cork, Ireland. As of September 27, 2008, the Company leased approximately 4.2 million square feet of space, primarily in the U.S., and to a lesser extent, in Europe, Japan, Canada, and the Asia Pacific region. The major facility leases are generally for terms of 3 to 20 years and generally provide renewal options for terms of 1 to 5 additional years. Leased space includes approximately 1.8 million square feet of retail space, a majority of which is in the U.S. Lease terms for retail space range from 5 to 20 years, the majority of which are for 10 years, and often contain multi-year renewal options.

As of September 27, 2008, the Company owned a 367,000 square-foot manufacturing facility in Cork, Ireland that also housed a customer support call center. The Company also owned 805,000 square feet of facilities in

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Sacramento, California that include warehousing and distribution operations, as well as a customer support call center. In addition, the Company owned approximately 2.3 million square feet of facilities for research and development and corporate functions in Cupertino, California, including approximately 1.0 million square feet purchased in 2007 and 2006 for the future development of the Company's second corporate campus in Cupertino, California, and approximately 107,000 square feet for a data center in Newark, California. Outside the U.S., the Company owned additional facilities totaling approximately 129,000 square feet as of September 27, 2008. The Company believes its existing facilities and equipment are well maintained and in good operating condition.

The Company has invested in internal capacity and strategic relationships with outside manufacturing vendors, and therefore believes it has adequate manufacturing capacity for the foreseeable future. The Company continues to make investments in capital equipment as needed to meet anticipated demand for its products.

Item 3. Legal Proceedings

As of September 27, 2008, the end of the annual period covered by this report, the Company is subject to the various legal proceedings and claims discussed below, as well as certain other legal proceedings and claims that have not been fully resolved and that have arisen in the ordinary course of business. In the opinion of management, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate have a material adverse effect on its financial condition or operating results. However, the results of legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected. The Company settled certain matters during the fourth quarter of 2008 that did not individually or in the aggregate have a material impact on the Company's results of operations.

Bader v. Anderson, et al.
Plaintiff filed this purported shareholder derivative action against the Company and each of its then current executive officers and members of its Board of Directors on May 19, 2005 in Santa Clara County Superior Court asserting claims for breach of fiduciary duty, material misstatements and omissions and violations of California Business & Professions Code §17200 (unfair competition). The complaint alleged that the Company's March 14, 2005, proxy statement was false and misleading for failure to disclose certain information relating to the Apple Computer, Inc. Performance Bonus Plan, which was approved by shareholders at the annual meeting held on April 21, 2005. Plaintiff, who ostensibly brought suit on the Company's behalf, made no demand on the Board of Directors and alleged that such demand was excused. The complaint sought injunctive and other relief for purported injury to the Company. On July 27, 2005, plaintiff filed an amended complaint alleging that, in addition to the purported derivative claims, adoption of the bonus plan and distribution of the proxy statement describing that plan also inflicted injury on her directly as an individual shareholder. On January 10, 2006, the Court sustained defendants' demurrer to the amended complaint, with leave to amend. Plaintiff filed a second amended complaint on February 7, 2006, and the Company filed a demurrer. After a hearing on June 13, 2006, the Court sustained the demurrer without leave to amend as to the non-director officers and with leave to amend as to the directors. On July 24, 2006, plaintiff filed a third amended complaint, which purported to bring claims derivatively as well as directly on behalf of a class of common stockholders who have been or will be harmed by virtue of the allegedly misleading proxy statement. In addition to reasserting prior causes of action, the third amended complaint included a claim that the Company violated the terms of the plan, and a claim for waste related to restricted stock unit grants to certain officers in 2003 and 2004 and an option grant to the Company's CEO in January 2000. The Company filed a demurrer to the third amended complaint. On January 30, 2007, the Court sustained the Company's demurrer with leave to amend. On May 8, 2007, plaintiff filed a fourth amended complaint. The Company filed a demurrer to the fourth amended complaint, which the Court sustained, without leave to amend, on October 12, 2007. On October 25, 2007, the Court entered a final judgment in favor of defendant and ordered the case dismissed with prejudice. On November 26, 2007, plaintiff filed a notice of appeal. Plaintiffs' appeal is pending.

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Birdsong v. Apple Computer, Inc.
This action alleges that the Company's iPod music players, and the ear bud headphones sold with them, are inherently defective in design and are sold without adequate warnings concerning the risk of noise-induced hearing loss by iPod users. The Birdsong action was initially filed on January 30, 2006 in the United States District Court for the Western District of Louisiana asserting Louisiana causes of action on behalf of a purported Louisiana class of iPod purchasers. A similar action *(Patterson v. Apple Computer, Inc.)* was filed on January 31, 2006 in the United States District Court for the Northern District of California asserting California causes of action on behalf of a purported class of all iPod purchasers within the four-year period before January 31, 2006. The Birdsong action was transferred to the Northern District of California, and the Patterson action was dismissed. An amended complaint was subsequently filed in Birdsong, dropping the Louisiana law-based claims and adding California law-based claims equivalent to those in Patterson. After the Company filed a motion to dismiss on November 3, 2006, plaintiffs agreed not to oppose the motion and filed a second amended complaint on January 16, 2007. That complaint alleges California law-based claims for breaches of implied and express warranties, violations of California Business & Professions Code §17200 (unfair competition), California Business & Professions Code §17500 (false advertising), the Consumer Legal Remedies Act and negligent misrepresentation on behalf of a putative nationwide class and a Louisiana law-based claim for redhibition for a Louisiana sub-class. On March 1, 2007, the Company filed a motion to dismiss the California law-based claims, which was heard on June 4, 2007. On December 14, 2007, the Court issued an order granting the Company's motion, with leave to amend the complaint. Plaintiffs filed a third amended complaint on January 11, 2008. On February 15, 2008, the Company filed a motion to dismiss the third amended complaint. On June 16, 2008, the Court granted the Company's motion to dismiss the third amended complaint with prejudice. On July 11, 2008, plaintiffs filed a notice of appeal. Plaintiffs' appeal is pending.

A similar complaint, *Royer-Brennan v. Apple Computer, Inc. and Apple Canada, Inc.,* was filed in Montreal, Quebec, Canada, on February 1, 2006, seeking authorization to institute a class action on behalf of iPod purchasers in Quebec. At the request of plaintiffs' counsel, the Court has postponed class certification proceedings in this action indefinitely.

Branning et al. v. Apple Computer, Inc.
Plaintiffs originally filed this purported class action in San Francisco County Superior Court on February 17, 2005. The initial complaint alleged violations of California Business & Professions Code §17200 (unfair competition) and violation of the Consumer Legal Remedies Act regarding a variety of purportedly unfair and unlawful conduct including, but not limited to, allegedly selling used computers as new and failing to honor warranties. Plaintiffs also brought causes of action for misappropriation of trade secrets, breach of contract and violation of the Song-Beverly Consumer Warranty Act. Plaintiffs requested unspecified damages and other relief. On May 9, 2005, the Court granted the Company's motion to transfer the case to Santa Clara County Superior Court. On May 2, 2005, plaintiffs filed an amended complaint adding two new named plaintiffs and three new causes of action including a claim for treble damages under the Cartwright Act (California Business & Professions Code §16700 et seq.) and a claim for false advertising. The Company filed a demurrer to the amended complaint, which the Court sustained in its entirety on November 10, 2005. The Court granted plaintiffs leave to amend and they filed an amended complaint on December 29, 2005. Plaintiffs' amended complaint added three plaintiffs and alleged many of the same factual claims as the previous complaints, such as alleged selling of used equipment as new, alleged failure to honor warranties and service contracts for the consumer plaintiffs, and alleged fraud related to the opening of the Apple retail stores. Plaintiffs continued to assert causes of action for unfair competition (§17200), violations of the Consumer Legal Remedies Act, breach of contract, misappropriation of trade secrets, violations of the Cartwright Act, and alleged new causes of action for fraud, conversion, and breach of the implied covenant of good faith and fair dealing. The Company filed a demurrer to the amended complaint on January 31, 2006, which the Court sustained on March 3, 2006 on sixteen of seventeen causes of action. Plaintiffs filed an amended complaint adding one new plaintiff. The Company filed a demurrer, which was granted in part on September 9, 2006. Plaintiffs filed a further amended complaint on September 21, 2006. On October 2, 2006, the Company filed an answer denying all allegations and asserting numerous affirmative defenses. On November 30, 2007, the Company filed a motion for judgment on the

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pleadings, which the Court denied. Plaintiffs filed a Fifth Amended Complaint on March 19, 2008 and a Corrected Fifth Amended Complaint on April 1, 2008. The Company filed an answer to the Corrected Fifth Amended Complaint on April 18, 2008. The Company filed a motion for judgment on the pleadings for an order dismissing plaintiffs' fraud claim based upon the statute of limitations, which was granted by the Court on June 24, 2008, with leave to amend. Plaintiffs filed a Sixth Amended Complaint on July 14, 2008 and a Seventh Amended Complaint on August 22, 2008, adding three new reseller plaintiffs. On September 22, 2008, the Company filed its answer to the consumer-related claims denying all allegations and asserting numerous affirmative defenses, and also filed a demurrer to the new reseller claims. The Company has filed motions for summary adjudication of two named plaintiffs' claims, which were heard on October 14, 2008. The Court requested further briefing on the motions for summary adjudication. On August 22, 2008, plaintiffs filed a motion to certify the consumer class and on October 10, 2008, the Company filed its opposition to plaintiffs' motion. The class certification hearing is set for December 19, 2008.

Gordon v. Apple Computer, Inc.
Plaintiff filed this purported class action on August 31, 2006 in the United States District Court for the Northern District of California, San Jose Division, on behalf of a purported nationwide class of consumers who purchased 65W Power Adapters for iBooks and Powerbooks between November 2002 and the present. The complaint alleges various problems with the 65W Adapter, including fraying, sparking, and premature failure. Plaintiff alleges violations of California Business & Professions Code §17200 (unfair competition), the Consumer Legal Remedies Act, the Song-Beverly Consumer Warranty Act and breach of warranties. The complaint seeks damages and equitable relief. The Company filed an answer on October 20, 2006 denying the material allegations and asserting numerous affirmative defenses. The Company has reached a settlement of this matter and the parties have received preliminary court approval for the settlement. The parties await final court approval for the settlement.

Harvey v. Apple Inc.
Plaintiff filed this action on August 6, 2007 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement by the Company of U.S. Patent No. 6,753,671 entitled "Recharger for use with a portable electronic device and which includes a proximally located light emitting device" and U.S. Patent No. 6,762,584 entitled "Recharger for use with a portable electronic device and which includes a connector terminus for communicating with rechargeable batteries contained within the device." The complaint seeks unspecified damages and other relief. The Company filed an answer on October 12, 2007 denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims for declaratory judgment of non-infringement and invalidity. On April 7, 2008, plaintiff filed an amended complaint further alleging infringement of the reissue patent of U.S. Patent No. 6,753,671. On April 28, 2008, the Company filed an answer denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims for declaratory judgment of non-infringement and invalidity. The Markman hearing is set for October 28, 2009, and trial is scheduled for April 5, 2010.

Honeywell International, Inc., et al. v. Apple Computer, Inc., et al.
Plaintiffs Honeywell International, Inc. and Honeywell Intellectual Properties, Inc. filed this action on October 6, 2004 in the United States District Court in Delaware alleging infringement by the Company and other defendants of U.S. Patent 5,280,371 entitled "Directional Diffuser for a Liquid Crystal Display." Plaintiffs seek unspecified damages and other relief. The Company filed an answer on December 21, 2004 denying all material allegations and asserting numerous affirmative defenses. The Company has tendered the case to several liquid crystal display manufacturer suppliers. On May 18, 2005 the Court stayed the case against the Company and the other non-manufacturer defendants. Plaintiffs filed an amended complaint on November 7, 2005 adding additional defendants and expanding the scope of the accused products. The Company's response to the amended complaint is not yet due. On April 2, 2008, the Court lifted the stay for the purpose of determining whether the liquid crystal display manufacturer suppliers used by the Company and certain other defendants are licensed under the '371 patent. On October 31, 2008, the Company filed a motion for summary judgment of non-infringement based on the contention that its suppliers are licensed under the '371 patent. A hearing on the motion is scheduled for December 19, 2008.

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In re Apple Computer, Inc. Derivative Litigation (formerly Karant v. Jobs, et al. and Related Actions) (Federal Action)
On June 30, 2006, a putative derivative action captioned *Karant v. Jobs, et. al.*, was filed in the United States District Court for the Northern District of California, San Jose Division. A number of related actions were filed in the subsequent weeks and have been consolidated into a single action captioned *In re Apple Computer, Inc. Derivative Litigation*, Master File No. C-06-04128-JF before the Hon. Jeremy Fogel. The actions were filed after the Company's announcement on June 29, 2006 that an internal investigation had discovered irregularities related to the issuance of certain stock option grants made between 1997 and 2001, that a special committee of the Company's outside directors had retained independent counsel to perform an investigation and that the Company had informed the Securities and Exchange Commission. The action purports to assert claims on behalf of the Company against several current and former executive officers and members of the Board of Directors alleging improper backdating of stock option grants to maximize certain defendants' profits, failing to properly account for and take tax deductions for those grants, insider trading, and issuing false financial statements. The Company is named as a nominal defendant. The consolidated complaint alleges various causes of action under federal and California law, including claims for unjust enrichment, breach of fiduciary duty, violation of the California Corporations Code, abuse of control, gross mismanagement, rescission, constructive fraud and waste of corporate assets, as well as claims under Sections 10(b), 14(a) and 20(a) of the Securities Exchange Act. Plaintiffs seek damages, disgorgement, restitution and imposition of a constructive trust. A Consolidated Shareholder Derivative Complaint was filed on December 18, 2006, and a First Amended Shareholder Derivative Complaint was filed on March 6, 2007. On June 12, 2007, the Company's Board of Directors approved a resolution appointing a Special Litigation Committee to make all decisions relating to options litigation. Defendants filed a motion to dismiss on April 20, 2007, which was heard on September 7, 2007. On November 19, 2007, the Court granted the defendants' motion to dismiss with leave to amend. Plaintiffs filed an amended complaint on December 19, 2007. Defendants filed motions to dismiss the amended complaint on January 25, 2008. The motions to dismiss were originally scheduled to be heard on April 4, 2008. Pursuant to a joint stipulation filed on April 3, 2008, the Court vacated the hearing date. The parties have reached a settlement, and the Court has granted preliminary approval of the settlement. The parties' request for final approval of the settlement is pending.

In re Apple Computer, Inc. Derivative Litigation (formerly Plumbers and Pipefitters v. Jobs, et al. and Related Actions) (State Action); Boston Retirement Board v. Apple Computer, Inc.
On July 5, 2006, a putative derivative action captioned *Plumbers and Pipefitters v. Jobs, et. al.*, was filed in California Superior Court for the County of Santa Clara. A number of related actions were filed in the subsequent weeks, and have been consolidated into a single action captioned *In re Apple Computer, Inc. Derivative Litigation*, No. 1:06CV066692, assigned to the Hon. Joseph Huber. These actions purport to assert claims on behalf of the Company against several current and former executive officers and members of the Board of Directors alleging improper backdating of stock option grants to maximize certain defendants' profits, failing to properly account for and take tax deductions for those grants and issuing false financial statements. The Company is named as a nominal defendant. A consolidated complaint was filed on October 5, 2006, alleging a variety of causes of action under California law, including claims for unjust enrichment, breach of fiduciary duty, violation of the California Corporations Code, abuse of control, accounting, constructive trust, rescission, deceit, gross mismanagement and waste of corporate assets. On December 7, 2006, the Court granted the Company's motion to stay these actions. The parties have reached a settlement, and the Court has granted preliminary approval of the settlement. The parties' request for final approval of the settlement is pending.

On November 3, 2006, the Boston Retirement Board, a purported shareholder, filed a petition for writ of mandate against the Company in California Superior Court for the County of Santa Clara (*Boston Retirement Board v. Apple Computer Inc.*). The petition sought to compel the Company to allow inspection of certain corporate records relating to the Company's option practices and the Special Committee's investigation. Following a trial held on September 24, 2007, the Court granted the petition for inspection but narrowed the scope of the records to be produced. On April 16, 2008, the Boston Retirement Board filed a derivative action in California Superior Court for the County of Santa Clara. On July 31, 2008, Boston Retirement Board attempted to serve the new

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complaint on the Company. On September 15, 2008, defendants filed a motion to quash service of summons. On October 17, 2008, the Court denied defendants' motion to quash. On October 20, 2008, defendants requested consolidation of this action with *In re Apple Computer, Inc. Derivative Litigation*, No. 1:06CV066692, and a stay of the action.

In re Apple iPod Nano Products Liability Litigation (formerly Wimmer v. Apple Computer, Inc.; Moschella, et al., v. Apple Computer, Inc.; Calado, et al. v. Apple Computer, Inc.; Kahan, et al., v. Apple Computer, Inc.; Jennings, et al., v. Apple Computer, Inc.; Rappel v. Apple Computer, Inc.; Mayo v. Apple Computer, Inc.; Valencia v. Apple Computer, Inc.; Williamson v. Apple Computer, Inc.; Sioson v. Apple Computer, Inc.

Beginning on October 19, 2005, eight complaints were filed in various United States District Courts and two complaints were filed in California State Court alleging that the Company's iPod nano was defectively designed so that it scratches excessively during normal use, rendering the screen unreadable.

The federal actions were coordinated in the United States District Court for the Northern District of California and assigned to the Hon. Ronald Whyte pursuant to an April 17, 2006 order of the Judicial Panel on Multidistrict Litigation. Plaintiffs filed a First Consolidated and Amended Master Complaint on September 21, 2006, alleging violations of California and other states' consumer protection and warranty laws and claiming unjust enrichment. The Master Complaint alleges two putative plaintiff classes: (1) all U.S. residents (excluding California residents) who purchased an iPod nano that was not manufactured or designed using processes necessary to ensure normal resistance to scratching of the screen; and (2) all iPod nano purchasers other than U.S. residents who purchased an iPod nano that was not manufactured or designed using processes necessary to ensure normal resistance to scratching of the screen. The Company answered the Master Complaint on November 20, 2006.

The two California State Court actions were coordinated on May 4, 2006, and assigned to the Hon. Carl West in Los Angeles Superior Court. Plaintiffs filed a Consolidated Amended Class Action Complaint on June 8, 2006, alleging violations of California state consumer protection, unfair competition, false advertising and warranty laws and claiming unjust enrichment. The Consolidated Complaint alleges a putative plaintiff class of all California residents who own an iPod nano containing a manufacturing defect that results in the nano being susceptible to excessive scratching. The Company answered the Consolidated Amended Complaint on October 6, 2006. The parties have reached a settlement, which is subject to court approval.

Two similar complaints, *Carpentier v. Apple Canada, Inc.*, and *Royer-Brennan v. Apple Computer, Inc. and Apple Canada, Inc.* were filed in Montreal, Quebec, Canada on October 27, 2005 and November 9, 2005, respectively, seeking authorization to institute class actions on behalf of iPod nano purchasers in Quebec. The Royer-Brennan file was stayed in May 2006 in favor of the Carpentier file. A similar complaint, *Mund v. Apple Canada Inc. and Apple Computer, Inc.*, was filed in Ontario, Canada on January 9, 2006 seeking authorization to institute a class action on behalf of iPod nano purchasers in Canada. Apple Canada Inc. and Apple Computer, Inc. have served Notices of Intent to Defend. The parties have reached a settlement of the Quebec cases, and have received final court approval of the settlement.

Individual Networks, LLC v. Apple, Inc.

Plaintiff filed this action against the Company on April 24, 2007 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement of U.S. Patent No. 7,117,516, entitled "Method and System for Providing a Customized Media List." Plaintiff alleges certain features of the iTunes store infringe the patent. The complaint seeks unspecified damages and other relief. The Company filed an answer on July 2, 2007, denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims for declaratory judgment of non-infringement and invalidity, as well as a counterclaim against Individual Networks LLC for infringement of U.S. Patent No. 5,724,567. The trial is scheduled for November 9, 2009. The Company has filed a petition with the United States Patent and Trademark Office requesting reexamination of U.S. Patent No. 7,117,516. The Markman hearing took place on October 8, 2008. The Company awaits the Court's Markman ruling.

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Macadam v. Apple Computer, Inc.; Santos v. Apple Computer, Inc.
The Macadam action was filed in late 2002 in Santa Clara County Superior Court asserting various causes of action including breach of contract, fraud, negligent and intentional interference with economic relationship, negligent misrepresentation, trade libel, unfair competition and false advertising. The complaint requested unspecified damages and other relief. The Company filed an answer on December 3, 2004 denying all allegations and asserting numerous defenses.

On October 1, 2003, Macadam was deauthorized as an Apple reseller. Macadam filed a motion for a temporary order to reinstate it as a reseller, which the Court denied. The Court denied Macadam's motion for a preliminary injunction on December 19, 2003. On December 6, 2004, Macadam filed for Chapter 11 bankruptcy in the Northern District of California, which placed a stay on the litigation as to Macadam. The Company filed a claim in the bankruptcy proceedings on February 16, 2005. The Macadam bankruptcy case was converted to Chapter 7 (liquidation) on April 29, 2005. The Company reached a settlement of Macadam's claims against the Company with the Chapter 7 Bankruptcy Trustee, and the Bankruptcy Court approved the settlement on July 17, 2006 over the objection of Tom Santos, Macadam's principal. Santos appealed the ruling approving the settlement, but the District Court denied the appeal. Santos appealed to the Ninth Circuit Court of Appeals. Santos' appeal was dismissed on October 3, 2008.

On December 19, 2005, Tom Santos filed a Fifth Amended Complaint on his own behalf (not on behalf of Macadam) alleging fraud, violations of California Business & Professions Code §17200 (unfair competition), California Business & Professions Code §17500 (false advertising) and the Consumer Legal Remedies Act. The Company filed a demurrer to Santos' amended complaint and a special motion to strike the defamation cause of action on January 20, 2006. The Court sustained the demurrer in part but denied the special motion to strike. Santos filed a Sixth Amended Complaint on July 14, 2006. The Company filed a demurrer, which was sustained on September 9, 2006. Santos filed a Seventh Amended Complaint in late September 2006. The Company filed a motion to strike, which was granted in part and denied in part on December 15, 2006. Santos filed an Eighth Amended Complaint on January 29, 2007. The Company filed a demurrer, which was heard on May 7, 2007. The court sustained the demurrer, and Santos filed a Ninth Amended Complaint on July 11, 2007. The Company filed a demurrer, which was overruled. The Company also filed a cross complaint against Santos on January 20, 2006 alleging violations of California Business & Professions Code §17200 and California Penal Code §502, fraud and deceit and breach of contract. The parties have reached a settlement.

Mediostream, Inc. v. Acer America Corp. et al.
Plaintiff filed this action against the Company, Acer America Corp., Dell, Inc. and Gateway, Inc. on August 28, 2007 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement of U.S. Patent No. 7,009,655, entitled "Method and System for Direct Recording of Video Information onto a Disk Medium." An amended complaint was served on November 7, 2007. The amended complaint seeks unspecified damages and other relief. On January 25, 2008, the Company filed an answer to the complaint denying all material allegations and asserting numerous affirmative defenses and also filed a motion to transfer the case to the Northern District of California. The Court has scheduled the Markman hearing for August 4, 2010 and trial for January 4, 2011.

OPTi Inc. v. Apple Inc.
Plaintiff filed this action against the Company on January 16, 2007 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement of U.S. Patent Nos. 5,710,906, 5,813,036 and 6,405,291, all entitled "Predictive Snooping of Cache Memory for Master-Initiated Accesses." The complaint seeks unspecified damages and other relief. The Company filed an answer on April 17, 2007 denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims for declaratory judgment of non-infringement and invalidity. The Markman hearing is set for November 26, 2008, and trial is scheduled for April 6, 2009.

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Quantum Technology Management, Ltd. v. Apple Computer, Inc.
Plaintiff filed this action on December 21, 2005 in the United States District Court for the District of Maryland against the Company and Fingerworks, Ltd., alleging infringement of U.S. Patent No. 5,730,165 entitled "Time Domain Capacitive Field Detector." The complaint seeks unspecified damages and other relief. On May 11, 2006, Quantum filed an amended complaint adding Cypress Semiconductor/MicroSystems, Inc. as a defendant. On July 31, 2006, the Company filed an answer denying all material allegations and asserting numerous affirmative defenses and also filed counterclaims for non-infringement and invalidity. On November 30, 2006, plaintiff filed a reply to the Company's counterclaims and a More Definite Statement. A Markman hearing was held on May 16, 2007. On June 7, 2007, the Court issued a claim construction ruling, and also issued an order invalidating six of plaintiff's asserted patent claims in response to the Company's motion for partial summary judgment of invalidity. On November 28, 2007, the Company filed a motion for summary judgment for non-infringement and invalidity, and a motion for summary judgment related to Quantum's state-law claims. On December 27, 2007, Quantum filed a motion for summary judgment for infringement on one patent claim. In March 2008, Quantum was acquired by Atmel Corporation. The parties have reached a settlement.

Saito Shigeru Kenchiku Kenkyusho (Shigeru Saito Architecture Institute) v. iPod; Apple Japan Inc. v. Shigeru Saito Architecture Institute
Plaintiff Saito filed a petition in the Japan Customs Office in Tokyo on January 23, 2007 alleging infringement by the Company of Japanese Patent No. 3852854, entitled "Touch Operation Input Device and Electronic Parts Thereof." The petition sought an order barring the importation into Japan of fifth generation iPods and second generation iPod nanos. The Customs Office held a hearing on March 22, 2007. The Customs Office rejected the petition to bar importation and dismissed plaintiff's case.

Apple Japan, Inc. filed a Declaratory Judgment action against Saito on February 6, 2007 in the Tokyo District Court, seeking a declaration that the '854 patent is invalid and not infringed. Saito filed a Counter Complaint for infringement seeking damages.

St-Germain v. Apple Canada, Inc.
Plaintiff filed this case in Montreal, Quebec, Canada, on August 5, 2005, seeking authorization to institute a class action for the refund by the Company of the Canadian Private Copying Levy that was applied to the iPod purchase price in Quebec between December 12, 2003 and December 14, 2004 but later declared invalid by the Canadian Court. The Company has completed a refund program for this levy. A class certification hearing took place January 13, 2006. On February 24, 2006, the Court granted class certification and notice was published during the last week of March 2006. The trial was conducted on October 15 and 16, 2007. On January 11, 2008, the Court issued a ruling in plaintiff's favor. The Court ruled that despite the Company's good faith efforts with the levy refund program, the Company must pay the amount claimed, and that the class is comprised of 20,000 persons who purchased an iPod in Quebec between December 12, 2003 and December 14, 2004. The Court ordered the Company to submit a statement of account showing the amount received by the Canadian Private Copying Collective, and the amount that has already been paid to class members in Quebec under the Company's levy refund program. The Court also ordered the parties to submit further briefing regarding the collective recovery award by February 23, 2008. On February 11, 2008, the Company filed an appeal. The Company's appeal is pending.

Texas MP3 Technologies Ltd v. Apple Inc. et al.
Plaintiff filed this action against the Company and other defendants on February 16, 2007 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement of U.S. Patent No. 7,065,417 entitled "MPEG Portable Sound Reproducing System and A Reproducing Method Thereof." The complaint seeks unspecified damages and other relief. On July 12, 2007, the Company filed a petition for reexamination of the patent, which the U.S. Patent and Trademark Office granted. Plaintiff filed an amended complaint on August 1, 2007, adding the iPhone as an accused device. On August 2, 2007, the Company filed a motion to stay the litigation pending the outcome of the reexamination, which the Court denied. The Company filed an answer on August 20, 2007, denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims for declaratory judgment of non-infringement and invalidity. The Markman hearing is set for March 12, 2009, and trial is scheduled for July 6, 2009.

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The Apple iPod iTunes Antitrust Litigation (formerly Charoensak v. Apple Computer, Inc. and Tucker v. Apple Computer, Inc.); Somers v. Apple Inc.
The first-listed action is a consolidated case combining two cases previously pending under the names *Charoensak v. Apple Computer Inc. (formerly Slattery v. Apple Computer Inc.)* and *Tucker v. Apple Computer, Inc.* The original plaintiff (Slattery) in the Charoensak case filed a purported class action on January 3, 2005 in the United States District Court for the Northern District of California alleging various claims including alleged unlawful tying of music purchased on the iTunes Store with the purchase of iPods and unlawful acquisition or maintenance of monopoly market power. Plaintiff's complaint alleged violations of §§1 and 2 of the Sherman Act (15 U.S.C. §§1 and 2), California Business & Professions Code §16700 et seq. (the Cartwright Act), California Business & Professions Code §17200 (unfair competition), common law unjust enrichment and common law monopolization. Plaintiff sought unspecified damages and other relief. The Company filed a motion to dismiss on February 10, 2005. On September 9, 2005, the Court denied the motion in part and granted it in part. Plaintiff filed an amended complaint on September 23, 2005 and the Company filed an answer on October 18, 2005. In August 2006, the Court dismissed Slattery without prejudice and allowed plaintiffs to file an amended complaint naming two new plaintiffs (Charoensak and Rosen). On November 2, 2006, the Company filed an answer to the amended complaint denying all material allegations and asserting numerous affirmative defenses.

The Tucker case was filed as a purported class action on July 21, 2006 in the United States District Court for the Northern District of California alleging various claims including alleged unlawful tying of music and videos purchased on the iTunes Store with the purchase of iPods and vice versa and unlawful acquisition or maintenance of monopoly market power. The complaint alleges violations of §§1 and 2 of the Sherman Act (15 U.S.C. §§1 and 2), California Business & Professions Code §16700 et seq. (the Cartwright Act), California Business & Professions Code §17200 (unfair competition) and the California Consumer Legal Remedies Act. Plaintiff sought unspecified damages and other relief. On November 3, 2006, the Company filed a motion to dismiss the complaint. On December 20, 2006, the Court denied the motion to dismiss. On January 11, 2007, The Company filed an answer denying all material allegations and asserting numerous defenses.

On March 20, 2007, the Court consolidated the two cases. Plaintiffs filed a consolidated complaint on April 19, 2007. On June 6, 2007, the Company filed an answer to the consolidated complaint denying all material allegations and asserting numerous affirmative defenses. On July 17, 2008, plaintiffs filed a motion for class certification and on October 17, 2008, the Company filed its opposition to plaintiffs' motion. The class certification hearing is set for December 15, 2008.

A related class action complaint, *Somers v. Apple Inc.*, was filed on December 31, 2007 in the United States District Court for the Northern District of California, alleging various claims including alleged unlawful tying of music and videos purchased on the iTunes Store with the purchase of iPods and vice versa and unlawful acquisition or maintenance of monopoly market power. The complaint alleges violations of §§1 and 2 of the Sherman Act (15 U.S.C. §§1 and 2), California Business & Professions Code §16700 et seq. (the Cartwright Act), California Business & Professions Code §17200 (unfair competition) and the California Consumer Legal Remedies Act. Plaintiff seeks unspecified damages and other relief. On February 21, 2008, the Company filed an answer denying all material allegations and asserting numerous defenses. The Court has scheduled the class certification hearing for April 20, 2009.

Tse v. Apple Computer, Inc. et al.
Plaintiff Ho Keung Tse filed this action against the Company and other defendants on August 5, 2005 in the United States District Court for the District of Maryland alleging infringement of U.S. Patent No. 6,665,797 entitled "Protection of Software Again [sic] Against Unauthorized Use." The complaint seeks unspecified damages and other relief. The Company filed an answer on October 31, 2005 denying all material allegations and asserting numerous affirmative defenses. On October 28, 2005, the Company and the other defendants filed a motion to transfer the case to the Northern District of California, which was granted on August 31, 2006. On July 24, 2007, the Company filed a petition for reexamination of the patent, which the U.S. Patent and Trademark Office granted. On July 25, 2007, the Company filed a motion to stay the litigation pending the outcome of the reexamination, which the Court granted on October 4, 2007.

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Union Fédérale des Consummateurs—Que Choisir v. Apple Computer France S.à.r.l. and iTunes S.à.r.l.
Plaintiff, a consumer association in France, filed this complaint on February 9, 2005 alleging that the above-listed entities are violating consumer law by (1) omitting to mention that the iPod is allegedly not compatible with music from online music services other than the iTunes Store and that the music from the iTunes Store is only compatible with the iPod and (2) allegedly tying the sales of iPods to the iTunes Store and vice versa. Plaintiff seeks damages, injunctive relief and other relief. The first hearing on the case took place on May 24, 2005. The Company's response to the complaint was served on November 8, 2005. Plaintiff's responsive pleading was filed on February 10, 2006. The Company filed a reply on June 6, 2006 and UFC filed a response on September 19, 2006.

Vitt v. Apple Computer, Inc.
Plaintiff filed this purported class action on November 7, 2006 in the United States District Court for the Central District of California on behalf of a purported nationwide class of all purchasers of the iBook G4 alleging that the computer's logic board fails at an abnormally high rate. The complaint alleges violations of California Business & Professions Code §17200 (unfair competition) and California Business & Professions Code §17500 (false advertising). Plaintiff seeks unspecified damages and other relief. The Company filed a motion to dismiss on January 19, 2007, which the Court granted on March 13, 2007. Plaintiffs filed an amended complaint on March 26, 2007. The Company filed a motion to dismiss on August 16, 2007, which was heard on October 4, 2007. The Court has not yet issued a ruling.

Vogel v. Jobs et al. (2006 Action)
Plaintiffs filed this purported class action on August 24, 2006, in the United States District Court for the Northern District of California against the Company and certain of the Company's current and former officers and directors alleging improper backdating of stock option grants to maximize certain defendants' profits, failing to properly account for those grants and issuing false financial statements. On January 19, 2007, the Court appointed the New York City Employees' Retirement System as lead plaintiff. On March 23, 2007, plaintiffs filed a Consolidated Class Action Complaint. The Consolidated Complaint purports to be brought on behalf of several classes of holders of the Company's stock and asserts claims under Section 14(a) and 20(a) of the Securities Exchange Act as well as state law. The Consolidated Complaint seeks rescission of amendments to various stock option and other incentive compensation plans, an accounting and damages in an unspecified amount. Defendants filed a motion to dismiss on June 8, 2007, which was heard on September 7, 2007. On November 14, 2007, the Court issued an order dismissing all securities claims with prejudice, and held that any amended complaint could only be styled as a derivative case. On December 14, 2007, plaintiff filed a motion for leave to file a first amended consolidated class action complaint. On January 23, 2008, defendants filed an opposition to plaintiff's motion. Plaintiff's motion was heard on March 21, 2008. On May 14, 2008, the Court issued an order denying plaintiffs' motion for leave to amend. The court entered judgment dismissing the case on June 12, 2008. On June 17, 2008, plaintiffs filed a notice of appeal. Plaintiffs' appeal is pending.

Vogel v. Apple Inc., et al. (2008 Action)
Plaintiff filed this purported class action on June 27, 2008, in the United States District Court for the Northern District of California against the Company and certain of the Company's current and former officers and directors. The allegations, which arise out of the Company's past stock option practices, are similar to those in the 2006 *Vogel v. Jobs et al.* action that was dismissed on June 12, 2008, as described above. The complaint purports to be brought on behalf of several classes of holders of the Company's stock and asserts claims under Sections 10(b) and 20(a) of the Securities Exchange Act. The complaint seeks rescission of amendments to various stock option and other incentive compensation plans, an accounting and damages in an unspecified amount. On July 22, 2008, the Court stayed this case pending the appeal in the 2006 Action.

Item 4. Submission of Matters to a Vote of Security Holders

None.

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's common stock is traded on the over-the-counter market and is quoted on the NASDAQ Global Select Market under the symbol AAPL and on the Frankfurt Stock Exchange under the symbol APCD.

Price Range of Common Stock

The price range per share of common stock presented below represents the highest and lowest sales prices for the Company's common stock on the NASDAQ Global Select Market during each quarter of the two most recent fiscal years.

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Fiscal 2008 price range per common share	$ 180.91 - $ 120.68	$ 192.24 - $ 142.52	$ 200.50 - $ 115.44	$ 202.96 - $ 150.63
Fiscal 2007 price range per common share	$ 155.00 - $ 111.62	$ 127.61 - $ 89.60	$ 97.80 - $ 81.90	$ 93.16 - $ 72.60

Holders

As of October 24, 2008, there were 30,445 shareholders of record.

Dividends

The Company did not declare or pay cash dividends in either fiscal 2008 or 2007. The Company anticipates that for the foreseeable future it will retain any earnings for use in the operation of its business.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

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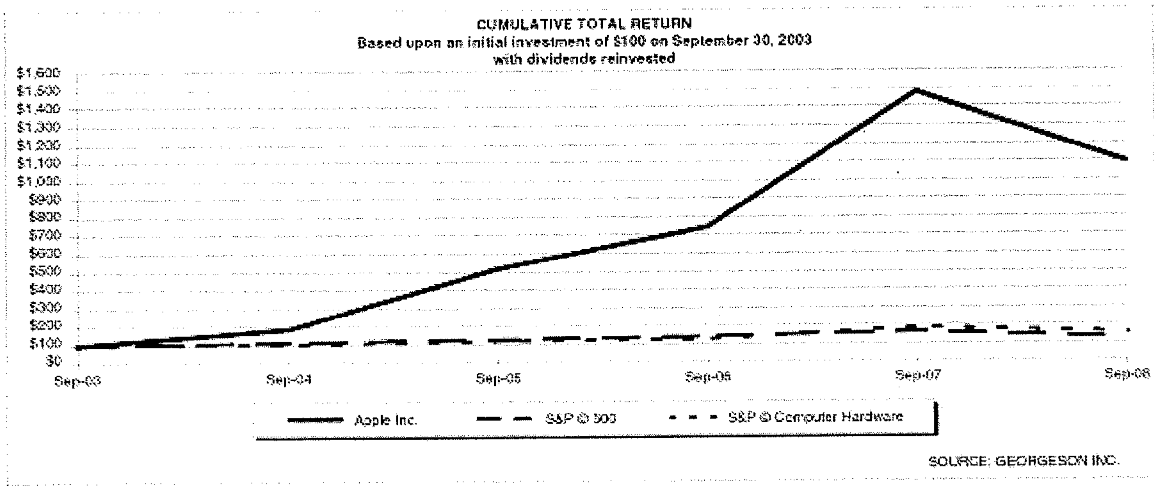
Company Stock Performance

The following graph shows a five-year comparison of cumulative total shareholder return, calculated on a dividend reinvested basis, for the Company, the S&P 500 Composite Index (the "S&P 500") and the S&P Computers (Hardware) Index (the "Industry Index"). The graph assumes $100 was invested in each of the Company's common stock, the S&P 500, and the Industry Index on September 30, 2003. Data points on the graph are annual. Note that historic stock price performance is not necessarily indicative of future stock price performance.



	Sep-03	Sep-04	Sep-05	Sep-06	Sep-07	Sep-08
Apple Inc.	$ 100	$ 187	$ 517	$ 743	$ 1,481	$ 1,097
S&P © 500	$ 100	$ 114	$ 128	$ 142	$ 165	$ 129
S&P © Computer Hardware	$ 100	$ 104	$ 119	$ 128	$ 188	$ 158

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Item 6. Selected Financial Data

The information set forth below for the five fiscal years ended September 27, 2008, is not necessarily indicative of results of future operations, and should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and related notes thereto included in Item 8 of this Form 10-K to fully understand factors that may affect the comparability of the information presented below (in millions, except share amounts which are reflected in thousands and per share amounts).

	2008	2007	2006	2005	2004
Net sales	$ 32,479	$ 24,006	$ 19,315	$ 13,931	$ 8,279
Net income	$ 4,834	$ 3,496	$ 1,989	$ 1,328	$ 266
Earnings per common share:					
Basic	$ 5.48	$ 4.04	$ 2.36	$ 1.64	$ 0.36
Diluted	$ 5.36	$ 3.93	$ 2.27	$ 1.55	$ 0.34
Cash dividends declared per common share	$ —	$ —	$ —	$ —	$ —
Shares used in computing earnings per share:					
Basic	881,592	864,595	844,058	808,439	743,180
Diluted	902,139	889,292	877,526	856,878	774,776
Cash, cash equivalents, and short-term investments	$ 24,490	$ 15,386	$ 10,110	$ 8,261	$ 5,464
Total assets	$ 39,572	$ 25,347	$ 17,205	$ 11,516	$ 8,039
Long-term debt	$ —	$ —	$ —	$ —	$ —
Total liabilities	$ 18,542	$ 10,815	$ 7,221	$ 4,088	$ 2,976
Shareholders' equity	$ 21,030	$ 14,532	$ 9,984	$ 7,428	$ 5,063

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This section and other parts of this Form 10-K contain forward-looking statements that involve risks and uncertainties. Forward-looking statements can also be identified by words such as "anticipates," "expects," "believes," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and the Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Risk Factors" above, which are incorporated herein by reference. The following discussion should be read in conjunction with the consolidated financial statements and notes thereto included in Item 8 of this Form 10-K. All information presented herein is based on the Company's fiscal calendar. Unless otherwise stated, references in this report to particular years or quarters refer to the Company's fiscal years ended in September and the associated quarters of those fiscal years. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Executive Overview

The Company designs, manufactures, and markets personal computers, portable digital music players, and mobile communication devices and sells a variety of related software, services, peripherals, and networking solutions. The Company's products and services include the Mac line of desktop and portable computers, the iPod line of portable digital music players, iPhone, Apple TV, Xserve, a portfolio of consumer and professional software applications, the Mac OS X operating system, third-party digital content through the iTunes Store, and a variety of accessory, service and support offerings. The Company sells its products worldwide through its online stores, its retail stores, its direct sales force, and third-party wholesalers, retailers, and value-added resellers. In addition, the Company sells a variety of third-party Mac, iPod and iPhone compatible products, including application software, printers, storage devices, speakers, headphones, and various other accessories and peripherals through its online and retail stores. The Company sells to consumer, small and mid-sized business ("SMB"), education, enterprise, government, and creative markets.

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The Company is focused on providing innovative products and solutions to consumer, SMB, education, enterprise, government and creative customers that greatly enhance their evolving digital lifestyles. The Company is the only participant in the personal computer and consumer electronics industries that controls the design and development of the entire personal computer, including the hardware, operating system, and sophisticated software applications, as well as the design and development of portable digital music players, mobile communication devices, and a variety of products and solutions for obtaining and enjoying digital content. The Company is therefore uniquely positioned to offer superior and well-integrated digital lifestyle products and solutions, which are further enhanced by the Company's emphasis on ease-of-use and creative industrial designs.

The Company participates in several highly competitive markets, including personal computers with its Mac line of personal computers, consumer electronics with its iPod product families, mobile communications with iPhone, and distribution of third-party digital content through its online iTunes Store. While the Company is widely recognized as a leading innovator in the personal computer and consumer electronics markets as well as a leader in the emerging market for distribution of digital content, these markets are highly competitive and subject to aggressive pricing. To remain competitive, the Company believes that increased investment in research and development and marketing and advertising is necessary to maintain or expand its position in the markets where it competes. The Company's R&D spending is focused on further developing its existing Mac line of personal computers, its operating system, application software, iPhone and iPods; developing new digital lifestyle consumer and professional software applications; and investing in new product areas and technologies. The Company also believes increased investment in marketing and advertising programs is critical to increasing product and brand awareness.

The Company utilizes a variety of direct and indirect distribution channels. The Company believes that sales of its innovative and differentiated products are enhanced by knowledgeable salespersons who can convey the value of the hardware, software, and peripheral integration, demonstrate the unique digital lifestyle solutions that are available only on Mac computers, and demonstrate the compatibility of the Mac with the Windows platform and networks. The Company further believes providing a high-quality sales and after-sales support experience is critical to attracting new and retaining existing customers. To ensure a high-quality buying experience for its products in which service and education are emphasized, the Company continues to expand and improve its distribution capabilities by opening its own retail stores in the U.S. and internationally. The Company had 247 stores open as of September 27, 2008.

The Company has also invested in programs to enhance reseller sales, including the Apple Sales Consultant Program, which places Apple employees and contractors at selected third-party reseller locations. The Company believes providing direct contact with its targeted customers is an efficient way to demonstrate the advantages of its Mac computers and other products over those of its competitors. The Company also sells to customers directly through its online stores around the world and through its direct sales force.

The Company's iPods are sold through a significant number of distribution points to provide broad access. iPods can be purchased in certain department stores, member-only warehouse stores, large retail chains, and specialty retail stores, as well as through the channels for Mac distribution listed above.

iPhone is distributed through the Company, its cellular network carriers' distribution channels, and certain third-party resellers. The Company has signed multi-year agreements with various cellular network carriers authorizing them to distribute and provide cellular network services for iPhone 3G in over 70 countries. These agreements are generally not exclusive with a specific carrier, except in the U.S., U.K., France, Germany, Spain, Ireland, and certain other countries. The Company expects to ship iPhone 3G in over 70 countries by the end of calendar year 2008.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles and the Company's discussion and analysis of its financial condition and operating results require the Company's management to make judgments, assumptions, and estimates that affect the amounts

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reported in its Consolidated Financial Statements and accompanying notes. Note 1 "Summary of Significant Accounting Policies" of Notes to Consolidated Financial Statements in this Form 10-K describes the significant accounting policies and methods used in the preparation of the Company's Consolidated Financial Statements. Management bases its estimates on historical experience and on various other assumptions it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates and such differences may be material.

Management believes the Company's critical accounting policies and estimates are those related to revenue recognition, allowance for doubtful accounts, inventory valuation and inventory purchase commitments, warranty costs, stock-based compensation, income taxes, and legal and other contingencies. Management considers these policies critical because they are both important to the portrayal of the Company's financial condition and operating results, and they require management to make judgments and estimates about inherently uncertain matters. The Company's senior management has reviewed these critical accounting policies and related disclosures with the Audit and Finance Committee of the Company's Board of Directors.

Revenue Recognition

Net sales consist primarily of revenue from the sale of hardware, software, music products, digital content, peripherals, and service and support contracts. The Company recognizes revenue for software products (operating system software and applications software), or any product that is considered to be software-related, in accordance with the guidance in Emerging Issues Task Force ("EITF") No. 03-5, *Applicability of AICPA Statement of Position 97-2 to Non-software Deliverables in an Arrangement Containing More-Than-Incidental Software*, (e.g., Mac computers, iPod portable digital music players and iPhone) pursuant to American Institute of Certified Public Accountants ("AICPA") Statement of Position ("SOP") No. 97-2, *Software Revenue Recognition*, as amended. For products that are not software or software-related, (e.g., digital content sold on the iTunes Store and certain Mac, iPod and iPhone supplies and accessories), the Company recognizes revenue pursuant to the Securities and Exchange Commission ("SEC") Staff Accounting Bulletin ("SAB") No. 104, *Revenue Recognition.*

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection is probable. Product is considered delivered to the customer once it has been shipped and title and risk of loss have been transferred. For most of the Company's product sales, these criteria are met at the time the product is shipped. For online sales to individuals, for some sales to education customers in the U.S., and for certain other sales, the Company defers revenue until the customer receives the product because the Company retains a portion of the risk of loss on these sales during transit. If at the outset of an arrangement the Company determines the arrangement fee is not, or is presumed not to be, fixed or determinable, revenue is deferred and subsequently recognized as amounts become due and payable and all other criteria for revenue recognition have been met.

For both Apple TV and iPhone, the Company has indicated that from time-to-time it may provide future unspecified features and additional software products free of charge to customers. Therefore, sales of Apple TV and iPhone handsets are recognized under subscription accounting in accordance with SOP No. 97-2. The Company recognizes the associated revenue and cost of goods sold on a straight-line basis over the currently estimated 24-month economic lives of these products, with any loss recognized at the time of sale. Costs incurred by the Company for engineering, sales, marketing, and warranty are expensed as incurred.

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end-user rebates, and other sales programs and volume-based incentives. For transactions involving price protection, the Company recognizes revenue net of the estimated amount to be refunded, provided the refund amount can be reasonably and reliably estimated and the other conditions for revenue recognition have been met. The Company's policy requires that, if refunds cannot be reliably estimated, revenue is not recognized until reliable estimates can be made or the price protection lapses. For customer incentive programs, the estimated cost of these programs is recognized at the later of the date at

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which the Company has sold the product or the date at which the program is offered. The Company also records reductions to revenue for expected future product returns based on the Company's historical experience. Future market conditions and product transitions may require the Company to increase customer incentive programs and incur incremental price protection obligations that could result in additional reductions to revenue at the time such programs are offered. Additionally, certain customer incentive programs require management to estimate the number of customers who will actually redeem the incentive based on historical experience and the specific terms and conditions of particular incentive programs. If a greater than estimated proportion of customers redeem such incentives, the Company would be required to record additional reductions to revenue, which would have a negative impact on the Company's results of operations.

Allowance for Doubtful Accounts
The Company distributes its products through third-party distributors and resellers and directly to certain education, consumer, and enterprise customers. The Company generally does not require collateral from its customers; however, the Company will require collateral in certain instances to limit credit risk. In addition, when possible the Company does attempt to limit credit risk on trade receivables with credit insurance for certain customers in Latin America, Europe, Asia, and Australia and by arranging with third-party financing companies to provide flooring arrangements and other loan and lease programs to the Company's direct customers. These credit-financing arrangements are directly between the third-party financing company and the end customer. As such, the Company generally does not assume any recourse or credit-risk-sharing related to any of these arrangements. However, considerable trade receivables that are not covered by collateral, third-party flooring arrangements, or credit insurance are outstanding with the Company's distribution and retail channel partners.

The allowance for doubtful accounts is based on management's assessment of the collectibility of specific customer accounts and includes consideration of the credit worthiness and financial condition of those specific customers. The Company records an allowance to reduce the specific receivables to the amount that it reasonably believes to be collectible. The Company also records an allowance for all other trade receivables based on multiple factors, including historical experience with bad debts, the general economic environment, the financial condition of the Company's distribution channels, and the aging of such receivables. If there is a deterioration of a major customer's financial condition, if the Company becomes aware of additional information related to the credit-worthiness of a major customer, or if future actual default rates on trade receivables in general differ from those currently anticipated, the Company may have to adjust its allowance for doubtful accounts, which would affect earnings in the period the adjustments are made.

Inventory Valuation and Inventory Purchase Commitments
The Company must order components for its products and build inventory in advance of product shipments. The Company records a write-down for inventories of components and products, including third-party products held for resale, which have become obsolete or are in excess of anticipated demand or net realizable value. The Company performs a detailed review of inventory each fiscal quarter that considers multiple factors including demand forecasts, product life cycle status, product development plans, current sales levels, and component cost trends. The personal computer, consumer electronics and mobile communications industries are subject to a rapid and unpredictable pace of product and component obsolescence and demand changes. If future demand or market conditions for the Company's products are less favorable than forecasted or if unforeseen technological changes negatively impact the utility of component inventory, the Company may be required to record additional write-downs, which would negatively affect gross margins in the period when the write-downs were recorded.

The Company accrues reserves for estimated cancellation fees related to component orders that have been cancelled or are expected to be cancelled. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. These commitments typically cover the Company's requirements for periods ranging from 30 to 150 days. If there is an abrupt and substantial decline in demand for one or more of the Company's products or an unanticipated change in technological requirements for any of the Company's products, the Company may be required to record additional reserves for cancellation fees that would negatively affect gross margins in the period when the cancellation fees are identified and recorded.

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Warranty Costs
The Company provides for the estimated cost for hardware and software warranties at the time the related revenue is recognized based on historical and projected warranty claim rates, historical and projected cost-per-claim, and knowledge of specific product failures that are outside of the Company's typical experience. Each quarter, the Company reevaluates its estimates to assess the adequacy of its recorded warranty liabilities considering the size of the installed base of products subject to warranty protection and adjusts the amounts as necessary. For products accounted for under subscription accounting pursuant to SOP No. 97-2, the Company recognizes warranty expense as incurred. If actual product failure rates or repair costs differ from estimates, revisions to the estimated warranty liability would be required and could negatively affect the Company's results of operations.

The Company periodically provides updates to its applications and operating system software to maintain the software's compliance with specifications. The estimated cost to develop such updates is accounted for as warranty cost that is recognized at the time related software revenue is recognized. Factors considered in determining appropriate accruals related to such updates include the number of units delivered, the number of updates expected to occur, and the historical cost and estimated future cost of the resources necessary to develop these updates.

Stock-Based Compensation
The Company accounts for stock-based compensation in accordance with Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), *Share-Based Payment*. Under the provisions of SFAS No. 123R, stock-based compensation cost is estimated at the grant date based on the award's fair-value as calculated by the Black-Scholes-Merton ("BSM") option-pricing model and is recognized as expense ratably on a straight-line basis over the requisite service period. The BSM option-pricing model requires various judgmental assumptions including expected volatility, forfeiture rates, and expected option life. Significant changes in any of these assumptions could materially affect the fair value of stock-based awards granted in the future.

Income Taxes
The Company records a tax provision for the anticipated tax consequences of the reported results of operations. In accordance with SFAS No. 109, *Accounting for Income Taxes*, the provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. The Company records a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized. Effective at the beginning of 2008, the Company adopted Financial Interpretation No. ("FIN") 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*. Further information may be found in Note 5, "Income Taxes" in the Notes to Consolidated Financial Statements of this Form 10-K.

Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets. In the event that the Company determines all or part of the net deferred tax assets are not realizable in the future, the Company will make an adjustment to the valuation allowance that would be charged to earnings in the period such determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of FIN 48 and other complex tax laws. Resolution of these uncertainties in a manner inconsistent with management's expectations could have a material impact on the Company's financial condition and operating results.

Legal and Other Contingencies
As discussed in Part I, Item 3 of this Form 10-K under the heading "Legal Proceedings" and in Note 8 "Commitments and Contingencies" in Notes to Consolidated Financial Statements, the Company is subject to

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various legal proceedings and claims that arise in the ordinary course of business. In accordance with SFAS No. 5, *Accounting for Contingencies*, the Company records a contingent liability when it is probable that a loss has been incurred and the amount is reasonably estimable. There is significant judgment required in both the probability determination and as to whether an exposure can be reasonably estimated. In management's opinion, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate have a material adverse effect on its financial condition or operating results. However, the outcomes of legal proceedings and claims brought against the Company are subject to significant uncertainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

Net Sales

Fiscal years 2008 and 2007 spanned 52 weeks while fiscal year 2006 spanned 53 weeks. An additional week is included in the first fiscal quarter approximately every six years to realign fiscal quarters with calendar quarters.

The following table summarizes net sales and Mac unit sales by operating segment and net sales and unit sales by product during the three fiscal years ended September 27, 2008 (in millions, except unit sales in thousands and per unit amounts):

	2008	Change	2007	Change	2006
Net Sales by Operating Segment:					
Americas net sales	$ 14,573	26%	$ 11,596	23%	$ 9,415
Europe net sales	7,622	40%	5,460	33%	4,096
Japan net sales	1,509	39%	1,082	(11)%	1,211
Retail net sales	6,315	53%	4,115	27%	3,246
Other Segments net sales (a)	2,460	40%	1,753	30%	1,347
Total net sales	$ 32,479	35%	$ 24,006	24%	$ 19,315
Unit Sales by Operating Segment:					
Americas Mac unit sales	3,980	32%	3,019	24%	2,432
Europe Mac unit sales	2,519	39%	1,816	35%	1,346
Japan Mac unit sales	389	29%	302	(1)%	304
Retail Mac unit sales	2,034	47%	1,386	56%	886
Other Segments Mac unit sales (a)	793	50%	528	58%	335
Total Mac unit sales	9,715	38%	7,051	33%	5,303
Net Sales by Product:					
Desktops (b)	$ 5,603	39%	$ 4,020	21%	$ 3,319
Portables (c)	8,673	38%	6,294	55%	4,056
Total Mac net sales	14,276	38%	10,314	40%	7,375
iPod	9,153	10%	8,305	8%	7,676
Other music related products and services (d)	3,340	34%	2,496	32%	1,885
iPhone and related products and services (e)	1,844	NM	123	NM	—
Peripherals and other hardware (f)	1,659	32%	1,260	15%	1,100
Software, service, and other sales (g)	2,207	46%	1,508	18%	1,279
Total net sales	$ 32,479	35%	$ 24,006	24%	$ 19,315
Unit Sales by Product:					
Desktops (b)	3,712	37%	2,714	12%	2,434
Portables (c)	6,003	38%	4,337	51%	2,869
Total Mac unit sales	9,715	38%	7,051	33%	5,303
Net sales per Mac unit sold (h)	$ 1,469	—%	$ 1,463	5%	$ 1,391
iPod unit sales	54,828	6%	51,630	31%	39,409
Net sales per iPod unit sold (i)	$ 167	4%	$ 161	(17)%	$ 195
iPhone unit sales	11,627	NM	1,389	NM	—

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(a) Other Segments include Asia Pacific and FileMaker.
(b) Includes iMac, Mac mini, Mac Pro, Power Mac, and Xserve product lines.
(c) Includes MacBook, iBook, MacBook Air, MacBook Pro, and PowerBook product lines.
(d) Consists of iTunes Store sales, iPod services, and Apple-branded and third-party iPod accessories.
(e) Derived from handset sales, carrier agreements, and Apple-branded and third-party iPhone accessories.
(f) Includes sales of Apple-branded and third-party displays, wireless connectivity and networking solutions, and other hardware accessories.
(g) Includes sales of Apple-branded operating system and application software, third-party software, AppleCare, and Internet services.
(h) Derived by dividing total Mac net sales by total Mac unit sales.
(i) Derived by dividing total iPod net sales by total iPod unit sales.
NM = Not Meaningful

Fiscal Year 2008 versus 2007

Net sales during 2008 increased 35% or $8.5 billion from 2007. Several factors contributed to these increases including the following:

- Mac net sales increased $4.0 billion or 38% during 2008 compared to 2007, while Mac unit sales increased by 2.7 million units or 38%. Net sales related to the Company's Mac shipments accounted for 44% of the Company's total net revenue. Higher Mac unit sales, which contributed to the increases in net sales, were driven by higher sales of all of the Company's portable products as well as the popularity of the iMac, which experienced strong growth in net sales and unit sales in all of the Company's reportable segments. Unit sales of the Company's portable products accounted for 62% of the Company's personal computer shipments in both 2008 and 2007. Net sales and unit sales of the Company's portable products both increased by 38% during 2008 compared to 2007. This growth was attributable to strong demand for all the portable products, particularly the MacBook, which had double-digit growth in all of the Company's operating segments, and the addition of the MacBook Air, which was introduced to the Company's portable product line in January 2008. Growth of the Company's desktop systems was also strong, with increased net sales and unit sales of 39% and 37%, respectively, during 2008 due primarily to strong sales of the iMac in all of the Company's operating segments.
- Net sales of iPods increased $848 million or 10% during 2008 compared to 2007 whereas unit sales of iPods increased 6% compared to 2007. The iPod unit growth was due to strong demand for the iPod touch, and to a lesser extent, higher unit sales of the iPod shuffle due to a price reduction in February 2008. iPod net sales grew faster than iPod unit sales due to higher average selling prices caused by a shift in overall iPod product mix to the higher priced iPod touch.
- Net sales of iPhone and related products and services were $1.8 billion for 2008, with iPhone handset unit sales totaling 11.6 million. During 2008, sales of iPhone expanded beyond the U.S. and the Company expects to be shipping iPhones in over 70 countries by the end of December 2008. Net sales of iPhone and related products and services were $123 million in 2007, which represented sales for one fiscal quarter. iPhone net sales include the portion of handset revenue recognized in accordance with subscription accounting over the product's 24-month estimated economic life, as well as revenue from sales of iPhone accessories and from carrier agreements.
- Net sales of other music related products and services increased $844 million or 34% during the 2008 compared to 2007, due primarily to significantly increased net sales from the iTunes Store in each of the Company's geographic segments. The Company believes this success is the result of heightened consumer interest in downloading third-party digital content, the expansion of third-party audio and video content available for sale and rent via the iTunes Store, and the launch of the iTunes App Store. The Company continues to expand its iTunes content offerings around the world.
- Net sales of peripherals and other hardware increased $399 million or 32% compared to 2007 due to an increase in wireless networking products and other hardware accessories, including printers and scanners, which was partially offset by a decrease in net sales of displays.

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- Net sales of software, service, and other sales rose $699 million or 46% during 2008 compared to 2007. This growth was due in large part to increased sales of Apple-branded and third-party developers' software products and increased net sales of AppleCare Protection Plan ("APP") extended service and support contracts.

Fiscal Year 2007 versus 2006
Net sales during 2007 increased 24% or $4.7 billion from 2006 even though fiscal year 2007 spanned 52 weeks while fiscal year 2006 spanned 53 weeks. Several factors contributed to these increases including the following:

- Mac net sales increased $3 billion or 40% during 2007 compared to 2006, while Mac unit sales increased by 1.75 million units or 33%. The 33% Mac unit sales growth rate is significantly greater than the estimated growth rate of the overall personal computer industry during that timeframe. Unit sales of the Company's portable products accounted for 62% of the Company's personal computer shipments in 2007, up from 54% in 2006. Net sales and unit sales of the Company's portable products increased 55% and 51%, respectively, during 2007 compared to 2006. This growth was due to strong demand for the MacBook, which increased in each of the Company's operating segments, as well as the MacBook Pro, which increased in each operating segment except Japan. Mac desktop net sales and unit sales increased by 21% and 12%, respectively, during 2007 due to stronger sales of the iMac in each of the Company's operating segments. The Mac desktop net sales growth was greater than the unit sales growth due primarily to a shift in desktop product mix away from the lower-price Mac Mini and discontinued eMac and toward the iMac.
- Net sales of iPods increased $629 million or 8% during 2007 compared to 2006. Unit sales of iPods increased 31% compared to 2006. The iPod growth was driven primarily by increased sales of the iPod shuffle and iPod nano particularly in international markets. iPod unit sales growth was significantly greater than iPod net sales due to a shift in overall iPod product mix, as well as due to lower selling prices for the iPod classic, iPod nano and iPod shuffle in 2007 compared to 2006.
- Net sales of iPhone and related products and services were $123 million in 2007. iPhone net sales include the portion of iPhone handset revenue recognized in accordance with subscription accounting over the product's 24-month estimated economic life, as well as sales of iPhone accessory products and revenue from carrier agreements. iPhone unit sales were 1.39 million in 2007.
- Net sales of other music related products and services increased $611 million or 32% during 2007 compared to 2006 due to increased net sales from the iTunes Store. The Company believes this growth was the result of heightened consumer interest in downloading digital content and the expansion of third-party audio and video content available for sale via the iTunes Store.
- Net sales of peripherals and other hardware increased $160 million or 15% compared to 2006 due to an increase in wireless networking products and other hardware accessories, including printers and scanners, which was partially offset by a decrease in net sales of displays.
- Net sales of software, service, and other sales rose $229 million or 18% during 2007 compared to 2006. This growth was attributable primarily to increased net sales of APP extended service and support contracts and increased sales of Apple branded and third-party developers' software products.

Segment Operating Performance
The Company manages its business primarily on a geographic basis. The Company's reportable operating segments consist of the Americas, Europe, Japan, and Retail. The Americas, Europe, and Japan reportable segments do not include activities related to the Retail segment. The Americas segment includes both North and South America. The Europe segment includes European countries as well as the Middle East and Africa. The Retail segment operates Apple-owned retail stores in the U.S. and in international markets. Each reportable geographic operating segment and the Retail operating segment provide similar hardware and software products and similar services. Further information regarding the Company's operating segments may be found in Note 9, "Segment Information and Geographic Data" in Notes to Consolidated Financial Statements of this Form 10-K.

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Americas
During 2008, net sales in the Americas segment increased $3.0 billion or 26% compared to 2007. The primary drivers of this growth were the significant year-over-year increase in sales of the iPod touch, Mac portable systems, content from the iTunes Store, and iPhone. The Company began shipping iPhone in June 2007 and the growth in iPhone sales in 2008 resulted from a full year of iPhone shipments. The increase in Mac net sales of $1.3 billion or 30% and Mac unit sales of 961 million or 32% is attributable to growth in all of the Mac portable systems, particularly the MacBook, and higher sales of the iMac. Net sales of iPods increased due to a shift in product mix toward higher priced iPods, particularly the iPod touch, which was upgraded in June 2008. In 2008, the Americas segment represented 45% of the Company's total net sales as compared to 48% in the same period of 2007. During 2008, U.S. education channel net sales and Mac unit sales increased by 14% and 19%, respectively, compared to 2007. Net sales from the higher education market grew 15% during 2008 compared to 2007, while net sales in the K-12 market grew 12% during the same period.

During 2007, net sales in the Americas segment increased $2.2 billion, or 23%, compared to 2006. The main sources of this growth were Mac portable products, iMacs, iPods, and the sales of third-party content from the iTunes Store. Sales of Mac portable products increased due to the popularity of the MacBook, introduced in May 2006 and updated in May 2007, as well as the MacBook Pro, introduced in January 2006 and updated in June 2007. Sales of iMacs grew due to a shift in desktop product mix away from the Mac mini and discontinued eMac as well as the strong reception of the new iMac introduced in August 2007. Sales of iPods grew due to increased demand for the iPod nano and iPod shuffle and the introduction of the iPod touch in September 2007. During 2007, the Americas segment represented 48% of the Company's total net sales as compared to 49% in the same period of 2006. During 2007, U.S. education channel net sales and Mac unit sales increased by 14% and 18%, respectively, compared to 2006. Net sales from the higher education market grew 17% during 2007 compared to 2006, while net sales in the K-12 market grew 10% during the same period.

Europe
For 2008, net sales and unit sales in Europe increased 40% and 39%, respectively, compared to the same period in 2007. The main drivers of this growth were strong sales of Mac portable systems and iMac, increased sales from the iTunes Store, and iPhone. Also contributing to the increase in net sales were higher iPod net sales due primarily to the iPod touch, which was upgraded in June 2008. Sales of Mac portable products increased due to the MacBook Pro and the MacBook, both updated in February 2008, as well as the MacBook Air, introduced in January 2008. Mac desktop sales also increased due primarily to the popularity of the iMac, which was updated in April 2008. Sales from the iTunes Store grew substantially by 79% from 2007 as a result of heightened consumer interest in downloading digital content and the expansion of third-party audio and video content available for sale via the iTunes Store. The Europe segment represented 23% of total net sales in 2008, consistent with 2007.

Europe segment net sales increased $1.4 billion or 33% during 2007 compared to 2006. Consistent with the Americas segment, the primary drivers of this growth were Mac portable products, iMacs, iPods, and the sales of third-party content from the iTunes Store. Sales of Mac portable products increased due to the popularity of both the MacBook and MacBook Pro. Sales of iMacs grew due to a shift in desktop product mix away from the Mac mini and discontinued eMac as well as the strong reception of the new iMac introduced in August 2007. Sales of iPods grew due primarily to increased demand for the iPod nano and iPod shuffle. The Company believes that the growth in iTunes Store sales was the result of heightened consumer interest in downloading digital content and the expansion of third-party audio and video content available for sale via the iTunes Store.

Japan
Japan net sales increased $427 million or 39% in 2008 compared to 2007. The primary contributors to the growth in net sales were increases in sales of iPods, iMac, Mac portable systems, and strong sales from the iTunes Store. Net sales, unit sales and the average selling price of iPods increased during 2008 compared to 2007, driven by strong demand for iPod touch and iPod nano. Additionally, Mac net sales and unit sales grew 42% and 29%, respectively, in 2008 compared to 2007 due to increase in sales of the iMac and Mac portable systems, particularly MacBook, as well as the introduction of MacBook Air in January 2008.

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Japan's net sales declined by $129 million or 11% in 2007 compared to 2006. Total Mac unit sales in Japan declined 1% during 2007. The decrease in the Japan segment's overall net sales was attributable primarily to decreases in iPod and Mac desktop sales, partially offset by an increase in revenue from MacBooks and sales of third-party content from the iTunes Store. The decline in net sales and Mac unit sales is partially attributable to Japan's declining consumer PC market, and the iPod sales decline is due primarily to lower average selling prices. The Company is continuing to evaluate ways to improve the future results of its Japan segment.

Retail

Retail net sales grew by 53% during 2008 compared to 2007, due in large part to increased sales of Mac portable and desktop products, strong demand for the iPhone and iPod touch, and new store openings. The Company opened 50 new retail stores during 2008, including a total of 19 international stores, bringing the total number of open stores to 247 as of September 27, 2008. This compares to 197 open stores as of September 29, 2007 and 165 open stores as of September 30, 2006. With an average of 211 stores and 178 stores opened during 2008 and 2007, respectively, average revenue per store increased to $29.9 million for 2008, compared to $23.1 million in 2007.

Retail Mac net sales and Mac unit sales grew by 42% and 47%, respectively, during 2008 compared to the 2007, due primarily to strong demand for MacBook, iMac, and MacBook Air, introduced in January 2008. Net sales of iPods increased due to the popularity of the iPod touch, which was upgraded in June 2008, and a higher average selling price compared to 2007. The higher iPod average selling price was due to strong demand for the iPod touch.

The Retail segment's net sales increased by 27% to $4.1 billion during 2007 compared to 2006. Retail segment Mac unit sales increased 56% during 2007 as compared to 2006. With an average of 178 stores open during 2007, average revenue per store was $23.1 million, compared to $22.9 million in 2006. The increase in Retail segment net sales during 2007 compared to 2006 was due primarily to stronger sales of Mac portable products, iMacs, accessories and services. The increase was partially offset primarily by lower net sales of iPods and other music related products due to the expanded availability of those products through third-party resellers.

As measured by the Company's operating segment reporting, the Retail segment reported operating income of $1.3 billion during 2008 as compared to operating income of $875 million and $600 million during 2007 and 2006, respectively. This improvement in 2008 was attributable primarily to the significant Retail net sales growth of 53% as compared to 2007.

Expansion of the Retail segment has required and will continue to require a substantial investment in fixed assets and related infrastructure, operating lease commitments, personnel, and other operating expenses. Capital asset purchases associated with the Retail segment were $389 million in 2008, bringing the total capital asset purchases since inception of the Retail segment to $1.4 billion. As of September 27, 2008, the Retail segment had approximately 15,900 full-time equivalent employees and had outstanding operating lease commitments associated with retail store space and related facilities of $1.4 billion. The Company would incur substantial costs if it were to close multiple retail stores. Such costs could adversely affect the Company's financial condition and operating results.

Other Segments

The Company's Other Segments, which consist of its Asia Pacific and FileMaker operations, experienced an increase in net sales of $707 million, or 40% during 2008 as compared to 2007. These increases are related primarily to strong growth in sales of all Mac portable systems, iPods, the iMac, and content from the iTunes Store in the Company's Asia Pacific region. Sales from the iTunes Store in the Company's Asia Pacific region grew significantly by 109% over 2007. Mac net sales and unit sales grew by 52% and 50%, respectively, due to increased sales of the iMac and all Mac portables.

The Company's Other Segments experienced an increase in net sales of $406 million, or 30% during 2007 compared to 2006. This increase related primarily to a 58% increase in sales of Mac portable products and strong iPod sales in the Company's Asia Pacific region.

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Gross Margin

Gross margin for the three fiscal years ended September 27, 2008, are as follows (in millions, except gross margin percentages):

	2008	2007	2006
Net sales	$ 32,479	$ 24,006	$ 19,315
Cost of sales	21,334	15,852	13,717
Gross margin	$ 11,145	$ 8,154	$ 5,598
Gross margin percentage	34.3%	34.0%	29.0%

Gross margin percentage was relatively flat in 2008 as compared to 2007. Gross margin percentage of 34.0% in 2007 increased significantly from 29.0% in 2006. The primary drivers of this increase were more favorable costs on certain commodity components, including NAND flash memory and DRAM memory, higher overall revenue that provided for more leverage on fixed production costs and a higher percentage of revenue from the Company's direct sales channels.

The Company expects its gross margin percentage to decrease in future periods compared to levels achieved during 2008 and 2007, and anticipates gross margin levels of about 30% in 2009. This expected decline is due largely to the anticipated impact of product transitions, flat or reduced pricing on new and innovative products that have higher cost structures, both expected and potential future cost increases for key components, a stronger U.S. dollar, and higher logistical costs.

The foregoing statements regarding the Company's expected gross margin percentage are forward-looking and could differ from anticipated levels because of several factors, including but not limited to certain of those set forth below in Part I, Item 1A, "Risk Factors" under the subheading "*Future operating results depend upon the Company's ability to obtain key components including, but not limited to microprocessors, NAND flash memory, DRAM and LCDs at favorable prices and in sufficient quantities*," which is incorporated herein by reference. There can be no assurance that targeted gross margin percentage levels will be achieved. In general, gross margins and margins on individual products will remain under downward pressure due to a variety of factors, including continued industry wide global product pricing pressures, increased competition, compressed product life cycles, product transitions and expected increases in the cost of key components including, but not limited to microprocessors, NAND flash memory, dynamic random access memory ("DRAM") and liquid crystal displays ("LCDs"), as well as potential increases in the costs of outside manufacturing services and a potential shift in the Company's sales mix towards products with lower gross margins. In response to these competitive pressures, the Company expects it will continue to take product pricing actions, which would adversely affect gross margins. Gross margins could also be affected by the Company's ability to manage product quality and warranty costs effectively and to stimulate demand for certain of its products. Due to the Company's significant international operations, financial results can be significantly affected in the short-term by fluctuations in exchange rates.

Operating Expenses

Operating expenses for the three fiscal years ended September 27, 2008, are as follows (in millions, except for percentages):

	2008	2007	2006
Research and development	$ 1,109	$ 782	$ 712
Percentage of net sales	3.4%	3.3%	3.7%
Selling, general, and administrative	$ 3,761	$ 2,963	$ 2,433
Percentage of net sales	11.6%	12.3%	12.6%

Research and Development ("R&D")

Expenditures for R&D increased 42% or $327 million to $1.1 billion in 2008 compared to 2007. These increases were due primarily to an increase in R&D headcount in the current year to support expanded R&D activities and higher stock-based compensation expenses. In 2008, $11 million of software development costs were capitalized

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related to Mac OS X Version 10.6 Snow Leopard and excluded from R&D expense, while R&D expense for 2007 excluded $75 million of capitalized software development costs related to Mac OS X Leopard and iPhone. Although total R&D expense increased 42% during 2008, it remained relatively flat as a percentage of net sales given the 35% increase in revenue during 2008. The Company continues to believe that focused investments in R&D are critical to its future growth and competitive position in the marketplace and are directly related to timely development of new and enhanced products that are central to the Company's core business strategy. As such, the Company expects to increase spending in R&D to remain competitive.

Expenditures for R&D increased 10% or $70 million to $782 million in 2007 compared to 2006. The increases in R&D expense were due primarily to an increase in R&D headcount in 2007 to support expanded R&D activities, partially offset by one less week of expenses in the first quarter of 2007 and the capitalized software development costs mentioned above.

Selling, General, and Administrative Expense ("SG&A")
Expenditures for SG&A increased $798 million or 27% to $3.8 billion in 2008 compared to 2007. These increases are due primarily to higher stock-based compensation expenses, higher variable selling expenses resulting from the significant year-over-year increase in total net sales and the Company's continued expansion of its Retail segment in both domestic and international markets. In addition, the Company incurred higher spending on marketing and advertising during 2008 compared to 2007.

Expenditures for SG&A increased $530 million or 22% during 2007 compared to 2006. The increase was due primarily to higher direct and indirect channel variable selling expenses resulting from the significant year-over-year increase in total net sales in 2007, the Company's continued expansion of its Retail segment in both domestic and international markets, and higher spending on marketing and advertising, partially offset by one less week of expenses in the first quarter of 2007.

Other Income and Expense
Other income and expense for the three fiscal years ended September 27, 2008, are as follows (in millions):

	2008	2007	2006
Interest income	$ 653	$ 647	$ 394
Other income (expense), net	(33)	(48)	(29)
Total other income and expense	$ 620	$ 599	$ 365

Total other income and expense increased $21 million to $620 million during 2008 as compared to $599 million and $365 million in 2007 and 2006, respectively. While the Company's cash, cash equivalents and short-term investment balances increased by 59% in 2008, other income and expense increased only 4% due to the decline in the weighted average interest rate earned of 3.44%. The overall increase in other income and expense is attributable to the Company's higher cash and short-term investment balances, which more than offset the decline in interest rates during 2008 as compared to 2007. The weighted average interest rate earned by the Company on its cash, cash equivalents, and short-term investments was 5.27% and 4.58% during 2007 and 2006, respectively. During 2008, 2007 and 2006, the Company had no debt outstanding and accordingly did not incur any related interest expense.

Provision for Income Taxes
The Company's effective tax rates were 30% for the years ended September 27, 2008 and September 29, 2007, and 29% for the year ended September 30, 2006. The Company's effective rates differ from the statutory federal income tax rate of 35% due primarily to certain undistributed foreign earnings for which no U.S. taxes are provided because such earnings are intended to be indefinitely reinvested outside the U.S.

As of September 27, 2008, the Company had deferred tax assets arising from deductible temporary differences, tax losses, and tax credits of $2.1 billion before being offset against certain deferred liabilities for presentation on the Company's balance sheet. Management believes it is more likely than not that forecasted income, including

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income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets. The Company released a valuation allowance of $5 million since it has been determined that it is more likely than not the associated deferred tax assets will be realized. The Company will continue to evaluate the realizability of deferred tax assets quarterly by assessing the need for and amount of the valuation allowance.

The Internal Revenue Service (the "IRS") has completed its field audit of the Company's federal income tax returns for the years 2002 through 2003 and proposed certain adjustments. The Company has contested certain of these adjustments through the IRS Appeals Office. All IRS audit issues for years prior to 2002 have been resolved. In addition, the Company is subject to audits by state, local, and foreign tax authorities. Management believes that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, *Fair Value Measurements,* which defines fair value, provides a framework for measuring fair value, and expands the disclosures required for fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require fair value measurements; it does not require any new fair value measurements. In February 2008, the FASB issued FASB Staff Position ("FSP") No. FAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13* and FSP No. FAS 157-2, *Effective Date of FASB Statement No. 157.* FSP 157-1 amends SFAS No. 157 to remove certain leasing transactions from its scope. FSP 157-2 delays the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) and will be adopted by the Company beginning in the first quarter of fiscal 2010. In October 2008, the FASB issued FSP No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*, to clarify the application of SFAS 157 in inactive markets for financial assets. FSP 157-3 became effective upon issuance and SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and will be adopted by the Company beginning in the first quarter of fiscal 2009. Although the Company will continue to evaluate the application of SFAS No. 157, management does not currently believe adoption will have a material impact on the Company's financial condition or operating results.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—including an amendment of FASB Statement No. 115.* SFAS No. 159 allows companies to choose to measure eligible financial instruments and certain other items at fair value that are not required to be measured at fair value. SFAS No. 159 requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings at each reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 and will be adopted by the Company beginning in the first quarter of fiscal 2009. Although the Company will continue to evaluate the application of SFAS No. 159, management does not currently believe adoption will have a material impact on the Company's financial condition or operating results.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations*, which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree in a business combination. SFAS No. 141R also establishes principles around how goodwill acquired in a business combination or a gain from a bargain purchase should be recognized and measured, as well as provides guidelines on the disclosure requirements on the nature and financial impact of the business combination. SFAS No. 141R is effective for fiscal years beginning on or after December 15, 2008 and will be adopted by the Company beginning in the first quarter of fiscal 2010. Although the Company will continue to evaluate the application of SFAS No. 141R, management does not currently believe adoption will have a material impact on the Company's financial condition or operating results.

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In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133,* which requires companies to provide additional disclosures about its objectives and strategies for using derivative instruments, how the derivative instruments and related hedged items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and related interpretations, and how the derivative instruments and related hedged items affect the Company's financial statements. SFAS No. 161 also requires companies to disclose information about credit risk-related contingent features in their hedged positions. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008 and is required to be adopted by the Company beginning in the second quarter of fiscal 2009. Although the Company will continue to evaluate the application of SFAS No. 161, management does not currently believe adoption will have a material impact on the Company's financial condition or operating results.

Liquidity and Capital Resources

The following table presents selected financial information and statistics as of and for the three fiscal years ended September 27, 2008 (in millions):

	2008	2007	2006
Cash, cash equivalents, and short-term investments	$ 24,490	$ 15,386	$ 10,110
Accounts receivable, net	$ 2,422	$ 1,637	$ 1,252
Inventory	$ 509	$ 346	$ 270
Working capital	$ 20,598	$ 12,676	$ 8,066
Annual operating cash flow	$ 9,596	$ 5,470	$ 2,220

As of September 27, 2008, the Company had $24.5 billion in cash, cash equivalents, and short-term investments, an increase of $9.1 billion from September 29, 2007. The principal components of this net increase were cash generated by operating activities of $9.6 billion, proceeds from the issuance of common stock under stock plans of $483 million and excess tax benefits from stock-based compensation of $757 million. These increases were partially offset by payments for acquisitions of property, plant, and equipment of $1.1 billion, payments made in connection with business acquisitions, net of cash acquired, of $220 million and payments for acquisitions of intangible assets of $108 million. The Company's cash generated by operating activities significantly exceeded its net income due primarily to the large increase in deferred revenue, net of deferred costs, associated with subscription accounting for iPhone.

The Company's short-term investment portfolio is invested primarily in highly rated securities with a minimum rating of single-A. As of September 27, 2008 and September 29, 2007, $11.3 billion and $6.5 billion, respectively, of the Company's cash, cash equivalents, and short-term investments were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. The Company had $117 million in net unrealized losses on its investment portfolio, primarily related to investments with stated maturities ranging from one to five years, as of September 27, 2008, and net unrealized losses of approximately $11 million on its investment portfolio, primarily related to investments with stated maturities from one to five years, as of September 29, 2007. The Company has the intent and ability to hold such investments for a sufficient period of time to allow for recovery of the principal amounts invested. Accordingly, none of these declines in fair value were recognized in the Company's Statement of Operations.

The Company believes its existing balances of cash, cash equivalents, and short-term investments will be sufficient to satisfy its working capital needs, capital expenditures, outstanding commitments, and other liquidity requirements associated with its existing operations over the next 12 months.

Capital Assets

The Company's cash payments for capital asset purchases were $1.1 billion during 2008, consisting of $389 million for retail store facilities and $702 million for real estate acquisitions and corporate infrastructure including information systems enhancements. The Company anticipates utilizing approximately $1.5 billion for capital asset purchases during 2009, including approximately $400 million for Retail facilities and approximately $1.1 billion for corporate facilities and infrastructure.

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Off-Balance Sheet Arrangements and Contractual Obligations

The Company has not entered into any transactions with unconsolidated entities whereby the Company has financial guarantees, subordinated retained interests, derivative instruments, or other contingent arrangements that expose the Company to material continuing risks, contingent liabilities, or any other obligation under a variable interest in an unconsolidated entity that provides financing, liquidity, market risk, or credit risk support to the Company.

The following table presents certain payments due by the Company under contractual obligations with minimum firm commitments as of September 27, 2008 and excludes amounts already recorded on the Company's balance sheet as current liabilities (in millions):

	Total	Payments Due in Less Than 1 Year	Payments Due in 1-3 Years	Payments Due in 4-5 Years	Payments Due in More Than 5 Years
Operating leases	$ 1,760	$ 195	$ 409	$ 368	$ 788
Purchase obligations	5,378	5,378	—	—	—
Asset retirement obligations	28	—	8	7	13
Other obligations	471	242	124	105	—
Total	$ 7,637	$ 5,815	$ 541	$ 480	$ 801

Lease Commitments

As of September 27, 2008, the Company had total outstanding commitments on noncancelable operating leases of $1.8 billion, $1.4 billion of which related to the lease of retail space and related facilities. The Company's major facility leases are generally for terms of 3 to 20 years and generally provide renewal options for terms of 1 to 5 additional years. Leases for retail space are for terms of 5 to 20 years, the majority of which are for 10 years, and often contain multi-year renewal options.

Purchase Commitments with Contract Manufacturers and Component Suppliers

The Company utilizes several contract manufacturers to manufacture sub-assemblies for the Company's products and to perform final assembly and test of finished products. These contract manufacturers acquire components and build product based on demand information supplied by the Company, which typically covers periods ranging from 30 to 150 days. The Company also obtains individual components for its products from a wide variety of individual suppliers. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. Such purchase commitments typically cover the Company's forecasted component and manufacturing requirements for periods ranging from 30 to 150 days. In addition, the Company has an off-balance sheet warranty obligation for products accounted for under subscription accounting pursuant to SOP No. 97-2 whereby the Company recognizes warranty expense as incurred. As of September 27, 2008, the Company had outstanding off-balance sheet third-party manufacturing commitments, component purchase commitments, and estimated warranty commitments of $5.4 billion.

During 2006, the Company entered into long-term supply agreements with Hynix Semiconductor, Inc., Intel Corporation, Micron Technology, Inc., Samsung Electronics Co., Ltd., and Toshiba Corporation to secure supply of NAND flash memory through calendar year 2010. As part of these agreements, the Company prepaid $1.25 billion for flash memory components during 2006, which will be applied to certain inventory purchases made over the life of each respective agreement. The Company utilized $567 million of the prepayment as of September 27, 2008.

Asset Retirement Obligations

The Company's asset retirement obligations are associated with commitments to return property subject to operating leases to original condition upon lease termination. As of September 27, 2008, the Company estimated that gross expected future cash flows of $28 million would be required to fulfill these obligations.

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Other Obligations
Other outstanding obligations were $471 million as of September 27, 2008, which related to advertising, research and development, Internet and telecommunications services, and other obligations.

During the first quarter of 2008, the Company adopted the provisions of FIN 48. The Company had historically classified interest and penalties and unrecognized tax benefits as current liabilities, but beginning with the adoption of FIN 48 the Company has reclassified gross interest and penalties and unrecognized tax benefits that are not expected to result in payment or receipt of cash within one year as non-current liabilities within the Consolidated Balance Sheet. As of September 27, 2008, the Company recorded gross unrecognized tax benefits of $506 million and gross interest and penalties of $219 million, both of which are classified as non-current liabilities in the Consolidated Balance Sheet. At this time, the Company is unable to make a reasonably reliable estimate of the timing of payments in individual years due to uncertainties in the timing of tax audit outcomes; therefore, such amounts are not included in the above contractual obligation table.

Indemnifications
The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against it or an indemnified third-party and, in the opinion of management, does not have a liability related to unresolved infringement claims subject to indemnification that would have a material adverse effect on its financial condition or operating results. Therefore, the Company did not record a liability for infringement costs as of either September 27, 2008 or September 29, 2007.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate and Foreign Currency Risk Management
The Company regularly reviews its foreign exchange forward and option positions, both on a stand-alone basis and in conjunction with its underlying foreign currency and interest rate related exposures. However, given the effective horizons of the Company's risk management activities and the anticipatory nature of the exposures, there can be no assurance the hedges will offset more than a portion of the financial impact resulting from movements in either foreign exchange or interest rates. In addition, the timing of the accounting for recognition of gains and losses related to mark-to-market instruments for any given period may not coincide with the timing of gains and losses related to the underlying economic exposures and, therefore, may adversely affect the Company's financial condition and operating results.

Interest Rate Risk
While the Company is exposed to interest rate fluctuations in many of the world's leading industrialized countries, the Company's interest income and expense is most sensitive to fluctuations in the general level of U.S. interest rates. As such, changes in U.S. interest rates affect the interest earned on the Company's cash, cash equivalents, and short-term investments, the value of those investments, as well as costs associated with foreign currency hedges.

The Company's short-term investment policy and strategy attempts primarily to preserve capital and meet liquidity requirements. A portion of the Company's cash is managed by external managers within the guidelines of the Company's investment policy and to an objective market benchmark. The Company's internal portfolio is benchmarked against external manager performance, allowing for differences in liquidity needs.

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's investment portfolio. The Company typically invests in highly rated securities and its policy generally limits the amount of credit exposure to any one issuer. The Company's investment policy requires investments to be rated single-A or better with the objective of minimizing the potential risk of principal loss. All highly liquid investments with initial maturities of three months or less at the date of purchase are classified as cash

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equivalents, while highly liquid investments with initial maturities greater than three months at the date of purchase are classified as short-term investments. As of September 27, 2008 and September 29, 2007, approximately \$2.4 billion and \$1.9 billion, respectively, of the Company's short-term investments had underlying maturities ranging from one to five years. The remainder all had underlying maturities of less than 12 months. The Company may sell its investments prior to their stated maturities for strategic purposes, in anticipation of credit deterioration, or for duration management. The Company recognized no material net gains or losses during 2008, 2007 and 2006 related to such sales.

To provide a meaningful assessment of the interest rate risk associated with the Company's investment portfolio, the Company performed a sensitivity analysis to determine the impact a change in interest rates would have on the value of the investment portfolio assuming a 100 basis point parallel shift in the yield curve. Based on investment positions as of September 27, 2008, a hypothetical 100 basis point increase in interest rates across all maturities would result in a \$46 million incremental decline in the fair market value of the portfolio. As of September 29, 2007, a similar 100 basis point shift in the yield curve would have resulted in a \$16 million incremental decline in the fair market value of the portfolio. Such losses would only be realized if the Company sold the investments prior to maturity.

Foreign Currency Risk
In general, the Company is a net receiver of currencies other than the U.S. dollar. Accordingly, changes in exchange rates, and in particular a strengthening of the U.S. dollar, will negatively affect the Company's net sales and gross margins as expressed in U.S. dollars. There is also a risk that the Company will have to adjust local currency product pricing due to competitive pressures when there has been significant volatility in foreign currency exchange rates.

The Company may enter into foreign currency forward and option contracts with financial institutions to protect against foreign exchange risks associated with existing assets and liabilities, certain firmly committed transactions, forecasted future cash flows, and net investments in foreign subsidiaries. Generally, the Company's practice is to hedge a majority of its material foreign exchange exposures, typically for three to six months. However, the Company may choose not to hedge certain foreign exchange exposures due to immateriality, prohibitive economic cost of hedging particular exposures, and limited availability of appropriate hedging instruments.

To provide a meaningful assessment of the foreign currency risk associated with certain of the Company's foreign currency derivative positions, the Company performed a sensitivity analysis using a value-at-risk ("VAR") model to assess the potential impact of fluctuations in exchange rates. The VAR model consisted of using a Monte Carlo simulation to generate 3,000 random market price paths. The VAR is the maximum expected loss in fair value, for a given confidence interval, to the Company's foreign exchange portfolio due to adverse movements in rates. The VAR model is not intended to represent actual losses but is used as a risk estimation and management tool. The model assumes normal market conditions. Forecasted transactions, firm commitments, and assets and liabilities denominated in foreign currencies were excluded from the model. Based on the results of the model, the Company estimates with 95% confidence a maximum one-day loss in fair value of \$60 million as of September 27, 2008 compared to a maximum one-day loss in fair value of \$13 million as of September 29, 2007. Because the Company uses foreign currency instruments for hedging purposes, losses incurred on those instruments are generally offset by increases in the fair value of the underlying exposures.

Actual future gains and losses associated with the Company's investment portfolio and derivative positions may differ materially from the sensitivity analyses performed as of September 27, 2008 due to the inherent limitations associated with predicting the changes in the timing and amount of interest rates, foreign currency exchanges rates, and the Company's actual exposures and positions.

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Item 8. Financial Statements and Supplementary Data

All financial statement schedules have been omitted, since the required information is not applicable or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Consolidated Financial Statements and Notes thereto.

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CONSOLIDATED BALANCE SHEETS
(In millions, except share amounts)

	September 27, 2008	September 29, 2007
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 11,875	$ 9,352
Short-term investments	12,615	6,034
Accounts receivable, less allowances of $47 in each period	2,422	1,637
Inventories	509	346
Deferred tax assets	1,447	782
Other current assets	5,822	3,805
Total current assets	34,690	21,956
Property, plant, and equipment, net	2,455	1,832
Goodwill	207	38
Acquired intangible assets, net	285	299
Other assets	1,935	1,222
Total assets	$ 39,572	$ 25,347
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	$ 5,520	$ 4,970
Accrued expenses	8,572	4,310
Total current liabilities	14,092	9,280
Non-current liabilities	4,450	1,535
Total liabilities	18,542	10,815
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value; 1,800,000,000 shares authorized; 888,325,973 and 872,328,972 shares issued and outstanding, respectively	7,177	5,368
Retained earnings	13,845	9,101
Accumulated other comprehensive income	8	63
Total shareholders' equity	21,030	14,532
Total liabilities and shareholders' equity	$ 39,572	$ 25,347

See accompanying Notes to Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except share amounts which are reflected in thousands and per share amounts)

Three fiscal years ended September 27, 2008	2008	2007	2006
Net sales	$ 32,479	$ 24,006	$ 19,315
Cost of sales (1)	21,334	15,852	13,717
Gross margin	11,145	8,154	5,598
Operating expenses:			
Research and development (1)	1,109	782	712
Selling, general, and administrative (1)	3,761	2,963	2,433
Total operating expenses	4,870	3,745	3,145
Operating income	6,275	4,409	2,453
Other income and expense	620	599	365
Income before provision for income taxes	6,895	5,008	2,818
Provision for income taxes	2,061	1,512	829
Net income	$ 4,834	$ 3,496	$ 1,989
Earnings per common share:			
Basic	$ 5.48	$ 4.04	$ 2.36
Diluted	$ 5.36	$ 3.93	$ 2.27
Shares used in computing earnings per share:			
Basic	881,592	864,595	844,058
Diluted	902,139	889,292	877,526

(1) Includes stock-based compensation expense as follows:

Cost of sales	$ 80	$ 35	$ 21
Research and development	$ 185	$ 77	$ 53
Selling, general, and administrative	$ 251	$ 130	$ 89

See accompanying Notes to Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In millions, except share amounts which are reflected in thousands)

	Common Stock		Deferred Stock Compensation	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
	Shares	Amount				
Balances as of September 24, 2005	835,019	$ 3,564	$ (61)	$ 3,925	$ —	$ 7,428
Components of comprehensive income:						
Net income	—	—	—	1,989	—	1,989
Change in foreign currency translation	—	—	—	—	19	19
Change in unrealized gain on available-for-sale securities, net of tax	—	—	—	—	4	4
Change in unrealized gain on derivative instruments, net of tax	—	—	—	—	(1)	(1)
Total comprehensive income						2,011
Common stock repurchased	(4,574)	(48)	—	(307)	—	(355)
Stock-based compensation	—	163	—	—	—	163
Deferred compensation	—	(61)	61	—	—	—
Common stock issued under stock plans	24,818	318	—	—	—	318
Tax benefit from employee stock plan awards	—	419	—	—	—	419
Balances as of September 30, 2006	855,263	4,355	—	5,607	22	9,984
Components of comprehensive income:						
Net income	—	—	—	3,496	—	3,496
Change in foreign currency translation	—	—	—	—	51	51
Change in unrealized loss on available-for-sale securities, net of tax	—	—	—	—	(7)	(7)
Change in unrealized gain on derivative instruments, net of tax	—	—	—	—	(3)	(3)
Total comprehensive income						3,537
Stock-based compensation	—	251	—	—	—	251
Common stock issued under stock plans, net of shares withheld for employee taxes	17,066	364	—	(2)	—	362
Tax benefit from employee stock plan awards	—	398	—	—	—	398
Balances as of September 29, 2007	872,329	5,368	—	9,101	63	14,532
Cumulative effect of change in accounting principle	—	45	—	11	—	56
Components of comprehensive income:						
Net income	—	—	—	4,834		4,834
Change in foreign currency translation	—	—	—	—	(11)	(11)
Change in unrealized loss on available-for-sale securities, net of tax	—	—	—	—	(63)	(63)
Change in unrealized gain on derivative instruments, net of tax	—	—	—	—	19	19
Total comprehensive income						4,779
Stock-based compensation	—	513	—	—	—	513
Common stock issued under stock plans, net of shares withheld for employee taxes	15,888	460	—	(101)	—	359
Issuance of common stock in connection with an asset acquisition	109	21	—	—	—	21
Tax benefit from employee stock plan awards	—	770	—	—	—	770

Balances as of September 27, 2008	888,326	$ 7,177	$ —	$ 13,845	$ 8	$ 21,030

See accompanying Notes to Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)

Three fiscal years ended September 27, 2008	2008	2007	2006
Cash and cash equivalents, beginning of the year	$ 9,352	$ 6,392	$ 3,491
Operating Activities:			
Net income	4,834	3,496	1,989
Adjustments to reconcile net income to cash generated by operating activities:			
Depreciation, amortization and accretion	473	317	225
Stock-based compensation expense	516	242	163
Provision for deferred income taxes	(368)	78	53
Loss on disposition of property, plant, and equipment	22	12	15
Changes in operating assets and liabilities:			
Accounts receivable, net	(785)	(385)	(357)
Inventories	(163)	(76)	(105)
Other current assets	(1,958)	(1,540)	(1,626)
Other assets	(492)	81	(1,040)
Accounts payable	596	1,494	1,611
Deferred revenue	5,642	1,139	319
Other liabilities	1,279	612	973
Cash generated by operating activities	9,596	5,470	2,220
Investing Activities:			
Purchases of short-term investments	(22,965)	(11,719)	(7,255)
Proceeds from maturities of short-term investments	11,804	6,483	7,226
Proceeds from sales of short-term investments	4,439	2,941	1,086
Purchases of long-term investments	(38)	(17)	(25)
Payments made in connection with business acquisitions, net of cash acquired	(220)	—	—
Payment for acquisition of property, plant, and equipment	(1,091)	(735)	(657)
Payment for acquisition of intangible assets	(108)	(251)	(28)
Other	(10)	49	10
Cash (used in)/generated by investing activities	(8,189)	(3,249)	357
Financing Activities:			
Proceeds from issuance of common stock	483	365	318
Excess tax benefits from stock-based compensation	757	377	361
Cash used to net share settle equity awards	(124)	(3)	(355)
Cash generated by financing activities	1,116	739	324
Increase in cash and cash equivalents	2,523	2,960	2,901
Cash and cash equivalents, end of the year	$ 11,875	$ 9,352	$ 6,392
Supplemental cash flow disclosures:			
Cash paid for income taxes, net	$ 1,267	$ 863	$ 194

See accompanying Notes to Consolidated Financial Statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1—Summary of Significant Accounting Policies

Apple Inc. and its wholly-owned subsidiaries (collectively "Apple" or the "Company") design, manufacture, and market personal computers, portable digital music players, and mobile communication devices and sell a variety of related software, services, peripherals, and networking solutions. The Company sells its products worldwide through its online stores, its retail stores, its direct sales force, and third-party wholesalers, resellers, and value-added resellers. In addition, the Company sells a variety of third-party Mac, iPod and iPhone compatible products including application software, printers, storage devices, speakers, headphones, and various other accessories and supplies through its online and retail stores. The Company sells to consumer, small and mid-sized business ("SMB"), education, enterprise, government, and creative customers.

Basis of Presentation and Preparation

The accompanying Consolidated Financial Statements include the accounts of the Company. Intercompany accounts and transactions have been eliminated. The preparation of these Consolidated Financial Statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in these Consolidated Financial Statements and accompanying notes. Actual results could differ materially from those estimates. Certain prior year amounts in the Consolidated Financial Statements and notes thereto have been reclassified to conform to the current year presentation.

The Company's fiscal year is the 52 or 53-week period that ends on the last Saturday of September. The Company's first quarter of fiscal years 2008 and 2007 contained 13 weeks and the first quarter of fiscal year 2006 contained 14 weeks. The Company's fiscal years 2008 and 2007 ended on September 27, 2008 and September 29, 2007, respectively, included 52 weeks, while fiscal year 2006 ended on September 30, 2006 included 53 weeks. Unless otherwise stated, references to particular years or quarters refer to the Company's fiscal years ended in September and the associated quarters of those fiscal years.

Financial Instruments

Cash Equivalents and Short-term Investments

All highly liquid investments with maturities of three months or less at the date of purchase are classified as cash equivalents. Highly liquid investments with maturities greater than three months at the date of purchase are classified as short-term investments. The Company's debt and marketable equity securities have been classified and accounted for as available-for-sale. Management determines the appropriate classification of its investments in debt securities at the time of purchase and reevaluates the available-for-sale designations as of each balance sheet date. These securities are carried at fair value, with the unrealized gains and losses, net of taxes, reported as a component of shareholders' equity. The cost of securities sold is based upon the specific identification method.

Derivative Financial Instruments

The Company accounts for its derivative instruments as either assets or liabilities and carries them at fair value. Derivatives that are not defined as hedges in Statement of Financial Accounting Standards ("SFAS") No. 133, *Accounting for Derivative Instruments and Hedging Activities,* as amended, must be adjusted to fair value through earnings.

For derivative instruments that hedge the exposure to variability in expected future cash flows that are designated as cash flow hedges, the effective portion of the gain or loss on the derivative instrument is reported as a component of accumulated other comprehensive income in shareholders' equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of the gain or loss on the derivative instrument is recognized in current earnings. To receive hedge accounting treatment, cash flow hedges must be highly effective in offsetting changes to expected future cash flows on hedged transactions. For options designated as cash flow hedges, changes in the time value are excluded from the assessment of hedge effectiveness and are recognized in earnings. For derivative instruments that hedge the exposure to changes in the fair value of an asset or a liability and that are designated as fair value hedges, the net

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

gain or loss on the derivative instrument as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in earnings in the current period. The net gain or loss on the effective portion of a derivative instrument that is designated as an economic hedge of the foreign currency translation exposure of the net investment in a foreign operation is reported in the same manner as a foreign currency translation adjustment. For forward contracts designated as net investment hedges, the Company excludes changes in fair value relating to changes in the forward carry component from its definition of effectiveness. Accordingly, any gains or losses related to this component are recognized in current earnings.

Inventories

Inventories are stated at the lower of cost, computed using the first-in, first-out method, or market. If the cost of the inventories exceeds their market value, provisions are made currently for the difference between the cost and the market value. The Company's inventories consist primarily of finished goods for all periods presented.

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. Depreciation is computed by use of the straight-line method over the estimated useful lives of the assets, which for buildings is the lesser of 30 years or the remaining life of the underlying building, up to 5 years for equipment, and the shorter of lease terms or 10 years for leasehold improvements. The Company capitalizes eligible costs to acquire or develop internal-use software that are incurred subsequent to the preliminary project stage. Capitalized costs related to internal-use software are amortized using the straight-line method over the estimated useful lives of the assets, which range from 3 to 5 years. Depreciation and amortization expense on property and equipment was $363 million, $249 million, and $180 million during 2008, 2007, and 2006 respectively.

Asset Retirement Obligations

The Company records obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs in accordance with SFAS No. 143, *Accounting for Asset Retirement Obligations*. The Company reviews legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the assets. If it is determined that a legal obligation exists, the fair value of the liability for an asset retirement obligation is recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset and this additional carrying amount is depreciated over the life of the asset. The difference between the gross expected future cash flow and its present value is accreted over the life of the related lease as an operating expense. All of the Company's existing asset retirement obligations are associated with commitments to return property subject to operating leases to original condition upon lease termination. The Company's asset retirement liability was $21 million and $18 million as of September 27, 2008 and September 29, 2007, respectively.

Long-Lived Assets Including Goodwill and Other Acquired Intangible Assets

The Company reviews property, plant, and equipment and certain identifiable intangibles, excluding goodwill, for impairment in accordance with SFAS No. 144, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of.* Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of these assets is measured by comparison of its carrying amount to future undiscounted cash flows the assets are expected to generate. If property, plant, and equipment and certain identifiable intangibles are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the assets exceeds its fair market value. The Company did not record any material impairments during 2008, 2007, and 2006.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

SFAS No. 142, *Goodwill and Other Intangible Assets* requires that goodwill and intangible assets with indefinite useful lives should not be amortized but rather be tested for impairment at least annually or sooner whenever events or changes in circumstances indicate that they may be impaired. The Company performs its goodwill impairment tests on or about August 31 of each year. The Company did not recognize any goodwill or intangible asset impairment charges in 2008, 2007, or 2006. The Company established reporting units based on its current reporting structure. For purposes of testing goodwill for impairment, goodwill has been allocated to these reporting units to the extent it relates to each reporting unit.

SFAS No. 142 also requires that intangible assets with definite lives be amortized over their estimated useful lives and reviewed for impairment in accordance with SFAS No. 144. The Company is currently amortizing its acquired intangible assets with definite lives over periods ranging from 1 to 10 years.

Foreign Currency Translation

The Company translates the assets and liabilities of its international non-U.S. dollar functional currency subsidiaries into U.S. dollars using exchange rates in effect at the end of each period. Revenue and expenses for these subsidiaries are translated using rates that approximate those in effect during the period. Gains and losses from these translations are credited or charged to foreign currency translation included in accumulated other comprehensive income in shareholders' equity. The Company's foreign manufacturing subsidiaries and certain other international subsidiaries that use the U.S. dollar as their functional currency remeasure monetary assets and liabilities at exchange rates in effect at the end of each period, and inventories, property, and nonmonetary assets and liabilities at historical rates. Gains and losses from these translations were insignificant and have been included in the Company's results of operations.

Revenue Recognition

Net sales consist primarily of revenue from the sale of hardware, software, music products, digital content, peripherals, and service and support contracts. For any product within these groups that either is software, or is considered software-related in accordance with the guidance in Emerging Issues Task Force ("EITF") No. 03-5, *Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software* (e.g., Mac computers, iPod portable digital music players and iPhones), the Company accounts for such products in accordance with the revenue recognition provisions of American Institute of Certified Public Accountants ("AICPA") Statement of Position ("SOP") No. 97-2, *Software Revenue Recognition*, as amended. The Company applies Staff Accounting Bulletin ("SAB") No. 104, *Revenue Recognition,* for products that are not software or software-related, such as digital content sold on the iTunes Store and certain Mac, iPod and iPhone supplies and accessories.

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection is probable. Product is considered delivered to the customer once it has been shipped and title and risk of loss have been transferred. For most of the Company's product sales, these criteria are met at the time the product is shipped. For online sales to individuals, for some sales to education customers in the U.S., and for certain other sales, the Company defers revenue until the customer receives the product because the Company legally retains a portion of the risk of loss on these sales during transit. If at the outset of an arrangement the Company determines the arrangement fee is not, or is presumed not to be, fixed or determinable, revenue is deferred and subsequently recognized as amounts become due and payable and all other criteria for revenue recognition have been met.

Revenue from service and support contracts is deferred and recognized ratably over the service coverage periods. These contracts typically include extended phone support, repair services, web-based support resources, diagnostic tools, and extend the service coverage offered under the Company's one-year limited warranty.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

The Company sells software and peripheral products obtained from other companies. The Company generally establishes its own pricing and retains related inventory risk, is the primary obligor in sales transactions with its customers, and assumes the credit risk for amounts billed to its customers. Accordingly, the Company generally recognizes revenue for the sale of products obtained from other companies based on the gross amount billed.

The Company accounts for multiple element arrangements that consist only of software or software-related products in accordance with SOP No. 97-2. If a multiple-element arrangement includes deliverables that are neither software nor software-related, the Company applies EITF No. 00-21, *Revenue Arrangements with Multiple Deliverables,* to determine if those deliverables constitute separate units of accounting from the SOP No. 97-2 deliverables. If the Company can separate the deliverables, the Company applies SOP No. 97-2 to the software and software-related deliverables and applies other appropriate guidance (e.g., SAB No. 104) to the deliverables outside the scope of SOP No. 97-2. Revenue on arrangements that include multiple elements such as hardware, software, and services is allocated to each element based on the relative fair value of each element. Each element's allocated revenue is recognized when the revenue recognition criteria for that element have been met. Fair value is generally determined by vendor specific objective evidence ("VSOE"), which is based on the price charged when each element is sold separately. If the Company cannot objectively determine the fair value of any undelivered element included in a multiple-element arrangement, the Company defers revenue until all elements are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered elements. When the fair value of a delivered element has not been established, the Company uses the residual method to recognize revenue if the fair value of all undelivered elements is determinable. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is allocated to the delivered elements and is recognized as revenue.

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end-user rebates, and other sales programs and volume-based incentives. The estimated cost of these programs is accrued as a reduction to revenue in the period the Company has sold the product and committed to a plan. The Company also records reductions to revenue for expected future product returns based on the Company's historical experience. Revenue is recorded net of taxes collected from customers that are remitted to governmental authorities, with the collected taxes recorded as current liabilities until remitted to the relevant government authority.

Generally, the Company does not offer specified or unspecified upgrade rights to its customers in connection with software sales or the sale of extended warranty and support contracts. When the Company does offer specified upgrade rights, the Company defers revenue for the fair value of the specified upgrade right until the future obligation is fulfilled or when the right to the specified upgrade expires. Additionally, a limited number of the Company's software products are available with maintenance agreements that grant customers rights to unspecified future upgrades over the maintenance term on a when and if available basis. Revenue associated with such maintenance is recognized ratably over the maintenance term.

In 2007, the Company began shipping Apple TV and iPhone. For Apple TV and iPhone, the Company indicated it may from time-to-time provide future unspecified features and additional software products free of charge to customers. Accordingly, Apple TV and iPhone handsets sales are accounted for under subscription accounting in accordance with SOP No. 97-2. As such, the Company's policy is to defer the associated revenue and cost of goods sold at the time of sale, and recognize both on a straight-line basis over the currently estimated 24-month economic life of these products, with any loss recognized at the time of sale. Costs incurred by the Company for engineering, sales, marketing and warranty are expensed as incurred.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

Allowance for Doubtful Accounts

The Company records its allowance for doubtful accounts based upon its assessment of various factors. The Company considers historical experience, the age of the accounts receivable balances, credit quality of the Company's customers, current economic conditions, and other factors that may affect customers' ability to pay.

Shipping Costs

For all periods presented, amounts billed to customers related to shipping and handling are classified as revenue, and the Company's shipping and handling costs are included in cost of sales.

Warranty Expense

The Company generally provides for the estimated cost of hardware and software warranties at the time the related revenue is recognized. The Company assesses the adequacy of its preexisting warranty liabilities and adjusts the amounts as necessary based on actual experience and changes in future estimates. For products accounted for under subscription accounting pursuant to SOP No. 97-2, the Company recognizes warranty expense as incurred.

Software Development Costs

Research and development costs are expensed as incurred. Development costs of computer software to be sold, leased, or otherwise marketed are subject to capitalization beginning when a product's technological feasibility has been established and ending when a product is available for general release to customers pursuant to SFAS No. 86, *Computer Software to be Sold, Leased, or Otherwise Marketed.* In most instances, the Company's products are released soon after technological feasibility has been established. Therefore, costs incurred subsequent to achievement of technological feasibility are usually not significant, and generally most software development costs have been expensed.

During 2008, the Company capitalized $11 million of costs associated with the development of Mac OS X Version 10.6 Snow Leopard. In 2007, the Company determined that both Mac OS X Version 10.5 Leopard ("Mac OS X Leopard") and iPhone achieved technological feasibility. During 2007, the Company capitalized $75 million of costs associated with the development of Leopard and iPhone. In accordance with SFAS No. 86, the capitalized costs related to Mac OS X Leopard and iPhone are amortized to cost of sales commencing when each respective product begins shipping and are recognized on a straight-line basis over a 3 year estimated useful life of the underlying technology.

Total amortization related to capitalized software development costs was $27 million, $13 million, and $18 million in 2008, 2007, and 2006, respectively.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expense was $486 million, $467 million, and $338 million for 2008, 2007, and 2006, respectively.

Stock-Based Compensation

The Company applies SFAS No. 123 (revised 2004), *Share-Based Payment*, for stock-based payment transactions in which the Company receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The Company uses the Black-Scholes-Merton ("BSM") option-pricing model to determine the fair-value of stock-based awards under SFAS No. 123R.

SFAS No. 123R prohibits recognition of a deferred tax asset for an excess tax benefit that has not been realized. The Company will recognize a benefit from stock-based compensation in equity if an incremental tax benefit is

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

realized by following the ordering provisions of the tax law. In addition, the Company accounts for the indirect effects of stock-based compensation on the research tax credit, the foreign tax credit, and the domestic manufacturing deduction through the income statement.

Further information regarding stock-based compensation can be found in Note 6, "Shareholders' Equity," and Note 7, "Stock-Based Compensation."

Income Taxes

In accordance with SFAS No. 109, *Accounting for Income Taxes*, the provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. The Company records a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized.

During 2008, the Company adopted the Financial Accounting Standards Board's ("FASB") Financial Interpretation No. ("FIN") 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*. FIN 48 changes the accounting for uncertainty in income taxes by creating a new framework for how companies should recognize, measure, present, and disclose uncertain tax positions in their financial statements. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon settlement. FIN 48 also provides guidance on the reversal of previously recognized tax positions, balance sheet classifications, accounting for interest and penalties associated with tax positions, and income tax disclosures. See Note 5, "Income Taxes" for additional information, including the effects of adoption on the Company's Consolidated Financial Statements.

Earnings Per Common Share

Basic earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the potentially dilutive securities had been issued. Potentially dilutive securities include outstanding stock options, shares to be purchased under the employee stock purchase plan, and unvested restricted stock units ("RSUs"). The dilutive effect of potentially dilutive securities is reflected in diluted earnings per share by application of the treasury stock method. Under the treasury stock method, an increase in the fair market value of the Company's common stock can result in a greater dilutive effect from potentially dilutive securities.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

The following table sets forth the computation of basic and diluted earnings per share for the three fiscal years ended September 27, 2008 (in thousands, except net income in millions and per share amounts):

	2008	2007	2006
Numerator:			
Net income	$ 4,834	$ 3,496	$ 1,989
Denominator:			
Weighted-average shares outstanding	881,592	864,595	844,058
Effect of dilutive securities	20,547	24,697	33,468
Denominator for diluted earnings per share	902,139	889,292	877,526
Basic earnings per share	$ 5.48	$ 4.04	$ 2.36
Diluted earnings per share	$ 5.36	$ 3.93	$ 2.27

Potentially dilutive securities representing 10.3 million, 13.7 million, and 3.9 million shares of common stock for the years ended September 27, 2008, September 29, 2007, and September 30, 2006, respectively, were excluded from the computation of diluted earnings per share for these periods because their effect would have been antidilutive.

Comprehensive Income

Comprehensive income consists of two components, net income and other comprehensive income. Other comprehensive income refers to revenue, expenses, gains, and losses that under U.S. generally accepted accounting principles are recorded as an element of shareholders' equity but are excluded from net income. The Company's other comprehensive income consists of foreign currency translation adjustments from those subsidiaries not using the U.S. dollar as their functional currency, unrealized gains and losses on marketable securities categorized as available-for-sale, and net deferred gains and losses on certain derivative instruments accounted for as cash flow hedges.

Segment Information

The Company reports segment information based on the "management" approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of the Company's reportable segments. Information about the Company's products, major customers, and geographic areas on a company-wide basis is also disclosed.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2—Financial Instruments

Cash, Cash Equivalents and Short-Term Investments

The following table summarizes the fair value of the Company's cash and available-for-sale securities held in its short-term investment portfolio, recorded as cash and cash equivalents or short-term investments as of September 27, 2008 and September 29, 2007 (in millions):

	2008	2007
Cash	$ 368	$ 256
U.S. Treasury and Agency Securities	2,916	670
U.S. Corporate Securities	4,975	5,597
Foreign Securities	3,616	2,829
Total cash equivalents	11,507	9,096
U.S. Treasury and Agency Securities	7,018	358
U.S. Corporate Securities	4,305	4,718
Foreign Securities	1,292	958
Total short-term investments	12,615	6,034
Total cash, cash equivalents, and short-term investments	$ 24,490	$ 15,386

The Company's U.S. Corporate Securities consist primarily of commercial paper, certificates of deposit, time deposits, and corporate debt securities. Foreign Securities consist primarily of foreign commercial paper issued by foreign companies, and certificates of deposit and time deposits with foreign institutions, most of which are denominated in U.S. dollars. As of September 27, 2008 and September 29, 2007, approximately $2.4 billion and $1.9 billion, respectively, of the Company's short-term investments had underlying maturities ranging from one to five years. The remaining short-term investments had maturities less than 12 months. The Company had $117 million in net unrealized losses on its investment portfolio, primarily related to investments with stated maturities ranging from one to five years, as of September 27, 2008, and net unrealized losses of approximately $11 million on its investment portfolio, primarily related to investments with stated maturities from one to five years, as of September 29, 2007. The Company may sell its investments prior to their stated maturities for strategic purposes, in anticipation of credit deterioration, or for duration management. The Company recognized no material net gains or losses during 2008, 2007 and 2006 related to such sales.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2—Financial Instruments (Continued)

In accordance with FASB Staff Position ("FSP") FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments,* the following table shows the gross unrealized losses and fair value for those investments that were in an unrealized loss position as of September 27, 2008 and September 29, 2007, aggregated by investment category and the length of time that individual securities have been in a continuous loss position (in millions):

	2008					
	Less than 12 Months		12 Months or Greater		Total	
Security Description	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and Agency Securities	$ 6,850	$ (13)	$ —	$ —	$ 6,850	$ (13)
U.S. Corporate Securities	2,536	(31)	1,030	(72)	3,566	(103)
Foreign Securities	321	—	118	(5)	439	(5)
Total	$ 9,707	$ (44)	$ 1,148	$ (77)	$ 10,855	$ (121)

	2007					
	Less than 12 Months		12 Months or Greater		Total	
Security Description	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and Agency Securities	$ 338	$ —	$ —	$ —	$ 338	$ —
U.S. Corporate Securities	2,521	(12)	32	—	2,553	(12)
Foreign Securities	474	(1)	8	—	482	(1)
Total	$ 3,333	$ (13)	$ 40	$ —	$ 3,373	$ (13)

The unrealized losses on the Company's investments in U.S. Treasury and Agency Securities, U.S. Corporate Securities, and Foreign Securities were caused primarily by changes in interest rates, specifically, widening credit spreads. The Company's investment policy requires investments to be rated single-A or better with the objective of minimizing the potential risk of principal loss. Therefore, the Company considers the declines to be temporary in nature. Fair values were determined for each individual security in the investment portfolio. When evaluating the investments for other-than-temporary impairment, the Company reviews factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer, and the Company's ability and intent to hold the investment for a period of time, which may be sufficient for anticipated recovery in market value. During 2008, the Company did not record any material impairment charges on its outstanding securities. As of September 27, 2008, the Company does not consider any of its investments to be other-than-temporarily impaired.

Accounts Receivable

Trade Receivables

The Company distributes its products through third-party distributors and resellers and directly to certain education, consumer, and commercial customers. The Company generally does not require collateral from its customers. In addition, when possible, the Company attempts to limit credit risk on trade receivables with credit insurance for certain customers in Latin America, Europe, Asia, and Australia and by arranging with third-party financing companies to provide flooring arrangements and other loan and lease programs to the Company's direct customers. These credit-financing arrangements are directly between the third-party financing company and the end customer. As such, the Company generally does not assume any recourse or credit risk sharing related to any of these arrangements. However, considerable trade receivables not covered by collateral, third-party flooring arrangements, or credit insurance are outstanding with the Company's distribution and retail channel partners. Trade receivables from two of the Company's customers accounted for 15% and 10% of trade receivables as of September 27, 2008, while one customer accounted for approximately 11% of trade receivables as of September 29, 2007.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2—Financial Instruments (Continued)

The following table summarizes the activity in the allowance for doubtful accounts for the three fiscal years ended September 27, 2008 (in millions):

	2008	2007	2006
Beginning allowance balance	$ 47	$ 52	$ 46
Charged to costs and expenses	3	12	17
Deductions	(3)	(17)	(11)
Ending allowance balance	$ 47	$ 47	$ 52

Vendor Non-Trade Receivables

The Company has non-trade receivables from certain of its manufacturing vendors resulting from the sale of raw material components to these manufacturing vendors who manufacture sub-assemblies or assemble final products for the Company. The Company purchases these raw material components directly from suppliers. These non-trade receivables, which are included in the Consolidated Balance Sheets in other current assets, totaled $2.3 billion and $2.4 billion as of September 27, 2008 and September 29, 2007, respectively. The Company does not reflect the sale of these components in net sales and does not recognize any profits on these sales until the related products are sold by the Company, at which time the profit is recognized as a reduction of cost of sales.

Derivative Financial Instruments

The Company uses derivatives to partially offset its business exposure to foreign exchange risk. Foreign currency forward and option contracts are used to offset the foreign exchange risk on certain existing assets and liabilities and to hedge the foreign exchange risk on expected future cash flows on certain forecasted revenue and cost of sales. The Company's accounting policies for these instruments are based on whether the instruments are designated as hedge or non-hedge instruments. The Company records all derivatives on the balance sheet at fair value.

The following table shows the notional principal, net fair value, and credit risk amounts of the Company's foreign currency instruments as of September 27, 2008 and September 29, 2007 (in millions):

	2008			2007		
	Notional Principal	Fair Value	Credit Risk Amounts	Notional Principal	Fair Value	Credit Risk Amounts
Foreign exchange instruments qualifying as accounting hedges:						
Spot/Forward contracts	$ 2,782	$ (2)	$ 43	$ 570	$ (8)	$ —
Purchased options	$ 3,120	$ 64	$ 64	$ 2,564	$ 10	$ 10
Sold options	$ 2,668	$ (23)	$ —	$ 1,498	$ (2)	$ —
Foreign exchange instruments other than accounting hedges:						
Spot/Forward contracts	$ 2,633	$ 3	$ 5	$ 1,768	$ (2)	$ —
Purchased options	$ 235	$ 3	$ 3	$ 161	$ 1	$ 1

The notional principal amounts for derivative instruments provide one measure of the transaction volume outstanding as of year-end, and do not represent the amount of the Company's exposure to credit or market loss. The credit risk amounts shown in the table above represents the Company's gross exposure to potential accounting loss on these transactions if all counterparties failed to perform according to the terms of the contract, based on then-current currency exchange rates at each respective date. The Company's exposure to credit loss and market risk will vary over time as a function of currency exchange rates.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2—Financial Instruments (Continued)

The estimates of fair value are based on applicable and commonly used pricing models and prevailing financial market information as of September 27, 2008 and September 29, 2007. Although the table above reflects the notional principal, fair value, and credit risk amounts of the Company's foreign exchange instruments, it does not reflect the gains or losses associated with the exposures and transactions that the foreign exchange instruments are intended to hedge. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

Foreign Exchange Risk Management

The Company may enter into foreign currency forward and option contracts with financial institutions to protect against foreign exchange risk associated with existing assets and liabilities, certain firmly committed transactions, forecasted future cash flows, and net investments in foreign subsidiaries. Generally, the Company's practice is to hedge some portion of its material foreign exchange exposures. However, the Company may choose not to hedge certain foreign exchange exposures for a variety of reasons, including but not limited to, immateriality, prohibitive economic cost of hedging particular exposures, or limited availability of appropriate hedging instruments.

To help protect gross margins from fluctuations in foreign currency exchange rates, certain of the Company's U.S. dollar functional subsidiaries hedge a portion of forecasted foreign currency revenue, and the Company's non-U.S. dollar functional subsidiaries selling in local currencies hedge a portion of forecasted inventory purchases not denominated in the subsidiaries' functional currency. Other comprehensive income associated with hedges of foreign currency revenue is recognized as a component of net sales in the same period as the related sales are recognized, and other comprehensive income related to inventory purchases is recognized as a component of cost of sales in the same period as the related costs are recognized. Typically, the Company hedges portions of its forecasted foreign currency exposure associated with revenue and inventory purchases for three to six months.

Derivative instruments designated as cash flow hedges must be de-designated as hedges when it is probable the forecasted hedged transaction will not occur in the initially identified time period or within a subsequent 2 month time period. Deferred gains and losses in other comprehensive income associated with such derivative instruments are immediately reclassified into earnings in other income and expense. Any subsequent changes in fair value of such derivative instruments are also reflected in current earnings unless they are re-designated as hedges of other transactions. The Company has not recognized any material net gains during 2008, 2007 and 2006, related to the loss of a hedge designation on discontinued cash flow hedges. As of September 27, 2008, the Company had a net deferred gain associated with cash flow hedges of approximately $19 million, net of taxes, substantially all of which is expected to be reclassified to earnings by the end of the second quarter of fiscal 2009.

The net gain or loss on the effective portion of a derivative instrument designated as a net investment hedge is included in the cumulative translation adjustment account of accumulated other comprehensive income within shareholders' equity. For the years ended September 27, 2008 and September 29, 2007, the Company had a net loss on net investment hedges of $12.2 million and $2.6 million, respectively, included in the cumulative translation adjustment.

The Company may also enter into foreign currency forward and option contracts to offset the foreign exchange gains and losses generated by the re-measurement of certain assets and liabilities recorded in non-functional currencies. Changes in the fair value of these derivatives are recognized in current earnings in other income and expense as offsets to the changes in the fair value of the related assets or liabilities. Due to currency market movements, changes in option time value can lead to increased volatility in other income and expense.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3—Consolidated Financial Statement Details

The following tables show the Company's Consolidated Financial Statement details as of September 27, 2008 and September 29, 2007 (in millions):

Other Current Assets

	2008	2007
Vendor non-trade receivables	$ 2,282	$ 2,392
Deferred costs under subscription accounting—current	1,931	247
NAND flash memory prepayments	475	417
Other current assets	1,134	749
Total other current assets	$ 5,822	$ 3,805

Property, Plant, and Equipment

	2008	2007
Land and buildings	$ 810	$ 762
Machinery, equipment, and internal-use software	1,491	954
Office furniture and equipment	122	106
Leasehold improvements	1,324	1,019
	3,747	2,841
Accumulated depreciation and amortization	(1,292)	(1,009)
Net property, plant, and equipment	$ 2,455	$ 1,832

Other Assets

	2008	2007
Deferred costs under subscription accounting—non-current	$ 1,089	$ 214
Long-term NAND flash memory prepayments	208	625
Deferred tax assets—non-current	138	88
Capitalized software development costs, net	67	83
Other assets	433	212
Total other assets	$ 1,935	$ 1,222

Accrued Expenses

	2008	2007
Deferred revenue—current	$ 4,853	$ 1,391
Deferred margin on component sales	681	545
Accrued marketing and distribution	329	288
Accrued compensation and employee benefits	320	254
Accrued warranty and related costs	267	230
Other accrued tax liabilities	100	488
Other current liabilities	2,022	1,114
Total accrued expenses	$ 8,572	$ 4,310

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3—Consolidated Financial Statement Details (Continued)

Non-Current Liabilities

	2008	2007
Deferred revenue—non-current	$ 3,029	$ 849
Deferred tax liabilities	675	619
Other non-current liabilities	746	67
Total non-current liabilities	$ 4,450	$ 1,535

Note 4—Goodwill and Other Intangible Assets

The Company is currently amortizing its acquired intangible assets with definite lives over periods ranging from 1 to 10 years. The following table summarizes the components of gross and net intangible asset balances as of September 27, 2008 and September 29, 2007 (in millions):

	2008			2007		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Definite lived and amortizable acquired technology	$ 308	$ (123)	$ 185	$ 276	$ (77)	$ 199
Indefinite lived and unamortizable trademarks	100	—	100	100	—	100
Total acquired intangible assets	$ 408	$ (123)	$ 285	$ 376	$ (77)	$ 299
Goodwill	$ 207	$ —	$ 207	$ 38	$ —	$ 38

In June 2008, the Company completed an acquisition of a business for total cash consideration, net of cash acquired, of $220 million, of which $169 million has been allocated to goodwill, $51 million to deferred tax assets and $7 million to acquired intangible assets.

The Company's goodwill is allocated primarily to the America's reportable operating segment. Amortization expense related to acquired intangible assets was $46 million, $35 million, and $12 million in 2008, 2007, and 2006, respectively. As of September 27, 2008, and September 29, 2007, the remaining weighted-average amortization period for acquired technology was 7.0 years and 7.1 years, respectively.

Expected annual amortization expense related to acquired technology as of September 27, 2008, is as follows (in millions):

Fiscal Years	
2009	$ 50
2010	35
2011	32
2012	26
2013	13
Thereafter	29
Total	$ 185

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 5—Income Taxes

The provision for income taxes for the three fiscal years ended September 27, 2008, consisted of the following (in millions):

	2008	2007	2006
Federal:			
Current	$ 1,942	$ 1,219	$ 619
Deferred	(155)	85	56
	1,787	1,304	675
State:			
Current	210	112	56
Deferred	(82)	9	14
	128	121	70
Foreign:			
Current	277	103	101
Deferred	(131)	(16)	(17)
	146	87	84
Provision for income taxes	$ 2,061	$ 1,512	$ 829

The foreign provision for income taxes is based on foreign pretax earnings of $3.5 billion, $2.2 billion, and $1.5 billion in 2008, 2007, and 2006, respectively. As of September 27, 2008 and September 29, 2007, $11.3 billion and $6.5 billion, respectively, of the Company's cash, cash equivalents, and short-term investments were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S. The Company's consolidated financial statements provide for any related tax liability on amounts that may be repatriated, aside from undistributed earnings of certain of the Company's foreign subsidiaries that are intended to be indefinitely reinvested in operations outside the U.S. U.S. income taxes have not been provided on a cumulative total of $3.8 billion of such earnings. It is not practicable to determine the income tax liability that might be incurred if these earnings were to be distributed.

Deferred tax assets and liabilities reflect the effects of tax losses, credits, and the future income tax effects of temporary differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases and are measured using enacted tax rates that apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 5—Income Taxes (Continued)

As of September 27, 2008 and September 29, 2007, the significant components of the Company's deferred tax assets and liabilities were (in millions):

	2008	2007
Deferred tax assets:		
Accrued liabilities and other reserves	$ 1,295	$ 679
Basis of capital assets and investments	173	146
Accounts receivable and inventory reserves	126	64
Tax losses and credits	47	8
Other	503	161
Total deferred tax assets	2,144	1,058
Less valuation allowance	—	5
Net deferred tax assets	2,144	1,053
Deferred tax liabilities—Unremitted earnings of subsidiaries:	1,234	803
Net deferred tax asset	$ 910	$ 250

As of September 27, 2008, the Company has tax loss and credit carryforwards in the tax effected amount of $47 million. The Company released a valuation allowance of $5 million recorded against the deferred tax asset for the benefit of state operating losses. Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets.

A reconciliation of the provision for income taxes, with the amount computed by applying the statutory federal income tax rate (35% in 2008, 2007, and 2006) to income before provision for income taxes for the three fiscal years ended September 27, 2008, is as follows (in millions):

	2008	2007	2006
Computed expected tax	$ 2,414	$ 1,753	$ 987
State taxes, net of federal effect	159	140	86
Indefinitely invested earnings of foreign subsidiaries	(492)	(297)	(224)
Nondeductible executive compensation	6	6	11
Research and development credit, net	(21)	(54)	(12)
Other items	(5)	(36)	(19)
Provision for income taxes	$ 2,061	$ 1,512	$ 829
Effective tax rate	30%	30%	29%

The Company's income taxes payable have been reduced by the tax benefits from employee stock options and employee stock purchase plan. The Company receives an income tax benefit calculated as the difference between the fair market value of the stock issued at the time of the exercise and the option price, tax effected. The net tax benefits from employee stock option transactions were $770 million, $398 million, and $419 million in 2008, 2007, and 2006, respectively, and were reflected as an increase to common stock in the Consolidated Statements of Shareholders' Equity.

On October 3, 2008, the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 was signed into law. This bill, among other things, retroactively extended the expired research and development tax credit. As a result, the Company expects to record a tax benefit of approximately $42 million in the first quarter of fiscal year 2009 to account for the retroactive effects of the research credit extension.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 5—Income Taxes (Continued)

FIN 48

In the first quarter of 2008, the Company adopted FIN 48. Upon adoption of FIN 48, the Company's cumulative effect of a change in accounting principle resulted in an increase to retained earnings of $11 million. The Company had historically classified interest and penalties and unrecognized tax benefits as current liabilities. Beginning with the adoption of FIN 48, the Company classifies gross interest and penalties and unrecognized tax benefits that are not expected to result in payment or receipt of cash within one year as non-current liabilities in the Consolidated Balance Sheet. The total amount of gross unrecognized tax benefits as of the date of adoption of FIN 48 was $475 million, of which $209 million, if recognized, would affect the Company's effective tax rate. As of September 27, 2008, the total amount of gross unrecognized tax benefits was $506 million, of which $253 million, if recognized, would affect the Company's effective tax rate. The Company's total gross unrecognized tax benefits are classified as non-current liabilities in the Consolidated Balance Sheet.

The aggregate changes in the balance of gross unrecognized tax benefits, which excludes interest and penalties, for the fiscal year ended September 27, 2008, is as follows (in millions):

Balance as of September 30, 2007	$ 475
Increases related to tax positions taken during a prior period	27
Decreases related to tax positions taken during a prior period	(70)
Increases related to tax positions taken during the current period	85
Decreases related to settlements with taxing authorities	—
Decreases related to expiration of statute of limitations	(11)
Balance as of September 27, 2008	$ 506

The Company's policy to include interest and penalties related to unrecognized tax benefits within the provision for income taxes did not change as a result of adopting FIN 48. As of the date of adoption, the Company had accrued $203 million for the gross interest and penalties relating to unrecognized tax benefits. As of September 27, 2008, the total amount of gross interest and penalties accrued was $219 million, which is classified as non-current liabilities in the Consolidated Balance Sheet. In 2008, the Company recognized interest expense in connection with tax matters of $16 million.

The Company is subject to taxation and files income tax returns in the U.S. federal jurisdiction and in many state and foreign jurisdictions. For U.S. federal income tax purposes, all years prior to 2002 are closed. The years 2002-2003 have been examined by the Internal Revenue Service (the "IRS") and disputed issues have been taken to administrative appeals. The IRS is currently examining the 2004-2006 years. In addition, the Company is also subject to audits by state, local, and foreign tax authorities. In major states and major foreign jurisdictions, the years subsequent to 1988 and 2000, respectively, generally remain open and could be subject to examination by the taxing authorities.

Management believes that an adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs. Although timing of the resolution and/or closure of audits is highly uncertain, the Company does not believe it is reasonably possible that its unrecognized tax benefits would materially change in the next 12 months.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 6—Shareholders' Equity

Preferred Stock

The Company has five million shares of authorized preferred stock, none of which is issued or outstanding. Under the terms of the Company's Restated Articles of Incorporation, the Board of Directors is authorized to determine or alter the rights, preferences, privileges and restrictions of the Company's authorized but unissued shares of preferred stock.

CEO Restricted Stock Award

On March 19, 2003, the Company's Board of Directors granted 10 million shares of restricted stock to the Company's CEO that vested on March 19, 2006. The amount of the restricted stock award expensed by the Company was based on the closing market price of the Company's common stock on the date of grant and was amortized ratably on a straight-line basis over the three-year requisite service period. Upon vesting during 2006, the 10 million shares of restricted stock had a fair value of $646.6 million and had grant-date fair value of $7.48 per share. The restricted stock award was net-share settled such that the Company withheld shares with value equivalent to the CEO's minimum statutory obligation for the applicable income and other employment taxes, and remitted the cash to the appropriate taxing authorities. The total shares withheld of 4.6 million were based on the value of the restricted stock award on the vesting date as determined by the Company's closing stock price of $64.66. The remaining shares net of those withheld were delivered to the Company's CEO. Total payments for the CEO's tax obligations to the taxing authorities was $296 million in 2006 and are reflected as a financing activity within the Consolidated Statements of Cash Flows. The net-share settlement had the effect of share repurchases by the Company as it reduced and retired the number of shares outstanding and did not represent an expense to the Company. The Company's CEO has no remaining shares of restricted stock. For the year ended September 30, 2006, compensation expense related to restricted stock was $4.6 million.

Comprehensive Income

Comprehensive income consists of two components, net income and other comprehensive income. Other comprehensive income refers to revenue, expenses, gains, and losses that under U.S. generally accepted accounting principles are recorded as an element of shareholders' equity but are excluded from net income. The Company's other comprehensive income consists of foreign currency translation adjustments from those subsidiaries not using the U.S. dollar as their functional currency, unrealized gains and losses on marketable securities categorized as available-for-sale, and net deferred gains and losses on certain derivative instruments accounted for as cash flow hedges.

The following table summarizes the components of accumulated other comprehensive income, net of taxes, as of the three fiscal years ended September 27, 2008 (in millions):

	2008	2007	2006
Unrealized losses on available-for-sale securities	$ (70)	$ (7)	$ —
Unrealized gains on derivative instruments	19	—	3
Cumulative foreign currency translation	59	70	19
Accumulated other comprehensive income	$ 8	$ 63	$ 22

The change in fair value of available-for-sale securities included in other comprehensive income was $(63) million, $(7) million, and $4 million, net of taxes in 2008, 2007, and 2006, respectively. The tax effect related to the change in unrealized gain/loss on available-for-sale securities was $42 million, $4 million, and $(2) million for 2008, 2007, and 2006, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 6—Shareholders' Equity (Continued)

The following table summarizes activity in other comprehensive income related to derivatives, net of taxes, held by the Company during the three fiscal years ended September 27, 2008 (in millions):

	2008	2007	2006
Changes in fair value of derivatives	$ 7	$ (1)	$ 11
Adjustment for net gains/(losses) realized and included in net income	12	(2)	(12)
Change in unrealized gains on derivative instruments	$ 19	$ (3)	$ (1)

The tax effect related to the changes in fair value of derivatives was $(5) million, $1 million, and $(8) million for 2008, 2007, and 2006, respectively. The tax effect related to derivative gains/losses reclassified from other comprehensive income to net income was $(9) million, $2 million, and $8 million for 2008, 2007, and 2006, respectively.

Employee Benefit Plans

2003 Employee Stock Plan

The 2003 Employee Stock Plan (the "2003 Plan") is a shareholder approved plan that provides for broad-based grants to employees, including executive officers. Based on the terms of individual option grants, options granted under the 2003 Plan generally expire 7 to 10 years after the grant date and generally become exercisable over a period of four years, based on continued employment, with either annual or quarterly vesting. The 2003 Plan permits the granting of incentive stock options, nonstatutory stock options, RSUs, stock appreciation rights, stock purchase rights and performance-based awards. As of September 27, 2008, approximately 50.3 million shares were reserved for future issuance under the 2003 Plan.

1997 Employee Stock Option Plan

In August 1997, the Company's Board of Directors approved the 1997 Employee Stock Option Plan (the "1997 Plan"), a non-shareholder approved plan for grants of stock options to employees who are not officers of the Company. Based on the terms of individual option grants, options granted under the 1997 Plan generally expire 7 to 10 years after the grant date and generally become exercisable over a period of four years, based on continued employment, with either annual or quarterly vesting. In October 2003, the Company terminated the 1997 Plan and no new options can be granted from this plan.

1997 Director Stock Option Plan

In August 1997, the Company's Board of Directors adopted a Director Stock Option Plan (the "Director Plan") for non-employee directors of the Company, which was approved by shareholders in 1998. Pursuant to the Director Plan, the Company's non-employee directors are granted an option to acquire 30,000 shares of common stock upon their initial election to the Board ("Initial Options"). The Initial Options vest and become exercisable in three equal annual installments on each of the first through third anniversaries of the grant date. On the fourth anniversary of a non-employee director's initial election to the Board and on each subsequent anniversary thereafter, the director will be entitled to receive an option to acquire 10,000 shares of common stock ("Annual Options"). Annual Options are fully vested and immediately exercisable on their date of grant. Options granted under the Director Plan expire 10 years after the grant date. As of September 27, 2008, approximately 290,000 shares were reserved for future issuance under the Director Plan.

Rule 10b5-1 Trading Plans

The following executive officers, Timothy D. Cook, Peter Oppenheimer, Philip W. Schiller, and Bertrand Serlet, have entered into trading plans pursuant to Rule 10b5-1(c)(1) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of November 1, 2008. A trading plan is a written document that

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 6—Shareholders' Equity (Continued)

pre-establishes the amounts, prices and dates (or formula for determining the amounts, prices and dates) of future purchases or sales of the Company's stock including the exercise and sale of employee stock options and shares acquired pursuant to the Company's employee stock purchase plan and upon vesting of RSUs.

Employee Stock Purchase Plan

The Company has a shareholder approved employee stock purchase plan (the "Purchase Plan"), under which substantially all employees may purchase common stock through payroll deductions at a price equal to 85% of the lower of the fair market values as of the beginning and end of six-month offering periods. Stock purchases under the Purchase Plan are limited to 10% of an employee's compensation, up to a maximum of $25,000 in any calendar year. The number of shares authorized to be purchased in any calendar year is limited to a total of 3 million shares. As of September 27, 2008, approximately 6.2 million shares were reserved for future issuance under the Purchase Plan.

Employee Savings Plan

The Company has an employee savings plan (the "Savings Plan") qualifying as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code. Under the Savings Plan, participating U.S. employees may defer a portion of their pre-tax earnings, up to the IRS annual contribution limit ($15,500 for calendar year 2008). The Company matches 50% to 100% of each employee's contributions, depending on length of service, up to a maximum 6% of the employee's eligible earnings. The Company's matching contributions to the Savings Plan were $50 million, $39 million, and $33 million in 2008, 2007, and 2006, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 6—Shareholders' Equity (Continued)

Stock Option Activity

A summary of the Company's stock option activity and related information for the three fiscal years ended September 27, 2008, is as follows (in thousands, except per share amounts and contractual term in years):

		Outstanding Options			
	Shares Available for Grant	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance at September 24, 2005	58,957	73,221	$ 17.79		
Restricted stock units granted	(2,950)	—	—		
Options granted	(3,881)	3,881	$ 65.28		
Options cancelled	2,325	(2,325)	$ 29.32		
Restricted stock units cancelled	625	—	—		
Options exercised	—	(21,795)	$ 11.78		
Plan shares expired	(82)	—	—		
Balance at September 30, 2006	54,994	52,982	$ 23.23		
Additional shares authorized	28,000	—	—		
Restricted stock units granted	(2,640)	—	—		
Options granted	(14,010)	14,010	$ 94.52		
Options cancelled	1,471	(1,471)	$ 55.38		
Restricted stock units cancelled	20	—	—		
Options exercised	—	(15,770)	$ 18.32		
Plan shares expired	(8)	—	—		
Balance at September 29, 2007	67,827	49,751	$ 43.91		
Restricted stock units granted	(9,834)	—	—		
Options granted	(9,359)	9,359	$ 171.36		
Options cancelled	1,236	(1,236)	$ 98.40		
Restricted stock units cancelled	714	—	—		
Options exercised	—	(13,728)	$ 27.88		
Plan shares expired	(12)	—	—		
Balance at September 27, 2008	50,572	44,146	$ 74.39	4.29	$ 2,377,262
Exercisable at September 27, 2008		24,751	$ 40.93	3.42	$ 2,161,010
Expected to Vest after September 27, 2008		18,701	$ 117.09	5.40	$ 208,517

Aggregate intrinsic value represents the value of the Company's closing stock price on the last trading day of the fiscal period in excess of the exercise price multiplied by the number of options outstanding or exercisable. Total intrinsic value of options at time of exercise was $2.0 billion, $1.3 billion, and $1.2 billion for 2008, 2007, and 2006, respectively.

Shares of RSUs granted after April 2005 have been deducted from the shares available for grant under the Company's stock option plans utilizing a factor of two times the number of RSUs granted. Similarly shares of RSUs granted after April 2005, that are subsequently cancelled have been added back to the shares available for grant under the Company's stock option plans utilizing a factor of two times the number of RSUs cancelled.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 6—Shareholders' Equity (Continued)

Restricted Stock Units

The Company's Board of Directors has granted RSUs to members of the Company's executive management team, excluding its Chief Executive Officer ("CEO"), as well as various employees within the Company. Outstanding RSU balances were not included in the outstanding options balances in the preceding table. A summary of the Company's RSU activity and related information for the three fiscal years ended September 27, 2008, is as follows (in thousands, except per share amounts):

	Number of Shares	Weighted-Average Grant Date Fair Value	Aggregate Intrinsic Value
Balance at September 24, 2005	5,030	$ 14.21	
Restricted stock units granted	1,475	$ 70.92	
Restricted stock units vested	(2,470)	$ 13.37	
Restricted stock units cancelled	(625)	$ 12.75	
Balance at September 30, 2006	3,410	$ 39.62	
Restricted stock units granted	1,320	$ 88.51	
Restricted stock units vested	(45)	$ 46.57	
Restricted stock units cancelled	(10)	$ 86.14	
Balance at September 29, 2007	4,675	$ 52.98	
Restricted stock units granted	4,917	$ 162.61	
Restricted stock units vested	(2,195)	$ 25.63	
Restricted stock units cancelled	(357)	$ 119.12	
Balance at September 27, 2008	7,040	$ 134.91	$ 902,749

Upon vesting, the RSUs are generally net share-settled to cover the required withholding tax and the remaining amount is converted into an equivalent number of shares of common stock. The majority of RSUs vested in 2008, 2007 and 2006, were net-share settled such that the Company withheld shares with value equivalent to the employees' minimum statutory obligation for the applicable income and other employment taxes, and remitted the cash to the appropriate taxing authorities. The total shares withheld were approximately 857,000, 20,000, and 986,000 for 2008, 2007, and 2006, respectively, which was based on the value of the RSUs on their vesting date as determined by the Company's closing stock price. Total payments for the employees' tax obligations to the taxing authorities were $124 million, $3 million, and $59 million in 2008, 2007, and 2006, respectively, and are reflected as a financing activity within the Consolidated Statements of Cash Flows. These net-share settlements had the effect of share repurchases by the Company as they reduced and retired the number of shares that would have otherwise been issued as a result of the vesting and did not represent an expense to the Company.

The Company recognized $516 million, $242 million and $163 million of stock-based compensation expense in 2008, 2007 and 2006, respectively. Stock-based compensation expense capitalized as software development costs was not significant as of September 27, 2008 or September 29, 2007. The income tax benefit related to stock-based compensation expense was $169 million, $81 million, and $39 million for the years ended September 27, 2008, September 29, 2007, and September 30, 2006, respectively. The total unrecognized compensation cost related to stock options and RSUs expected to vest was $1.4 billion and $631 million as of September 27, 2008 and September 29, 2007, respectively. The total unrecognized compensation cost as of September 27, 2008, is expected to be recognized over a weighted-average period of 2.92 years.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 7—Stock-Based Compensation

SFAS No. 123R requires the use of a valuation model to calculate the fair value of stock-based awards. The Company uses the BSM option-pricing model to calculate the fair value of stock-based awards. The BSM option-pricing model incorporates various assumptions including expected volatility, expected life, and interest rates. The expected volatility is based on the historical volatility of the Company's common stock over the most recent period commensurate with the estimated expected life of the Company's stock options and other relevant factors including implied volatility in market traded options on the Company's common stock. The Company bases its expected life assumption on its historical experience and on the terms and conditions of the stock awards it grants to employees. Stock-based compensation cost is estimated at the grant date based on the award's fair-value as calculated by the BSM option-pricing model and is recognized as expense ratably on a straight-line basis over the requisite service period.

The compensation expense incurred by the Company for RSUs is based on the closing market price of the Company's common stock on the date of grant and is amortized ratably on a straight-line basis over the requisite service period.

The weighted-average assumptions used for the three fiscal years ended September 27, 2008, and the resulting estimates of weighted-average fair value per share of options granted and of employee stock purchase plan rights during those periods are as follows:

	2008	2007	2006
Expected life of stock options	3.41 years	3.46 years	3.56 years
Expected life of stock purchase rights	6 months	6 months	6 months
Interest rate—stock options	3.40%	4.61%	4.60%
Interest rate—stock purchase rights	3.48%	5.13%	4.29%
Volatility—stock options	45.64%	38.13%	40.34%
Volatility—stock purchase rights	38.51%	39.22%	39.56%
Dividend yields	—	—	—
Weighted-average fair value of stock options granted during the year	$ 62.73	$ 31.86	$ 23.16
Weighted-average fair value of employee stock purchase plan rights during the year	$ 42.27	$ 20.90	$ 14.06

Note 8—Commitments and Contingencies

Lease Commitments

The Company leases various equipment and facilities, including retail space, under noncancelable operating lease arrangements. The Company does not currently utilize any other off-balance sheet financing arrangements. The major facility leases are generally for terms of 3 to 20 years and generally provide renewal options for terms of 1 to 5 additional years. Leases for retail space are for terms of 5 to 20 years, the majority of which are for 10 years, and often contain multi-year renewal options. As of September 27, 2008, the Company's total future minimum lease payments under noncancelable operating leases were $1.8 billion, of which $1.4 billion related to leases for retail space.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 8—Commitments and Contingencies (Continued)

Rent expense under all operating leases, including both cancelable and noncancelable leases, was $207 million, $151 million, and $138 million in 2008, 2007, and 2006, respectively. Future minimum lease payments under noncancelable operating leases having remaining terms in excess of one year as of September 27, 2008, are as follows (in millions):

Fiscal Years	
2009	$ 195
2010	209
2011	200
2012	191
2013	177
Thereafter	788
Total minimum lease payments	$ 1,760

Accrued Warranty and Indemnifications

The Company offers a basic limited parts and labor warranty on its hardware products. The basic warranty period for hardware products is typically one year from the date of purchase by the end-user. The Company also offers a 90-day basic warranty for its service parts used to repair the Company's hardware products. The Company provides currently for the estimated cost that may be incurred under its basic limited product warranties at the time related revenue is recognized. Factors considered in determining appropriate accruals for product warranty obligations include the size of the installed base of products subject to warranty protection, historical and projected warranty claim rates, historical and projected cost-per-claim, and knowledge of specific product failures that are outside of the Company's typical experience. The Company assesses the adequacy of its preexisting warranty liabilities and adjusts the amounts as necessary based on actual experience and changes in future estimates. For products accounted for under subscription accounting pursuant to SOP No. 97-2, the Company recognizes warranty expense as incurred.

The Company periodically provides updates to its applications and system software to maintain the software's compliance with published specifications. The estimated cost to develop such updates is accounted for as warranty costs that are recognized at the time related software revenue is recognized. Factors considered in determining appropriate accruals related to such updates include the number of units delivered, the number of updates expected to occur, and the historical cost and estimated future cost of the resources necessary to develop these updates.

The following table reconciles changes in the Company's accrued warranties and related costs for the three fiscal years ended September 27, 2008 (in millions):

	2008	2007	2006
Beginning accrued warranty and related costs	$ 230	$ 284	$ 188
Cost of warranty claims	(319)	(281)	(267)
Accruals for product warranties	356	227	363
Ending accrued warranty and related costs	$ 267	$ 230	$ 284

The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 8—Commitments and Contingencies (Continued)

However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against it or an indemnified third-party and, in the opinion of management, does not have a potential liability related to unresolved infringement claims subject to indemnification that would have a material adverse effect on its financial condition or operating results. Therefore, the Company did not record a liability for infringement costs as of either September 27, 2008 or September 29, 2007.

Concentrations in the Available Sources of Supply of Materials and Product

Although most components essential to the Company's business are generally available from multiple sources, certain key components including, but not limited to microprocessors, enclosures, certain liquid crystal displays ("LCDs"), certain optical drives, and application-specific integrated circuits ("ASICs") are currently obtained by the Company from single or limited sources, which subjects the Company to significant supply and pricing risks. Many of these and other key components that are available from multiple sources including, but not limited to NAND flash memory, dynamic random access memory ("DRAM"), and certain LCDs, are subject at times to industry-wide shortages and significant commodity pricing fluctuations. In addition, the Company has entered into certain agreements for the supply of key components including, but not limited to microprocessors, NAND flash memory, DRAM and LCDs at favorable pricing, but there is no guarantee that the Company will be able to extend or renew these agreements on similar favorable terms, or at all, upon expiration or otherwise obtain favorable pricing in the future. Therefore, the Company remains subject to significant risks of supply shortages and/or price increases that can have a material adverse effect on its financial condition and operating results.

The Company and other participants in the personal computer, consumer electronics and mobile communication industries also compete for various components with other industries that have experienced increased demand for their products. In addition, the Company uses some custom components that are not common to the rest of the personal computer, consumer electronics and mobile communication industries, and new products introduced by the Company often utilize custom components available from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. When a component or product uses new technologies, initial capacity constraints may exist until the suppliers' yields have matured. If the Company's supply of a key single-sourced component for a new or existing product were delayed or constrained, if such components were available only at significantly higher prices, or if a key manufacturing vendor delayed shipments of completed products to the Company, the Company's financial condition and operating results could be materially adversely affected. The Company's business and financial performance could also be adversely affected depending on the time required to obtain sufficient quantities from the original source, or to identify and obtain sufficient quantities from an alternative source. Continued availability of these components at acceptable prices, or at all, may be affected if those suppliers decided to concentrate on the production of common components instead of components customized to meet the Company's requirements.

Significant portions of the Company's Mac computers, iPods, iPhones, logic boards, and other assembled products are now manufactured by outsourcing partners, primarily in various parts of Asia. A significant concentration of this outsourced manufacturing is currently performed by only a few of the Company's outsourcing partners, often in single locations. Certain of these outsourcing partners are the sole-sourced supplier of components and manufacturing outsourcing for many of the Company's key products including, but not limited to final assembly of substantially all of the Company's portable Mac computers, iPods, iPhones and most of the Company's iMacs. Although the Company works closely with its outsourcing partners on manufacturing schedules, the Company's operating results could be adversely affected if its outsourcing partners were unable to meet their production commitments. The Company's purchase commitments typically cover its requirements for periods ranging from 30 to 150 days.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 8—Commitments and Contingencies (Continued)

Long-Term Supply Agreements

During 2006, the Company entered into long-term supply agreements with Hynix Semiconductor, Inc., Intel Corporation, Micron Technology, Inc., Samsung Electronics Co., Ltd., and Toshiba Corporation to secure supply of NAND flash memory through calendar year 2010. As part of these agreements, the Company prepaid $1.25 billion for flash memory components during 2006, which will be applied to certain inventory purchases made over the life of each respective agreement. The Company utilized $567 million of the prepayment as of September 27, 2008.

Contingencies

The Company is subject to certain other legal proceedings and claims that have arisen in the ordinary course of business and have not been fully adjudicated. In the opinion of management, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate have a material adverse effect on its financial condition or operating results. However, the results of legal proceedings cannot be predicted with certainty. If the Company failed to prevail in any of these legal matters or if several of these legal matters were resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

Production and marketing of products in certain states and countries may subject the Company to environmental, product safety and other regulations including, in some instances, the requirement to provide customers the ability to return product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have been passed in several jurisdictions in which the Company operates, including various countries within Europe and Asia, certain Canadian provinces and certain states within the U.S. Although the Company does not anticipate any material adverse effects in the future based on the nature of its operations and the thrust of such laws, there is no assurance that such existing laws or future laws will not have a material adverse effect on the Company's financial condition or operating results.

Note 9—Segment Information and Geographic Data

In accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, the Company reports segment information based on the "management" approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of the Company's reportable segments.

The Company manages its business primarily on a geographic basis. Accordingly, the Company determined its operating segments, which are generally based on the nature and location of its customers, to be the Americas, Europe, Japan, Asia-Pacific, Retail, and FileMaker operations. The Company's reportable operating segments consist of Americas, Europe, Japan, and Retail operations. Other operating segments include Asia Pacific, which encompasses Australia and Asia except for Japan, and the Company's FileMaker, Inc. subsidiary. The Americas, Europe, Japan, and Asia Pacific segments exclude activities related to the Retail segment. The Americas segment includes both North and South America. The Europe segment includes European countries, as well as the Middle East and Africa. The Retail segment operates Apple-owned retail stores in the U.S. and in international markets. Each reportable operating segment provides similar hardware and software products and similar services to the same types of customers. The accounting policies of the various segments are the same as those described in Note 1, "Summary of Significant Accounting Policies."

The Company evaluates the performance of its operating segments based on net sales and operating income. Net sales for geographic segments are generally based on the location of customers, while Retail segment net sales are based on sales from the Company's retail stores. Operating income for each segment includes net sales to third parties, related cost of sales, and operating expenses directly attributable to the segment. Advertising

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 9—Segment Information and Geographic Data (Continued)

expenses are generally included in the geographic segment in which the expenditures are incurred. Operating income for each segment excludes other income and expense and certain expenses managed outside the operating segments. Costs excluded from segment operating income include various corporate expenses, such as manufacturing costs and variances not included in standard costs, research and development, corporate marketing expenses, stock-based compensation expense, income taxes, various nonrecurring charges, and other separately managed general and administrative costs. The Company does not include intercompany transfers between segments for management reporting purposes. Segment assets exclude corporate assets, such as cash, short-term and long-term investments, manufacturing and corporate facilities, miscellaneous corporate infrastructure, goodwill and other acquired intangible assets. Except for the Retail segment, capital asset purchases for long-lived assets are not reported to management by segment. Cash payments for capital asset purchases by the Retail segment were $389 million, $294 million, and $200 million for 2008, 2007, and 2006 respectively.

The Company has certain retail stores that have been designed and built to serve as high-profile venues to promote brand awareness and serve as vehicles for corporate sales and marketing activities. Because of their unique design elements, locations and size, these stores require substantially more investment than the Company's more typical retail stores. The Company allocates certain operating expenses associated with its high-profile stores to corporate marketing expense to reflect the estimated Company-wide benefit. The allocation of these operating costs to corporate expense is based on the amount incurred for a high-profile store in excess of that incurred by a more typical Company retail location. The Company had opened a total of 11 high-profile stores as of September 27, 2008. Expenses allocated to corporate marketing resulting from the operations of high-profile stores were $53 million, $39 million, and $33 million for the years ended September 27, 2008, September 29, 2007, and September 30, 2006 respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 9—Segment Information and Geographic Data (Continued)

Summary information by operating segment for the three fiscal years ended September 27, 2008 is as follows (in millions):

	2008	2007	2006
Americas:			
Net sales	$ 14,573	$ 11,596	$ 9,415
Operating income	$ 4,051	$ 2,949	$ 1,899
Depreciation, amortization, and accretion	$ 9	$ 9	$ 6
Segment assets (a)	$ 3,039	$ 1,497	$ 896
Europe:			
Net sales	$ 7,622	$ 5,460	$ 4,096
Operating income	$ 2,313	$ 1,348	$ 627
Depreciation, amortization, and accretion	$ 6	$ 6	$ 4
Segment assets	$ 1,775	$ 595	$ 471
Japan:			
Net sales	$ 1,509	$ 1,082	$ 1,211
Operating income	$ 440	$ 232	$ 208
Depreciation, amortization, and accretion	$ 2	$ 3	$ 3
Segment assets	$ 302	$ 159	$ 181
Retail:			
Net sales	$ 6,315	$ 4,115	$ 3,246
Operating income	$ 1,337	$ 875	$ 600
Depreciation, amortization, and accretion (b)	$ 108	$ 88	$ 59
Segment assets (b)	$ 1,869	$ 1,085	$ 651
Other Segments (c):			
Net sales	$ 2,460	$ 1,753	$ 1,347
Operating income	$ 615	$ 388	$ 235
Depreciation, amortization, and accretion	$ 4	$ 3	$ 3
Segment assets	$ 534	$ 252	$ 180

(a) The Americas asset figures do not include fixed assets held in the U.S. Such fixed assets are not allocated specifically to the Americas segment and are included in the corporate assets figures below.

(b) Retail segment depreciation and asset figures reflect the cost and related depreciation of its retail stores and related infrastructure.

(c) Other Segments include Asia-Pacific and FileMaker.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 9—Segment Information and Geographic Data (Continued)

A reconciliation of the Company's segment operating income and assets to the Consolidated Financial Statements for the three fiscal years ended September 27, 2008 is as follows (in millions):

	2008	2007	2006
Segment operating income	$ 8,756	$ 5,792	$ 3,569
Other corporate expenses, net (a)	(1,965)	(1,141)	(953)
Stock-based compensation expense	(516)	(242)	(163)
Total operating income	$ 6,275	$ 4,409	$ 2,453
Segment assets	$ 7,519	$ 3,588	$ 2,379
Corporate assets	32,053	21,759	14,826
Consolidated assets	$ 39,572	$ 25,347	$ 17,205
Segment depreciation, amortization, and accretion	$ 129	$ 109	$ 75
Corporate depreciation, amortization, and accretion	344	208	150
Consolidated depreciation, amortization, and accretion	$ 473	$ 317	$ 225

(a) Other corporate expenses include research and development, corporate marketing expenses, manufacturing costs and variances not included in standard costs, and other separately managed general and administrative expenses, including certain corporate expenses associated with support of the Retail segment.

No single customer or single country outside of the U.S. accounted for more than 10% of net sales in 2008, 2007, or 2006. Net sales and long-lived assets related to the U.S. and international operations for the three fiscal years ended September 27, 2008, are as follows (in millions):

	2008	2007	2006
Net sales:			
U.S.	$ 18,469	$ 14,128	$ 11,486
International	14,010	9,878	7,829
Total net sales	$ 32,479	$ 24,006	$ 19,315
Long-lived assets:			
U.S.	$ 2,269	$ 1,752	$ 1,150
International	410	260	218
Total long-lived assets	$ 2,679	$ 2,012	$ 1,368

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 9—Segment Information and Geographic Data (Continued)

Information regarding net sales by product for the three fiscal years ended September 27, 2008, is as follows (in millions):

	2008	2007	2006
Net sales:			
Desktops (a)	$ 5,603	$ 4,020	$ 3,319
Portables (b)	8,673	6,294	4,056
Total Mac net sales	14,276	10,314	7,375
iPod	9,153	8,305	7,676
Other music related products and services (c)	3,340	2,496	1,885
iPhone and related products and services (d)	1,844	123	—
Peripherals and other hardware (e)	1,659	1,260	1,100
Software, service, and other net sales (f)	2,207	1,508	1,279
Total net sales	$ 32,479	$ 24,006	$ 19,315

(a) Includes iMac, Mac mini, Mac Pro, Power Mac, and Xserve product lines.
(b) Includes MacBook, iBook, MacBook Air, MacBook Pro, and PowerBook product lines.
(c) Consists of iTunes Store sales and iPod services, and Apple-branded and third-party iPod accessories.
(d) Derived from handset sales, carrier agreements, and Apple-branded and third-party iPhone accessories.
(e) Includes sales of Apple-branded and third-party displays, wireless connectivity and networking solutions, and other hardware accessories.
(f) Includes sales of Apple-branded operating system and application software, third-party software, AppleCare, and Internet services.

Note 10—Related Party Transactions and Certain Other Transactions

The Company entered into a Reimbursement Agreement with its CEO, Steve Jobs, for the reimbursement of expenses incurred by Mr. Jobs in the operation of his private plane when used for Apple business. The Company recognized a total of approximately $871,000, $776,000, and $202,000 in expenses pursuant to the Reimbursement Agreement during 2008, 2007, and 2006, respectively. All expenses recognized pursuant to the Reimbursement Agreement have been included in selling, general, and administrative expenses in the Consolidated Statements of Operations.

In 2006, the Company entered into an agreement with Pixar to sell certain of Pixar's short films on the iTunes Store. Mr. Jobs was the CEO, Chairman, and a large shareholder of Pixar. On May 5, 2006, The Walt Disney Company ("Disney") acquired Pixar, which resulted in Pixar becoming a wholly-owned subsidiary of Disney. Upon Disney's acquisition of Pixar, Mr. Jobs' shares of Pixar common stock were exchanged for Disney's common stock and he was elected to the Disney Board of Directors. Royalty expense recognized by the Company under the arrangement with Pixar from September 25, 2005 through May 5, 2006 was less than $1 million.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 11—Selected Quarterly Financial Information (Unaudited)

The following tables set forth a summary of the Company's quarterly financial information for each of the four quarters ended September 27, 2008 and September 29, 2007 (in millions, except per share amounts):

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
2008				
Net sales	$ 7,895	$ 7,464	$ 7,512	$ 9,608
Gross margin	$ 2,739	$ 2,600	$ 2,474	$ 3,332
Net income	$ 1,136	$ 1,072	$ 1,045	$ 1,581
Earnings per common share:				
Basic	$ 1.28	$ 1.21	$ 1.19	$ 1.81
Diluted	$ 1.26	$ 1.19	$ 1.16	$ 1.76
2007				
Net sales	$ 6,217	$ 5,410	$ 5,264	$ 7,115
Gross margin	$ 2,090	$ 1,995	$ 1,849	$ 2,220
Net income	$ 904	$ 818	$ 770	$ 1,004
Earnings per common share:				
Basic	$ 1.04	$ 0.94	$ 0.89	$ 1.17
Diluted	$ 1.01	$ 0.92	$ 0.87	$ 1.14

Basic and diluted earnings per share are computed independently for each of the quarters presented. Therefore, the sum of quarterly basic and diluted per share information may not equal annual basic and diluted earnings per share.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Apple Inc.:

We have audited the accompanying consolidated balance sheets of Apple Inc. and subsidiaries (the Company) as of September 27, 2008 and September 29, 2007, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended September 27, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Apple Inc. and subsidiaries as of September 27, 2008 and September 29, 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended September 27, 2008, in conformity with U.S. generally accepted accounting principles.

As discussed in note 1 to the Consolidated Financial Statements, effective September 30, 2007, the Company adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109.*

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Apple Inc.'s internal control over financial reporting as of September 27, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated November 4, 2008 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Mountain View, California
November 4, 2008

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Apple Inc.:

We have audited Apple Inc.'s internal control over financial reporting as of September 27, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Apple's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Apple Inc. maintained, in all material respects, effective internal control over financial reporting as of September 27, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by the COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Apple Inc. and subsidiaries as of September 27, 2008 and September 29, 2007, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended September 27, 2008, and our report dated November 4, 2008 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Mountain View, California
November 4, 2008

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures
Based on an evaluation under the supervision and with the participation of the Company's management, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ("Exchange Act") were effective as of September 27, 2008 to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Inherent Limitations Over Internal Controls
The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the Company's assets;

(ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that the Company's receipts and expenditures are being made only in accordance with authorizations of the Company's management and directors; and

(iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Management, including the Company's Chief Executive Officer and Chief Financial Officer, does not expect that the Company's internal controls will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of internal controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Also, any evaluation of the effectiveness of controls in future periods are subject to the risk that those internal controls may become inadequate because of changes in business conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management's Annual Report on Internal Control Over Financial Reporting
The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). Management conducted an evaluation of the effectiveness of the Company's internal control over financial reporting based on the criteria set forth in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on this evaluation, management has concluded that the Company's internal control over financial reporting was effective as of September 27, 2008. The Company's independent registered public accounting firm, KPMG LLP, has issued an audit report on the Company's internal control over financial reporting. The report on the audit of internal control over financial reporting appears on page 89 of this Form 10-K.

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Changes in Internal Control Over Financial Reporting
There were no changes in the Company's internal control over financial reporting during the fourth quarter of fiscal 2008, which were identified in connection with management's evaluation required by paragraph (d) of rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information

On November 3, 2008, Tony Fadell, Senior Vice President, iPod Division of the Company became Special Advisor to the Company's Chief Executive Officer. In this new position, Mr. Fadell no longer will be an executive officer of the Company. In connection therewith, Mr. Fadell and the Company have entered into a Transition Agreement and a Settlement Agreement and Release (the "Transition Agreement" and the "Settlement Agreement," respectively), under which Mr. Fadell will receive a salary of three hundred thousand dollars annually, and will be entitled to bonus and other health and welfare benefits generally available to other senior managers for the duration of the Transition Agreement, which remains in effect until March 24, 2010. The Transition Agreement also provides for the cancellation of outstanding and unvested 155,000 restricted stock units held by Mr. Fadell. Upon approval by the Compensation Committee of the Company's Board of Directors, Mr. Fadell will be granted 77,500 restricted stock units that will vest in full on March 24, 2010, subject to his continued employment with the Company through the vesting date and further subject to accelerated vesting if the Company terminates his employment without cause. The restricted stock units are payable upon vesting in shares of the Company's common stock on a one-for-one basis. The Settlement Agreement includes Mr. Fadell's release of claims against the Company and agreement not to solicit the Company's employees for one year following the termination of his employment.

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PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this Item under the heading "Directors" is incorporated herein by reference from the information to be contained in the Company's 2009 Proxy Statement to be filed with the U.S. Securities and Exchange Commission in connection with the solicitation of proxies for the Company's Annual Meeting of Shareholders to be held on February 25, 2009 ("2009 Proxy Statement"). The information under the heading "Executive Officers of the Registrant" in Part I, Item 1 of this Form 10-K is also incorporated herein by reference.

Item 11. Executive Compensation

The information required by this Item under the headings "Executive Compensation" and "Compensation Discussion and Analysis" is incorporated herein by reference from the information to be contained in the Company's 2009 Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item under the headings "Security Ownership of Certain Beneficial Owners and Management" and "Equity Compensation Plan Information" are incorporated herein by reference from the information to be contained in the Company's 2009 Proxy Statement.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this Item under the heading "Review, Approval or Ratification of Transactions with Related Persons" is incorporated herein by reference from the information to be contained in the Company's 2009 Proxy Statement.

Item 14. Principal Accountant Fees and Services

The information required by this Item under the heading "Fees Paid to Auditors" is incorporated herein by reference from the information to be contained in the Company's 2009 Proxy Statement.

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PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) Documents filed as part of this report

(1) All financial statements

(2) Financial Statement Schedules

All financial statement schedules have been omitted, since the required information is not applicable or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Consolidated Financial Statements and Notes thereto.

(b) Exhibits required by Item 601 of Regulation S-K

The information required by this Item is set forth on the exhibit index that follows the signature page of this report.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, this 4th day of November 2008.

APPLE INC.

By: /s/ PETER OPPENHEIMER
Peter Oppenheimer
Senior Vice President and
Chief Financial Officer

Power of Attorney

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Steven P. Jobs and Peter Oppenheimer, jointly and severally, his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this Annual Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Name	Title	Date
/s/ STEVEN P. JOBS STEVEN P. JOBS	Chief Executive Officer and Director (Principal Executive Officer)	November 4, 2008
/s/ PETER OPPENHEIMER PETER OPPENHEIMER	Senior Vice President and Chief Financial Officer (Principal Financial and Principal Accounting Officer)	November 4, 2008
/s/ WILLIAM V. CAMPBELL WILLIAM V. CAMPBELL	Director	November 4, 2008
/s/ MILLARD S. DREXLER MILLARD S. DREXLER	Director	November 4, 2008
/s/ ALBERT GORE, JR. ALBERT GORE, JR.	Director	November 4, 2008
/s/ ANDREA JUNG ANDREA JUNG	Director	November 4, 2008
/s/ ARTHUR D. LEVINSON ARTHUR D. LEVINSON	Director	November 4, 2008
/s/ ERIC E. SCHMIDT ERIC E. SCHMIDT	Director	November 4, 2008
/s/ JEROME B. YORK JEROME B. YORK	Director	November 4, 2008

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EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference Form	Filing Date/ Period End Date
3.1	Restated Articles of Incorporation, filed with the Secretary of State of the State of California on January 27, 1988.	S-3	7/27/88
3.2	Certificate of Amendment to Restated Articles of Incorporation, filed with the Secretary of State of the State of California on May 4, 2000.	10-Q	5/11/00
3.3	Certificate of Amendment to Restated Articles of Incorporation, as amended, filed with the Secretary of State of the State of California on February 25, 2005.	10-Q	3/26/05
3.4	Certificate of Determination of Preferences of Series A Non-Voting Convertible Preferred Stock of the Registrant.	10-K	9/26/97
3.5	By-Laws of the Registrant, as amended through August 20, 2008.	8-K	8/25/08
4.1	Form of Stock Certificate of the Registrant.	10-Q	12/30/06
10.1*	Employee Stock Purchase Plan, as amended through May 10, 2007.	8-K	5/16/07
10.2*	Form of Indemnification Agreement between the Registrant and each officer of the Registrant.	10-K	9/26/97
10.3*	1997 Employee Stock Option Plan, as amended through October 19, 2001.	10-K	9/28/02
10.4*	1997 Director Stock Option Plan, as amended through May 10, 2007.	8-K	5/16/07
10.5*	2003 Employee Stock Plan, as amended through May 10, 2007.	8-K	5/16/07
10.6*	Reimbursement Agreement dated as of May 25, 2001 by and between the Registrant and Steven P. Jobs.	10-Q	6/29/02
10.7*	Performance Bonus Plan dated April 21, 2005.	10-Q	3/26/05
10.8*	Form of Option Agreements.	10-K	9/24/05
10.9*	Form of Restricted Stock Unit Award Agreement effective as of August 28, 2007.	10-K	9/29/07
14.1	Business Conduct Policy of the Registrant dated January 2008.	10-Q	12/29/07
21**	Subsidiaries of the Registrant.		
23.1**	Consent of Independent Registered Public Accounting Firm.		
24.1**	Power of Attorney (included on the Signature Page of this Annual Report on Form 10-K).		
31.1**	Rule 13a-14(a) / 15d-14(a) Certification of Chief Executive Officer.		
31.2**	Rule 13a-14(a) / 15d-14(a) Certification of Chief Financial Officer.		
32.1***	Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer.		

* Indicates management contract or compensatory plan or arrangement.

** Filed herewith.

*** Furnished herewith.