

APPLE INC
Form 10-Q
April 27, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 26, 2016

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: **001-36743**

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)

(408) 996-1010

(Registrant's telephone number, including area code)

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 (§232.405 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 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 a 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 Exchange Act).

Yes No

5,477,425,000 shares of common stock, par value \$0.00001 per share, issued and outstanding as of April 8, 2016

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Apple Inc.

Form 10-Q

For the Fiscal Quarter Ended March 26, 2016

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****Apple Inc.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**

(In millions, except number of shares which are reflected in thousands and per share amounts)

	Three Months Ended		Six Months Ended	
	March 26,	March 28,	March 26,	March 28,
	2016	2015	2016	2015
Net sales	\$ 50,557	\$ 58,010	\$ 126,429	\$ 132,609
Cost of sales	30,636	34,354	76,085	79,212
Gross margin	19,921	23,656	50,344	53,397
Operating expenses:				
Research and development	2,511	1,918	4,915	3,813
Selling, general and administrative	3,423	3,460	7,271	7,060
Total operating expenses	5,934	5,378	12,186	10,873
Operating income	13,987	18,278	38,158	42,524
Other income/(expense), net	155	286	557	456
Income before provision for income taxes	14,142	18,564	38,715	42,980
Provision for income taxes	3,626	4,995	9,838	11,387
Net income	\$ 10,516	\$ 13,569	\$ 28,877	\$ 31,593
Earnings per share:				
Basic	\$ 1.91	\$ 2.34	\$ 5.22	\$ 5.43
Diluted	\$ 1.90	\$ 2.33	\$ 5.19	\$ 5.39
Shares used in computing earnings per share:				
Basic	5,514,381	5,793,799	5,536,656	5,818,441
Diluted	5,540,886	5,834,858	5,567,506	5,858,330

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Cash dividends declared per share	\$	0.52	\$	0.47	\$	1.04	\$	0.94
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See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents**Apple Inc.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)**

(In millions)

	Three Months Ended		Six Months Ended	
	March 26, 2016	March 28, 2015	March 26, 2016	March 28, 2015
Net income	\$ 10,516	\$ 13,569	\$ 28,877	\$ 31,593
Other comprehensive income/(loss):				
Change in foreign currency translation, net of tax	120	(180)	18	(246)
Change in unrealized gains/losses on derivative instruments:				
Change in fair value of derivatives, net of tax	(178)	1,037	109	3,019
Adjustment for net (gains)/losses realized and included in net income, net of tax	(528)	(739)	(973)	(1,304)
Total change in unrealized gains/losses on derivative instruments, net of tax	(706)	298	(864)	1,715
Change in unrealized gains/losses on marketable securities:				
Change in fair value of marketable securities, net of tax	969	593	47	137
Adjustment for net (gains)/losses realized and included in net income, net of tax	49	36	96	22
Total change in unrealized gains/losses on marketable securities, net of tax	1,018	629	143	159
Total other comprehensive income/(loss)	432	747	(703)	1,628
Total comprehensive income	\$ 10,948	\$ 14,316	\$ 28,174	\$ 33,221

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents**Apple Inc.****CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)**

(In millions, except number of shares which are reflected in thousands and par value)

	March 26, 2016	September 26, 2015
ASSETS:		
Current assets:		
Cash and cash equivalents	\$ 21,514	\$ 21,120
Short-term marketable securities	33,769	20,481
Accounts receivable, less allowances of \$60 and \$63, respectively	12,229	16,849
Inventories	2,281	2,349
Vendor non-trade receivables	7,595	13,494
Other current assets	10,204	15,085
Total current assets	87,592	89,378
Long-term marketable securities	177,645	164,065
Property, plant and equipment, net	23,203	22,471
Goodwill	5,249	5,116
Acquired intangible assets, net	3,843	3,893
Other non-current assets	7,745	5,556
Total assets	\$ 305,277	\$ 290,479
LIABILITIES AND SHAREHOLDERS EQUITY:		
Current liabilities:		
Accounts payable	\$ 25,098	\$ 35,490
Accrued expenses	23,208	25,181
Deferred revenue	9,461	8,940
Commercial paper	7,998	8,499
Current portion of long-term debt	2,500	2,500
Total current liabilities	68,265	80,610
Deferred revenue, non-current	3,322	3,624
Long-term debt	69,374	53,463
Other non-current liabilities	33,859	33,427
Total liabilities	174,820	171,124
Commitments and contingencies		

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Shareholders' equity:			
Common stock and additional paid-in capital, \$0.00001 par value: 12,600,000 shares authorized; 5,478,446 and 5,578,753 shares issued and outstanding, respectively		29,484	27,416
Retained earnings		102,021	92,284
Accumulated other comprehensive income/(loss)		(1,048)	(345)
Total shareholders' equity		130,457	119,355
Total liabilities and shareholders' equity	\$	305,277	\$ 290,479

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents**Apple Inc.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

(In millions)

	Six Months Ended	
	March 26, 2016	March 28, 2015
Cash and cash equivalents, beginning of the period	\$ 21,120	\$ 13,844
Operating activities:		
Net income	28,877	31,593
Adjustments to reconcile net income to cash generated by operating activities:		
Depreciation and amortization	5,431	5,054
Share-based compensation expense	2,126	1,815
Deferred income tax expense	3,092	1,879
Changes in operating assets and liabilities:		
Accounts receivable, net	4,620	6,555
Inventories	68	(285)
Vendor non-trade receivables	5,899	2,500
Other current and non-current assets	300	2,448
Accounts payable	(9,475)	(5,428)
Deferred revenue	219	993
Other current and non-current liabilities	(2,093)	5,679
Cash generated by operating activities	39,064	52,803
Investing activities:		
Purchases of marketable securities	(86,242)	(92,523)
Proceeds from maturities of marketable securities	9,148	5,871
Proceeds from sales of marketable securities	50,051	48,924
Payments made in connection with business acquisitions, net	(140)	(115)
Payments for acquisition of property, plant and equipment	(5,948)	(5,586)
Payments for acquisition of intangible assets	(657)	(155)
Other	(322)	88
Cash used in investing activities	(34,110)	(43,496)
Financing activities:		
Proceeds from issuance of common stock	247	309
Excess tax benefits from equity awards	264	357
Payments for taxes related to net share settlement of equity awards	(751)	(608)

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Payments for dividends and dividend equivalents	(5,871)	(5,544)
Repurchase of common stock	(13,530)	(12,000)
Proceeds from issuance of term debt, net	15,584	11,332
Change in commercial paper, net	(503)	(2,508)
Cash used in financing activities	(4,560)	(8,662)
Increase in cash and cash equivalents	394	645
Cash and cash equivalents, end of the period	\$ 21,514	\$ 14,489
Supplemental cash flow disclosure:		
Cash paid for income taxes, net	\$ 6,630	\$ 7,058
Cash paid for interest	\$ 565	\$ 220

See accompanying Notes to Condensed Consolidated Financial Statements.

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Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 1 Summary of Significant Accounting Policies

Apple Inc. and its wholly-owned subsidiaries (collectively Apple or the Company) designs, manufactures and markets mobile communication and media devices, personal computers and portable digital music players, and sells a variety of related software, services, accessories, networking solutions and third-party digital content and applications. The Company sells its products worldwide through its retail stores, online stores and direct sales force, as well as through third-party cellular network carriers, wholesalers, retailers and value-added resellers. In addition, the Company sells a variety of third-party Apple-compatible products, including application software and various accessories through its online and retail stores. The Company sells to consumers, small and mid-sized businesses and education, enterprise and government customers.

Basis of Presentation and Preparation

The accompanying condensed consolidated financial statements include the accounts of the Company. Intercompany accounts and transactions have been eliminated. In the opinion of the Company's management, the condensed consolidated financial statements reflect all adjustments, which are normal and recurring in nature, necessary for fair financial statement presentation. The preparation of these condensed 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 condensed consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates. Certain prior period amounts in the condensed consolidated financial statements have been reclassified to conform to the current period's presentation.

These condensed consolidated financial statements and accompanying notes should be read in conjunction with the Company's annual consolidated financial statements and the notes thereto included in its Annual Report on Form 10-K for the fiscal year ended September 26, 2015 (the 2015 Form 10-K). The Company's fiscal year is the 52 or 53-week period that ends on the last Saturday of September. An additional week is included in the first fiscal quarter approximately every six years to realign fiscal quarters with calendar quarters. The Company's fiscal years 2016 and 2015 each include 52 weeks. Unless otherwise stated, references to particular years, quarters or months refer to the Company's fiscal years ended in September and the associated quarters or months of those fiscal years.

During the first quarter of 2016, the Company adopted an accounting standard that simplified the presentation of deferred taxes by requiring deferred tax assets and liabilities be classified as noncurrent in a classified statement of financial position. The Company has adopted this accounting standard prospectively; accordingly, the prior period amounts in the Company's Condensed Consolidated Balance Sheets within this Quarterly Report on Form 10-Q were not adjusted to conform to the new accounting standard. The adoption of this accounting standard was not material to the Company's condensed consolidated financial statements.

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Basic earnings per 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 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 Company's employee stock purchase plan, unvested restricted stock 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.

The following table shows the computation of basic and diluted earnings per share for the three- and six-month periods ended March 26, 2016 and March 28, 2015 (net income in millions and shares in thousands):

	Three Months Ended		Six Months Ended	
	March 26,	March 28,	March 26,	March 28,
	2016	2015	2016	2015
Numerator:				
Net income	\$ 10,516	\$ 13,569	\$ 28,877	\$ 31,593
Denominator:				
Weighted-average shares outstanding	5,514,381	5,793,799	5,536,656	5,818,441
Effect of dilutive securities	26,505	41,059	30,850	39,889
Weighted-average diluted shares	5,540,886	5,834,858	5,567,506	5,858,330
Basic earnings per share	\$ 1.91	\$ 2.34	\$ 5.22	\$ 5.43
Diluted earnings per share	\$ 1.90	\$ 2.33	\$ 5.19	\$ 5.39

Potentially dilutive securities whose effect would have been antidilutive are excluded from the computation of diluted earnings per share.

Note 2 Financial Instruments**Cash, Cash Equivalents and Marketable Securities**

The following tables show the Company's cash and available-for-sale securities' adjusted cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category recorded as cash and cash equivalents or short- or long-term marketable securities as of March 26, 2016 and September 26, 2015 (in millions):

March 26, 2016

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	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short-Term Marketable Securities	Long Term Mark Secu
	\$ 10,199	\$ 0	\$ 0	\$ 10,199	\$ 10,199	\$ 0	\$
1):							
market funds	2,798	0	0	2,798	2,798	0	
funds	1,772	0	(203)	1,569	0	1,569	
	4,570	0	(203)	4,367	2,798	1,569	
2):							
treasury securities	47,883	207	(24)	48,066	3,753	10,614	
agency securities	6,641	12	(2)	6,651	465	2,703	
U.S. government securities	6,873	91	(121)	6,843	0	696	
certificates of deposit and time deposits	4,169	0	0	4,169	1,529	660	
commercial paper	4,500	0	0	4,500	2,681	1,819	
corporate securities	129,394	543	(1,074)	128,863	89	15,553	
municipal securities	952	6	0	958	0	72	
structured and asset-backed securities	18,268	86	(42)	18,312	0	83	
	218,680	945	(1,263)	218,362	8,517	32,200	
	\$ 233,449	\$ 945	\$ (1,466)	\$ 232,928	\$ 21,514	\$ 33,769	\$

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	September 26, 2015						
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short-Term Marketable Securities	Long Term Mark Secu
	\$ 11,389	\$ 0	\$ 0	\$ 11,389	\$ 11,389	\$ 0	\$
(1):							
market funds	1,798	0	0	1,798	1,798	0	
unds	1,772	0	(144)	1,628	0	1,628	
	3,570	0	(144)	3,426	1,798	1,628	
(2):							
asury securities	34,902	181	(1)	35,082	0	3,498	
ncy securities	5,864	14	0	5,878	841	767	
. government securities	6,356	45	(167)	6,234	43	135	
tes of deposit and time deposits	4,347	0	0	4,347	2,065	1,405	
cial paper	6,016	0	0	6,016	4,981	1,035	
e securities	116,908	242	(985)	116,165	3	11,948	
al securities	947	5	0	952	0	48	
e- and asset-backed securities	16,121	87	(31)	16,177	0	17	
	191,461	574	(1,184)	190,851	7,933	18,853	
	\$ 206,420	\$ 574	\$ (1,328)	\$ 205,666	\$ 21,120	\$ 20,481	\$

(1) The fair value of Level 1 securities is estimated based on quoted prices in active markets for identical assets or liabilities.

(2) The fair value of Level 2 securities is estimated based on 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.

The Company may sell certain of its marketable securities prior to their stated maturities for strategic reasons including, but not limited to, anticipation of credit deterioration and duration management. The maturities of the Company's long-term marketable securities generally range from one to five years.

The Company considers the declines in market value of its marketable securities investment portfolio to be temporary in nature. The Company typically invests in highly-rated securities, and its investment policy generally limits the amount of credit exposure to any one issuer. The policy generally requires investments to be investment grade, with the primary objective of minimizing the potential risk of principal loss. Fair values were determined for each individual security in the investment portfolio. When evaluating an investment for other-than-temporary impairment

the Company reviews factors such as the length of time and extent to which fair value has been below its cost basis, the financial condition of the issuer and any changes thereto, changes in market interest rates 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 cost basis. As of March 26, 2016, the Company does not consider any of its investments to be other-than-temporarily impaired.

Derivative Financial Instruments

The Company may use derivatives to partially offset its business exposure to foreign currency and interest rate risk on expected future cash flows, on net investments in certain foreign subsidiaries and on certain existing assets and liabilities. However, the Company may choose not to hedge certain exposures for a variety of reasons including, but not limited to, 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 or interest rates.

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 may hedge a portion of forecasted foreign currency revenue, and 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 may enter into forward contracts, option contracts or other instruments to manage this risk and may designate these instruments as cash flow hedges. The Company typically hedges portions of its forecasted foreign currency exposure associated with revenue and inventory purchases, typically for up to 12 months.

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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. In addition, the Company may use non-derivative financial instruments, such as its foreign currency-denominated debt, as economic hedges of its net investments in certain foreign subsidiaries. In both of these cases, the Company designates these instruments as net investment hedges.

The Company may also enter into non-designated foreign currency 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.

The Company may enter into interest rate swaps, options, or other instruments to manage interest rate risk. These instruments may offset a portion of changes in income or expense, or changes in fair value of the Company's term debt or investments. The Company designates these instruments as either cash flow or fair value hedges. The Company's hedged interest rate transactions as of March 26, 2016 are expected to be recognized within ten years.

Cash Flow Hedges

The effective portions of cash flow hedges are recorded in accumulated other comprehensive income (AOCI) until the hedged item is recognized in earnings. Deferred gains and losses associated with cash flow hedges of foreign currency revenue are recognized as a component of net sales in the same period as the related revenue is recognized, and deferred gains and losses related to cash flow hedges of inventory purchases are recognized as a component of cost of sales in the same period as the related costs are recognized. Deferred gains and losses associated with cash flow hedges of interest income or expense are recognized in other income/(expense), net in the same period as the related income or expense is recognized. The ineffective portions and amounts excluded from the effectiveness testing of cash flow hedges are recognized in other income/(expense), net.

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 AOCI associated with such derivative instruments are reclassified immediately into other income/(expense), net. Any subsequent changes in fair value of such derivative instruments are reflected in other income/(expense), net unless they are re-designated as hedges of other transactions.

Net Investment Hedges

The effective portions of net investment hedges are recorded in other comprehensive income (OCI) as a part of the cumulative translation adjustment. The ineffective portions and amounts excluded from the effectiveness testing of net investment hedges are recognized in other income/(expense), net.

Fair Value Hedges

Gains and losses related to changes in fair value hedges are recognized in earnings along with a corresponding loss or gain related to the change in value of the underlying hedged item.

Non-Designated Derivatives

Derivatives that are not designated as hedging instruments are adjusted to fair value through earnings in the financial statement line item to which the derivative relates.

The Company records all derivatives in the Condensed Consolidated Balance Sheets at fair value. The Company's accounting treatment for these derivative instruments is based on its hedge designation. The following tables show the Company's derivative instruments at gross fair value as of March 26, 2016 and September 26, 2015 (in millions):

	March 26, 2016		
	Fair Value of	Fair Value of	Total
	Derivatives Designated	Derivatives Not Designated	Fair Value
	as Hedge Instruments	as Hedge Instruments	
Derivative assets ⁽¹⁾ :			
Foreign exchange contracts	\$ 564	\$ 69	\$ 633
Interest rate contracts	\$ 557	\$ 0	\$ 557
Derivative liabilities ⁽²⁾ :			
Foreign exchange contracts	\$ 1,033	\$ 243	\$ 1,276
Interest rate contracts	\$ 36	\$ 0	\$ 36

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	September 26, 2015		
	Fair Value of Derivatives Designated as Hedge Instruments	Fair Value of Derivatives Not Designated as Hedge Instruments	Total Fair Value
Derivative assets ⁽¹⁾ :			
Foreign exchange contracts	\$ 1,442	\$ 109	\$ 1,551
Interest rate contracts	\$ 394	\$ 0	\$ 394
Derivative liabilities ⁽²⁾ :			
Foreign exchange contracts	\$ 905	\$ 94	\$ 999
Interest rate contracts	\$ 13	\$ 0	\$ 13

(1) The fair value of derivative assets is measured using Level 2 fair value inputs and is recorded as other current assets in the Condensed Consolidated Balance Sheets.

(2) The fair value of derivative liabilities is measured using Level 2 fair value inputs and is recorded as accrued expenses in the Condensed Consolidated Balance Sheets.

The following table shows the pre-tax gains and losses of the Company's derivative and non-derivative instruments designated as cash flow, net investment and fair value hedges on OCI and the Condensed Consolidated Statements of Operations for the three- and six-month periods ended March 26, 2016 and March 28, 2015 (in millions):

	Three Months Ended		Six Months Ended	
	March 26, 2016	March 28, 2015	March 26, 2016	March 28, 2015
Gains/(Losses) recognized in OCI effective portion:				
Cash flow hedges:				
Foreign exchange contracts	\$ (138)	\$ 1,249	\$ 188	\$ 3,750
Interest rate contracts	(50)	(87)	(42)	(91)
Total	\$ (188)	\$ 1,162	\$ 146	\$ 3,659
Net investment hedges:				
Foreign exchange contracts	\$ 0	\$ (6)	\$ 0	\$ 112
Foreign currency debt	(87)	0	(77)	0
Total	\$ (87)	\$ (6)	\$ (77)	\$ 112

Gains/(Losses) reclassified from AOCI into net income effective portion:

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Cash flow hedges:

Foreign exchange contracts	\$	668	\$	818	\$	1,183	\$	1,485
Interest rate contracts		(3)		(5)		(7)		(9)
Total	\$	665	\$	813	\$	1,176	\$	1,476

Gains/(Losses) on derivative instruments:

Fair value hedges:

Interest rate contracts	\$	250	\$	122	\$	139	\$	239
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Gains/(Losses) related to hedged items:

Fair value hedges:

Interest rate contracts	\$	(250)	\$	(122)	\$	(139)	\$	(239)
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The following table shows the notional amounts of the Company's outstanding derivative instruments and credit risk amounts associated with outstanding or unsettled derivative instruments as of March 26, 2016 and September 26, 2015 (in millions):

	March 26, 2016		September 26, 2015	
	Notional Amount	Credit Risk Amount	Notional Amount	Credit Risk Amount
Instruments designated as accounting hedges:				
Foreign exchange contracts	\$ 41,996	\$ 564	\$ 70,054	\$ 1,385
Interest rate contracts	\$ 23,750	\$ 557	\$ 18,750	\$ 394
Instruments not designated as accounting hedges:				
Foreign exchange contracts	\$ 30,573	\$ 69	\$ 49,190	\$ 109

The notional amounts for outstanding derivative instruments provide one measure of the transaction volume outstanding 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 derivative instruments that are outstanding or unsettled if all counterparties failed to perform according to the terms of the contract, based on then-current currency or interest rates at each respective date. The Company's exposure to credit loss and market risk will vary over time as currency and interest rates change. Although the table above reflects the notional and credit risk amounts of the Company's derivative instruments, it does not reflect the gains or losses associated with the exposures and transactions that the 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 are designed to 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 or posted when the net fair value of certain financial instruments fluctuates from contractually established thresholds. The Company presents its derivative assets and derivative liabilities at their gross fair values in its Condensed Consolidated Balance Sheets. As of March 26, 2016, the net cash collateral posted by the Company related to derivative instruments under its collateral security arrangements was \$3 million, which was recorded as other current assets in the Condensed Consolidated Balance Sheet. As of September 26, 2015, the net cash collateral received by the Company related to derivative instruments under its collateral security arrangements was \$1.0 billion, which was recorded as accrued expenses in the Condensed Consolidated Balance Sheet.

Under master netting arrangements with the respective counterparties to the Company's derivative contracts, the Company is allowed to net settle transactions with a single net amount payable by one party to the other. As of March 26, 2016 and September 26, 2015, the potential effects of these rights of set-off associated with the Company's derivative contracts, including the effects of collateral, would be a reduction to both derivative assets and derivative liabilities of \$1.4 billion and \$2.2 billion, respectively, resulting in net derivative liabilities of \$119 million and \$78 million, respectively.

Accounts Receivable

Trade Receivables

The Company has considerable trade receivables outstanding with its third-party cellular network carriers, wholesalers, retailers, value-added resellers, small and mid-sized businesses and education, enterprise and government customers that are not covered by collateral, third-party financing arrangements or credit insurance. As of March 26, 2016 and September 26, 2015, the Company had one customer that represented 12% of total trade receivables. The Company's cellular network carriers accounted for 55% and 71% of trade receivables as of March 26, 2016 and September 26, 2015, respectively.

Vendor Non-Trade Receivables

The Company has non-trade receivables from certain of its manufacturing vendors resulting from the sale of components to these vendors who manufacture sub-assemblies or assemble final products for the Company. Vendor non-trade receivables from three of the Company's vendors accounted for 55%, 14% and 11% of total vendor non-trade receivables as of March 26, 2016 and three of the Company's vendors accounted for 38%, 18% and 14% of total vendor non-trade receivables as of September 26, 2015.

Table of Contents**Note 3 Condensed Consolidated Financial Statement Details**

The following tables show the Company's condensed consolidated financial statement details as of March 26, 2016 and September 26, 2015 (in millions):

Property, Plant and Equipment, Net

	March 26, 2016	September 26, 2015
Land and buildings	\$ 8,391	\$ 6,956
Machinery, equipment and internal-use software	39,723	37,038
Leasehold improvements	5,937	5,263
Gross property, plant and equipment	54,051	49,257
Accumulated depreciation and amortization	(30,848)	(26,786)
Total property, plant and equipment, net	\$ 23,203	\$ 22,471

Other Non-Current Liabilities

	March 26, 2016	September 26, 2015
Deferred tax liabilities	\$ 22,955	\$ 24,062
Other non-current liabilities	10,904	9,365
Total other non-current liabilities	\$ 33,859	\$ 33,427

Other Income/(Expense), Net

The following table shows the detail of other income/(expense), net for the three- and six-month periods ended March 26, 2016 and March 28, 2015 (in millions):

	Three Months Ended		Six Months Ended	
	March 26, 2016	March 28, 2015	March 26, 2016	March 28, 2015
Interest and dividend income	\$ 986	\$ 675	\$ 1,927	\$ 1,329
Interest expense	(321)	(163)	(597)	(294)
Other expense, net	(510)	(226)	(773)	(579)

Total other income/(expense), net	\$	155	\$	286	\$	557	\$	456
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Note 4 Acquired Intangible Assets

The Company's acquired intangible assets with definite useful lives primarily consist of patents and licenses and are amortized over periods typically from three to seven years. The following table summarizes the components of gross and net acquired intangible asset balances as of March 26, 2016 and September 26, 2015 (in millions):

	March 26, 2016			September 26, 2015		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Definite-lived and amortizable acquired intangible assets	\$ 8,797	\$ (5,054)	\$ 3,743	\$ 8,125	\$ (4,332)	\$ 3,793
Indefinite-lived and non-amortizable acquired intangible assets	100	0	100	100	0	100
Total acquired intangible assets	\$ 8,897	\$ (5,054)	\$ 3,843	\$ 8,225	\$ (4,332)	\$ 3,893

Table of Contents**Note 5 Income Taxes**

As of March 26, 2016, the Company recorded gross unrecognized tax benefits of \$7.5 billion, of which \$2.8 billion, if recognized, would affect the Company's effective tax rate. As of September 26, 2015, the total amount of gross unrecognized tax benefits was \$6.9 billion, of which \$2.5 billion, if recognized, would have affected the Company's effective tax rate. The Company's total gross unrecognized tax benefits are classified as other non-current liabilities in the Condensed Consolidated Balance Sheets. The Company had \$1.5 billion and \$1.3 billion of gross interest and penalties accrued as of March 26, 2016 and September 26, 2015, respectively, which are classified as other non-current liabilities in the Condensed Consolidated Balance Sheets.

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 taxes in the period such resolution occurs. Although timing of the resolution and/or closure of audits is not certain, the Company believes it is reasonably possible that its gross unrecognized tax benefits could decrease (whether by payment, release or a combination of both) in the next 12 months by as much as \$800 million.

On June 11, 2014, the European Commission issued an opening decision initiating a formal investigation against Ireland for alleged state aid to the Company. The opening decision concerns the allocation of profits for taxation purposes of the Irish branches of two subsidiaries of the Company. The Company believes the European Commission's assertions are without merit. If the European Commission were to conclude against Ireland, the European Commission could require Ireland to recover from the Company past taxes covering a period of up to 10 years reflective of the disallowed state aid. While such amount could be material, as of March 26, 2016 the Company is unable to estimate the impact.

Note 6 Debt**Commercial Paper**

The Company issues unsecured short-term promissory notes (Commercial Paper) pursuant to a commercial paper program. The Company uses net proceeds from the commercial paper program for general corporate purposes, including dividends and share repurchases. As of March 26, 2016 and September 26, 2015, the Company had \$8.0 billion and \$8.5 billion of Commercial Paper outstanding, respectively, with maturities generally less than nine months. The weighted-average interest rate of the Company's Commercial Paper was 0.39% as of March 26, 2016 and 0.14% as of September 26, 2015.

The following table provides a summary of cash flows associated with the issuance and maturities of Commercial Paper for the six months ended March 26, 2016 and March 28, 2015 (in millions):

	Six Months Ended	
	March 26, 2016	March 28, 2015
Maturities less than 90 days:		
Proceeds from (repayments of) commercial paper, net	\$ 660	\$ 985

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Maturities greater than 90 days:			
Proceeds from commercial paper		669	547
Repayments of commercial paper		(1,832)	(4,040)
Proceeds from (repayments of) commercial paper, net		(1,163)	(3,493)
Total change in commercial paper, net	\$	(503)	\$ (2,508)

Table of Contents**Long-Term Debt**

As of March 26, 2016, the Company had outstanding floating- and fixed-rate notes with varying maturities for an aggregate principal amount of \$71.3 billion (collectively the Notes). The Notes are senior unsecured obligations, and interest is payable in arrears, quarterly for the U.S. dollar-denominated and Australian dollar-denominated floating-rate notes, semi-annually for the U.S. dollar-denominated, Australian dollar-denominated, British pound-denominated and Japanese yen-denominated fixed-rate notes and annually for the euro-denominated and Swiss franc-denominated fixed-rate notes. The following table provides a summary of the Company's term debt as of March 26, 2016 and September 26, 2015:

	Maturities	March, 26, 2016		September 26, 2015	
		Amount (in millions)	Effective Interest Rate	Amount (in millions)	Effective Interest Rate
2013 debt issuance of \$17.0 billion:					
Floating-rate notes	2016 - 2018	\$ 3,000	0.51% - 1.10%	\$ 3,000	0.51% - 1.10%
Fixed-rate 0.45% - 3.85% notes	2016 - 2043	14,000	0.51% - 3.91%	14,000	0.51% - 3.91%
2014 debt issuance of \$12.0 billion:					
Floating-rate notes	2017 - 2019	2,000	0.69% - 0.92%	2,000	0.37% - 0.60%
Fixed-rate 1.05% - 4.45% notes	2017 - 2044	10,000	0.69% - 4.48%	10,000	0.37% - 4.48%
2015 debt issuances of \$27.3 billion:					
Floating-rate notes	2017 - 2020	1,781	0.67% - 1.87%	1,743	0.36% - 1.87%
Fixed-rate 0.35% - 4.375% notes	2017 - 2045	25,063	0.28% - 4.51%	24,958	0.28% - 4.51%
Second quarter 2016 debt issuance of \$15.5 billion:					
Floating-rate notes	2019	500	1.44%	0	0
Floating-rate notes	2021	500	1.75%	0	0
Fixed-rate 1.30% notes	2018	500	1.32%	0	0
Fixed-rate 1.70% notes	2019	1,000	1.71%	0	0
Fixed-rate 2.25% notes	2021	3,000	1.80%	0	0
Fixed-rate 2.85% notes	2023	1,500	2.48%	0	0
Fixed-rate 3.25% notes	2026	3,250	2.33%	0	0
Fixed-rate 4.50% notes	2036	1,250	4.54%	0	0
Fixed-rate 4.65% notes	2046	4,000	4.58%	0	0
Total debt issuance		15,500		0	

Total term debt	71,344	55,701
Unamortized premium/(discount)	15	(114)
Hedge accounting fair value adjustments	515	376
Less: Current portion of long-term debt	(2,500)	(2,500)
Total long-term debt	\$ 69,374	\$ 53,463

During the second quarter of 2016, the Company issued \$15.5 billion U.S. dollar-denominated notes. To manage interest rate risk on the U.S. dollar-denominated fixed-rate notes maturing in 2021, 2023 and 2026, the Company entered into interest rate swaps with an aggregate notional amount of \$5.0 billion, which effectively converted a portion of the fixed interest rates on these notes to a floating interest rate.

As of March 26, 2016, ¥149.3 billion of Japanese yen-denominated notes was designated as a hedge of the foreign currency exposure of its net investment in a foreign operation. The foreign currency transaction gain or loss on the Japanese yen-denominated debt designated as a hedge is recorded in OCI as a part of the cumulative translation adjustment. As of March 26, 2016 and September 26, 2015, the carrying value of the debt designated as a net investment hedge was \$1.3 billion and \$2.1 billion, respectively. For further discussion regarding the Company's use of derivative instruments see the Derivative Financial Instruments section of Note 2, Financial Instruments.

The effective interest rates for the Notes include the interest on the Notes, amortization of the discount and, if applicable, adjustments related to hedging. The Company recognized \$311 million and \$582 million of interest expense on its term debt for the three- and six-month periods ended March 26, 2016, respectively. The Company recognized \$161 million and \$289 million of interest expense on its term debt for the three- and six-month periods ended March 28, 2015, respectively.

As of March 26, 2016 and September 26, 2015, the fair value of the Company's Notes, based on Level 2 inputs, was \$72.4 billion and \$54.9 billion, respectively.

Table of Contents**Note 7 Shareholders Equity****Dividends**

The Company declared and paid cash dividends per share during the periods presented as follows:

	Dividends Per Share	Amount (in millions)
2016:		
Second quarter	\$ 0.52	\$ 2,879
First quarter	0.52	2,898
Total cash dividends declared and paid	\$ 1.04	\$ 5,777
2015:		
Fourth quarter	\$ 0.52	\$ 2,950
Third quarter	0.52	2,997
Second quarter	0.47	2,734
First quarter	0.47	2,750
Total cash dividends declared and paid	\$ 1.98	\$ 11,431

Future dividends are subject to declaration by the Board of Directors.

Share Repurchase Program

In 2015, the Company's Board of Directors increased the share repurchase authorization to \$140 billion of the Company's common stock, of which \$117 billion had been utilized as of March 26, 2016. The Company's share repurchase program does not obligate it to acquire any specific number of shares. Under the program, shares may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended (the Exchange Act).

The Company has entered, and in the future may enter, into accelerated share repurchase arrangements (ASRs) with financial institutions. In exchange for up-front payments, the financial institutions deliver shares of the Company's common stock during the purchase periods of each ASR. The total number of shares ultimately delivered, and therefore the average repurchase price paid per share, is determined at the end of the applicable purchase period of each ASR based on the volume weighted-average price of the Company's common stock during that period. The shares received are retired in the periods they are delivered, and the up-front payments are accounted for as a reduction to shareholders' equity in the Company's Condensed Consolidated Balance Sheets in the periods the payments are made. The Company reflects the ASRs as a repurchase of common stock in the period delivered for purposes of calculating earnings per share and as forward contracts indexed to its own common stock. The ASRs met all of the applicable criteria for equity classification, and therefore were not accounted for as derivative instruments.

The following table shows the Company's ASR activity and related information during the six months ended March 26, 2016 and the year ended September 26, 2015:

	Purchase Period End Date	Number of Shares (in thousands)	Average Repurchase Price Per Share	ASR Amount (in millions)
November 2015 ASR	April 2016	20,382 ⁽¹⁾	\$ ⁽¹⁾	\$ 3,000
May 2015 ASR	July 2015	48,293	\$ 124.24	\$ 6,000
August 2014 ASR	February 2015	81,525	\$ 110.40	\$ 9,000
January 2014 ASR	December 2014	134,247	\$ 89.39	\$ 12,000

- (1) Number of Shares represents those shares delivered in the beginning of the purchase period and does not represent the final number of shares to be delivered under the ASR. The total number of shares ultimately delivered, and therefore the average repurchase price paid per share, will be determined at the end of the applicable purchase period based on the volume-weighted average price of the Company's common stock during that period. The November 2015 ASR purchase period will end in or before April 2016.

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Additionally, the Company repurchased shares of its common stock in the open market, which were retired upon repurchase, during the periods presented as follows:

	Number of Shares (in thousands)	Average Repurchase Price Per Share	Amount (in millions)
2016:			
Second quarter	71,766	\$ 97.54	\$ 7,000
First quarter	25,984	\$ 115.45	3,000
Total open market common stock repurchases	97,750		\$ 10,000
2015:			
Fourth quarter	121,802	\$ 115.15	\$ 14,026
Third quarter	31,231	\$ 128.08	4,000
Second quarter	56,400	\$ 124.11	7,000
First quarter	45,704	\$ 109.40	5,000
Total open market common stock repurchases	255,137		\$ 30,026

Note 8 Comprehensive Income

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

The following table shows the pre-tax amounts reclassified from AOCI into the Condensed Consolidated Statements of Operations, and the associated financial statement line item, for the three- and six-month periods ended March 26, 2016 and March 28, 2015 (in millions):

Financial Statement Line Item	Three Months Ended		Six Months Ended	
	March 26, 2016	March 28, 2015	March 26, 2016	March 28, 2015
Comprehensive Income Components				
Unrealized (gains)/losses on derivative instruments:				
Foreign exchange contracts				
Revenue	\$ (325)	\$ (558)	\$ (654)	\$ (1,007)
Cost of sales	(219)	(608)	(525)	(921)
Other income/(expense), net	(131)	348	(11)	443
Interest rate contracts				
Other income/(expense), net	3	4	7	8

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		(672)	(814)	(1,183)	(1,477)
Unrealized (gains)/losses on marketable securities	Other income/(expense), net	76	56	149	34
Total amounts reclassified from AOCI		\$ (596)	\$ (758)	\$ (1,034)	\$ (1,443)

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The following table shows the changes in AOCI by component for the six months ended March 26, 2016 (in millions):

	Cumulative Foreign Currency Translation	Unrealized Gains/Losses on Derivative Instruments	Unrealized Gains/Losses on Marketable Securities	Total
Balance at September 26, 2015	\$ (653)	\$ 772	\$ (464)	\$ (345)
Other comprehensive income/(loss) before reclassifications	18	146	69	233
Amounts reclassified from AOCI	0	(1,183)	149	(1,034)
Tax effect	0	173	(75)	98
Other comprehensive income/(loss)	18	(864)	143	(703)
Balance at March 26, 2016	\$ (635)	\$ (92)	\$ (321)	\$ (1,048)

Note 9 Benefit Plans**Stock Plans**

The Company had 377.3 million shares reserved for future issuance under its stock plans as of March 26, 2016. RSUs granted generally vest over four years, based on continued employment, and are settled upon vesting in shares of the Company's common stock on a one-for-one basis. Each share issued with respect to RSUs granted under the Company's stock plans reduces the number of shares available for grant under the plan by two shares. RSUs cancelled and shares withheld to satisfy tax withholding obligations increase the number of shares available for grant under the plans utilizing a factor of two times the number of RSUs cancelled or shares withheld. Stock options count against the number of shares available for grant on a one-for-one basis.

Rule 10b5-1 Trading Plans

During the three months ended March 26, 2016, Section 16 officers Timothy D. Cook, Angela Ahrendts, Luca Maestri, Daniel Riccio, Philip Schiller and Jeffrey Williams had equity trading plans in place in accordance with Rule 10b5-1(c)(1) under the Exchange Act. An equity 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 shares acquired pursuant to the Company's employee and director equity plans.

Restricted Stock Units

A summary of the Company's RSU activity and related information for the six months ended March 26, 2016 is as follows:

	Number of RSUs (in thousands)	Weighted-Average Grant Date Fair Value Per Share	Aggregate Intrinsic Value (in millions)
Balance at September 26, 2015	101,467	\$ 85.77	
RSUs granted	43,513	\$ 110.57	
RSUs vested	(22,353)	\$ 78.86	
RSUs cancelled	(2,413)	\$ 93.43	
Balance at March 26, 2016	120,214	\$ 95.80	\$ 12,703

RSUs that vested during the three- and six-month periods ended March 26, 2016 had fair values of \$450 million and \$2.5 billion, respectively, as of the vesting date. RSUs that vested during the three- and six-month periods ended March 28, 2015 had fair values of \$317 million and \$2.0 billion, respectively, as of the vesting date.

Stock Options

The Company had 1.1 million stock options outstanding as of March 26, 2016, with a weighted-average exercise price per share of \$15.48 and weighted-average remaining contractual term of 3.7 years, substantially all of which are exercisable. The aggregate intrinsic value of the stock options outstanding as of March 26, 2016 was \$100 million, which represents the value of the Company's closing stock price on the last trading day of the period in excess of the weighted-average exercise price multiplied by the number of options outstanding.

Table of Contents**Share-Based Compensation**

The following table shows a summary of the share-based compensation expense included in the Condensed Consolidated Statements of Operations for the three- and six-month periods ended March 26, 2016 and March 28, 2015 (in millions):

	Three Months Ended		Six Months Ended	
	March 26, 2016	March 28, 2015	March 26, 2016	March 28, 2015
Cost of sales	\$ 191	\$ 142	\$ 395	\$ 282
Research and development	468	384	934	758
Selling, general and administrative	389	401	797	775
Total share-based compensation expense	\$ 1,048	\$ 927	\$ 2,126	\$ 1,815

The income tax benefit related to share-based compensation expense was \$347 million and \$760 million for the three- and six-month periods ended March 26, 2016, respectively, and was \$311 million and \$662 million for the three- and six-month periods ended March 28, 2015, respectively. As of March 26, 2016, the total unrecognized compensation cost related to outstanding stock options, RSUs and restricted stock was \$9.1 billion, which the Company expects to recognize over a weighted-average period of 2.9 years.

Note 10 Commitments and Contingencies**Accrued Warranty and Indemnification**

The following table shows changes in the Company's accrued warranties and related costs for the three- and six-month periods ended March 26, 2016 and March 28, 2015 (in millions):

	Three Months Ended		Six Months Ended	
	March 26, 2016	March 28, 2015	March 26, 2016	March 28, 2015
Beginning accrued warranty and related costs	\$ 5,236	\$ 5,195	\$ 4,780	\$ 4,159
Cost of warranty claims	(1,128)	(1,030)	(2,397)	(2,074)
Accruals for product warranty	877	978	2,602	3,058
Ending accrued warranty and related costs	\$ 4,985	\$ 5,143	\$ 4,985	\$ 5,143

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. In the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss with respect to indemnification of end-users of its operating system or application software for infringement of third-party intellectual property rights.

The Company offers an iPhone Upgrade Program, which is available to customers who purchase an iPhone 6s and 6s Plus in one of its U.S. physical retail stores and activate the purchased iPhone with one of the four national carriers. The iPhone Upgrade Program provides customers the right to trade in that iPhone for a new iPhone, provided certain conditions are met. One of the conditions of this program requires the customer to finance the initial purchase price of the iPhone with a third-party lender. Upon exercise of the trade-in right and purchase of a new iPhone, the Company satisfies the customer's outstanding balance due to the third-party lender on the original device. The Company accounts for the trade-in right as a guarantee liability and recognizes arrangement revenue net of the fair value of such right with subsequent changes to the guarantee liability recognized within revenue.

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.

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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, a number of components are currently obtained from single or limited sources. In addition, the Company competes for various components with other participants in the markets for mobile communication and media devices and personal computers. Therefore, many components used by the Company, including those that are available from multiple sources, are at times subject to industry-wide shortage and significant pricing fluctuations that could materially adversely affect the Company's financial condition and operating results.

The Company uses some custom components that are not commonly used by its competitors, and new products introduced by the Company often utilize custom components available from only one source. 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 components for a new or existing product were delayed or constrained, or if an outsourcing partner 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 materially 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 concentrated on the production of common components instead of components customized to meet the Company's requirements.

The Company has entered into agreements for the supply of many components; however, there can be no guarantee that the Company will be able to extend or renew these agreements on similar terms, or at all. Therefore, the Company remains subject to significant risks of supply shortages and price increases that could materially adversely affect its financial condition and operating results.

Substantially all of the Company's hardware products are manufactured by outsourcing partners that are located primarily in Asia. A significant concentration of this manufacturing is currently performed by a small number of outsourcing partners, often in single locations. Certain of these outsourcing partners are the sole-sourced suppliers of components and manufacturers for many of the Company's 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 its requirements for periods up to 150 days.

Other Off-Balance Sheet Commitments

Operating Leases

The Company leases various equipment and facilities, including retail space, under noncancelable operating lease arrangements. The major facility leases are typically for terms not exceeding 10 years and generally contain multi-year renewal options. As of March 26, 2016, the Company had a total of 475 retail stores. Leases for retail space are for terms ranging from five to 20 years, the majority of which are for 10 years, and often contain multi-year renewal options. As of March 26, 2016, the Company's total future minimum lease payments under noncancelable operating leases were \$6.8 billion, of which \$3.9 billion related to leases for retail space.

Contingencies

The Company is subject to various legal proceedings and claims that have arisen in the ordinary course of business and that have not been fully adjudicated, certain of which are discussed in Part II, Item 1 of this Form 10-Q under the heading Legal Proceedings and in Part II, Item 1A of this Form 10-Q under the heading Risk Factors. In the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies for asserted legal and other claims. However, the outcome of litigation is inherently uncertain. Therefore, although management considers the likelihood of such an outcome to be remote, if one or more of these legal matters were resolved against the Company in a reporting period for amounts in excess of management's expectations, the Company's consolidated financial statements for that reporting period could be materially adversely affected.

Apple Inc. v. Samsung Electronics Co., Ltd., et al.

On August 24, 2012, a jury returned a verdict awarding the Company \$1.05 billion in its lawsuit against Samsung Electronics Co., Ltd. and affiliated parties in the United States District Court, Northern District of California, San Jose Division. On March 6, 2014, the District Court entered final judgment in favor of the Company in the amount of approximately \$930 million. On May 18, 2015, the U.S. Court of Appeals for the Federal Circuit affirmed in part, and reversed in part, the decision of the District Court. As a result, the Court of Appeals ordered entry of final judgment on damages in the amount of approximately \$548 million, with the District Court to determine supplemental damages and interest, as well as damages owed for products subject to the reversal in part. Samsung paid \$548 million to the Company in December 2015, which was included in net sales in the Condensed Consolidated Statement of Operations. Because the case remains subject to further proceedings, the Company has not recognized any further amounts in its results of operations. On March 21, 2016, the United States Supreme Court agreed to hear Samsung's request for appeal related to the \$548 million in damages.

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Note 11 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 operating segments.

The Company manages its business primarily on a geographic basis. The Company's reportable operating segments consist of the Americas, Europe, Greater China, Japan and Rest of Asia Pacific. The Americas segment includes both North and South America. The Europe segment includes European countries, as well as India, the Middle East and Africa. The Greater China segment includes China, Hong Kong and Taiwan. The Rest of Asia Pacific segment includes Australia and those Asian countries not included in the Company's other reportable operating segments. Although the reportable operating segments provide similar hardware and software products and similar services, each one is managed separately to better align with the location of the Company's customers and distribution partners and the unique market dynamics of each geographic region. The accounting policies of the various segments are the same as those described in Note 1, Summary of Significant Accounting Policies of the Notes to Consolidated Financial Statements in Part II, Item 8 of the 2015 Form 10-K.

The Company evaluates the performance of its reportable operating segments based on net sales and operating income. Net sales for geographic segments are generally based on the location of customers and sales through the Company's retail stores located in those geographic locations. 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 reportable operating segments. Costs excluded from segment operating income include various corporate expenses such as research and development, corporate marketing expenses, certain share-based compensation expenses, 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.

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The following table shows information by reportable operating segment for the three- and six-month periods ended March 26, 2016 and March 28, 2015 (in millions):

	Three Months Ended		Six Months Ended	
	March 26, 2016	March 28, 2015	March 26, 2016	March 28, 2015
Americas:				
Net sales	\$ 19,096	\$ 21,316	\$ 48,421	\$ 51,882
Operating income	\$ 6,116	\$ 7,186	\$ 16,134	\$ 17,887
Europe:				
Net sales	\$ 11,535	\$ 12,204	\$ 29,467	\$ 29,418
Operating income	\$ 3,602	\$ 4,112	\$ 9,381	\$ 9,994
Greater China:				
Net sales	\$ 12,486	\$ 16,823	\$ 30,859	\$ 32,967
Operating income	\$ 4,818	\$ 6,714	\$ 12,394	\$ 13,080
Japan:				
Net sales	\$ 4,281	\$ 3,457	\$ 9,075	\$ 8,905
Operating income	\$ 1,930	\$ 1,699	\$ 4,170	\$ 4,187
Rest of Asia Pacific:				
Net sales	\$ 3,159	\$ 4,210	\$ 8,607	\$ 9,437
Operating income	\$ 1,095	\$ 1,600	\$ 3,127	\$ 3,449

A reconciliation of the Company's segment operating income to the Condensed Consolidated Statements of Operations for the three- and six-month periods ended March 26, 2016 and March 28, 2015 (in millions):

	Three Months Ended		Six Months Ended	
	March 26, 2016	March 28, 2015	March 26, 2016	March 28, 2015
Segment operating income	\$ 17,561	\$ 21,311	\$ 45,206	\$ 48,597
Research and development expense	(2,511)	(1,918)	(4,915)	(3,813)
Other corporate expenses, net	(1,063)	(1,115)	(2,133)	(2,260)
Total operating income	\$ 13,987	\$ 18,278	\$ 38,158	\$ 42,524

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

This section and other parts of this Quarterly Report on Form 10-Q contain forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, that involve risks and uncertainties. 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 future, anticipates, believes, estimates, expects, intends, plans, predicts, will, would, could, can, may, 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 Part II, Item 1A of this Form 10-Q under the heading Risk Factors, which are incorporated herein by reference. The following discussion should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended September 26, 2015 (the 2015 Form 10-K) filed with the U.S. Securities and Exchange Commission (the SEC) and the condensed consolidated financial statements and notes thereto included elsewhere in this Form 10-Q. All information presented herein is based on the Company's fiscal calendar. Unless otherwise stated, references to particular years, quarters, months or periods refer to the Company's fiscal years ended in September and the associated quarters, months and periods of those fiscal years. Each of the terms the Company and Apple as used herein refers collectively to Apple Inc. and its wholly-owned subsidiaries, unless otherwise stated. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

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 (the Exchange Act), are filed with the SEC. The Company is subject to the informational requirements of the Exchange Act and files or furnishes reports, proxy statements, and other information with 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 investor.apple.com/sec.cfm when such reports are available on the SEC's 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 www.sec.gov. The contents of websites are not incorporated into this filing. Further, the Company's references to website URLs are intended to be inactive textual references only.

Overview and Highlights*Company Background*

The Company designs, manufactures and markets mobile communication and media devices, personal computers and portable digital music players, and sells a variety of related software, services, accessories, networking solutions and third-party digital content and applications. The Company's products and services include iPhone®, iPad®, Mac®, iPod®, Apple Watch®, Apple TV®, a portfolio of consumer and professional software applications, iOS, OS X®, watchOS® and tvOS® operating systems, iCloud®, Apple Pay® and a variety of accessory, service and support offerings. The Company sells and delivers digital content and applications through the iTunes Store®, App Store®, Mac App Store, TV App Store, iBooks Store and Apple Music (collectively Internet Services). The Company sells its products worldwide through its retail stores, online stores and direct sales force, as well as through third-party cellular network carriers, wholesalers, retailers and value-added resellers. In addition, the Company sells a variety of third-party Apple compatible products, including application software and various accessories through its online and

retail stores. The Company sells to consumers, small and mid-sized businesses and education, enterprise and government customers.

Business Strategy

The Company is committed to bringing the best user experience to its customers through its innovative hardware, software and services. The Company's business strategy leverages its unique ability to design and develop its own operating systems, hardware, application software and services to provide its customers products and solutions with innovative design, superior ease-of-use and seamless integration. As part of its strategy, the Company continues to expand its platform for the discovery and delivery of digital content and applications through its Internet Services, which allows customers to discover and download digital content, iOS, Mac, Apple Watch and Apple TV applications, and books through either a Mac or Windows-based computer or through iPhone, iPad and iPod touch® devices (iOS devices) and Apple Watch. The Company also supports a community for the development of third-party software and hardware products and digital content that complement the Company's offerings. 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. Therefore, the Company's strategy also includes building and expanding its own retail and online stores and its third-party distribution network to effectively reach more customers and provide them with a high-quality sales and post-sales support experience. The Company believes ongoing investment in research and development (R&D), marketing and advertising is critical to the development and sale of innovative products and technologies.

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Business Seasonality and Product Introductions

The Company has historically experienced higher net sales in its first quarter compared to other quarters in its fiscal year due in part to seasonal holiday demand. Additionally, new product introductions can significantly impact net sales, product costs and operating expenses. Product introductions can also impact the Company's net sales to its indirect distribution channels as these channels are filled with new product inventory following a product introduction, and often, channel inventory of a particular product declines as the next related major product launch approaches. Net sales can also be affected when consumers and distributors anticipate a product introduction. However, neither historical seasonal patterns nor historical patterns of product introductions should be considered reliable indicators of the Company's future pattern of product introductions, future net sales or financial performance.

Second Quarter Fiscal 2016 Highlights

Net sales decreased 13% or \$7.5 billion during the second quarter of 2016 compared to the same quarter in 2015, primarily driven by lower iPhone sales and the effect of weakness in most foreign currencies relative to the U.S. dollar. The Company had strong year-over-year net sales growth in Services and Other Products. During the second quarter of 2016, the Company introduced iPhone SE and the 9.7-inch iPad Pro, both of which were available beginning in the third quarter of 2016.

The Company utilized \$7.0 billion to repurchase shares of its common stock and paid dividends and dividend equivalents of \$2.9 billion during the second quarter of 2016. Additionally, the Company issued \$15.5 billion of U.S. dollar-denominated long-term debt.

Sales Data

The following table shows net sales by operating segment and net sales and unit sales by product for the three- and six-month periods ended March 26, 2016 and March 28, 2015 (dollars in millions and units in thousands):

	Three Months Ended			Six Months Ended		
	March 26, 2016	March 28, 2015	Change	March 26, 2016	March 28, 2015	Change
Net Sales by Operating Segment:						
Americas	\$ 19,096	\$ 21,316	(10)%	\$ 48,421	\$ 51,882	(7)%
Europe	11,535	12,204	(5)%	29,467	29,418	0%
Greater China	12,486	16,823	(26)%	30,859	32,967	(6)%
Japan	4,281	3,457	24%	9,075	8,905	2%
Rest of Asia Pacific	3,159	4,210	(25)%	8,607	9,437	(9)%
Total net sales	\$ 50,557	\$ 58,010	(13)%	\$ 126,429	\$ 132,609	(5)%
Net Sales by Product:						
iPhone ⁽¹⁾	\$ 32,857	\$ 40,282	(18)%	\$ 84,492	\$ 91,464	(8)%
iPad ⁽¹⁾	4,413	5,428	(19)%	11,497	14,413	(20)%
Mac ⁽¹⁾	5,107	5,615	(9)%	11,853	12,559	(6)%

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Services ⁽²⁾	5,991	4,996	20%	12,047	9,795	23%
Other Products ⁽¹⁾⁽³⁾	2,189	1,689	30%	6,540	4,378	49%
Total net sales	\$ 50,557	\$ 58,010	(13)%	\$ 126,429	\$ 132,609	(5)%
Unit Sales by Product:						
iPhone	51,193	61,170	(16)%	125,972	135,638	(7)%
iPad	10,251	12,623	(19)%	26,373	34,042	(23)%
Mac	4,034	4,563	(12)%	9,346	10,082	(7)%

(1) Includes deferrals and amortization of related software upgrade rights and non-software services.

(2) Includes revenue from Internet Services, AppleCare[®], Apple Pay, licensing and other services.

(3) Includes sales of Apple TV, Apple Watch, Beats[®] products, iPod and Apple-branded and third-party accessories.

Table of Contents**Product Performance***iPhone*

The following table presents iPhone net sales and unit sales information for the three- and six-month periods ended March 26, 2016 and March 28, 2015 (dollars in millions and units in thousands):

	Three Months Ended			Six Months Ended		
	March 26, 2016	March 28, 2015	Change	March 26, 2016	March 28, 2015	Change
Net sales	\$ 32,857	\$ 40,282	(18)%	\$ 84,492	\$ 91,464	(8)%
Percentage of total net sales	65%	69%		67%	69%	
Unit sales	51,193	61,170	(16)%	125,972	135,638	(7)%

iPhone net sales and unit sales decreased during the second quarter and first six months of 2016 compared to the same periods in 2015. The Company believes the unit sales decline is due primarily to the acceleration of iPhone upgrades in the first half of 2015 and challenging macroeconomic conditions around the world. Average selling prices (ASPs) for iPhone were lower year-over-year during the second quarter and first six months of 2016 due to a change in the mix of iPhones and the effect of weakness in foreign currencies relative to the U.S. dollar.

iPad

The following table presents iPad net sales and unit sales information for the three- and six-month periods ended March 26, 2016 and March 28, 2015 (dollars in millions and units in thousands):

	Three Months Ended			Six Months Ended		
	March 26, 2016	March 28, 2015	Change	March 26, 2016	March 28, 2015	Change
Net sales	\$ 4,413	\$ 5,428	(19)%	\$ 11,497	\$ 14,413	(20)%
Percentage of total net sales	9%	9%		9%	11%	
Unit sales	10,251	12,623	(19)%	26,373	34,042	(23)%

iPad net sales and unit sales declined during the second quarter and first six months of 2016 compared to the same periods in 2015. The Company believes the decline in iPad sales is due in part to a longer repurchase cycle for iPads and some level of cannibalization from the Company's other products. Year-over-year ASPs for iPad were flat during the second quarter of 2016 and increased 3% during the first six months of 2016 due primarily to a shift in mix to higher-capacity iPads and the launch of iPad Pro, partially offset by the effect of weakness in foreign currencies relative to the U.S. dollar.

Mac

The following table presents Mac net sales and unit sales information for the three- and six-month periods ended March 26, 2016 and March 28, 2015 (dollars in millions and units in thousands):

	Three Months Ended			Six Months Ended		
	March 26, 2016	March 28, 2015	Change	March 26, 2016	March 28, 2015	Change
Net sales	\$ 5,107	\$ 5,615	(9)%	\$ 11,853	\$ 12,559	(6)%
Percentage of total net sales	10%	10%		9%	9%	
Unit sales	4,034	4,563	(12)%	9,346	10,082	(7)%

Mac net sales and unit sales declined during the second quarter and first six months of 2016 compared to the same periods in 2015, similar to the overall market contraction. Mac ASPs increased during the second quarter and first six months of 2016 compared to the same periods in 2015 due primarily to a change in the mix of Macs, partially offset by the effect of weakness in foreign currencies relative to the U.S. dollar.

Table of Contents*Services*

The following table presents net sales information of Services for the three- and six-month periods ended March 26, 2016 and March 28, 2015 (dollars in millions):

	Three Months Ended			Six Months Ended		
	March 26, 2016	March 28, 2015	Change	March 26, 2016	March 28, 2015	Change
Net sales	\$ 5,991	\$ 4,996	20%	\$ 12,047	\$ 9,795	23%
Percentage of total net sales	12%	9%		10%	7%	

The year-over-year increase in net sales of Services in the second quarter and first six months of 2016 was due primarily to higher App Store, licensing and AppleCare sales. During the first quarter of 2016, the Company received \$548 million from Samsung Electronics Co., Ltd. related to its patent infringement lawsuit, which was recorded as licensing net sales within Services.

Segment Operating Performance

The Company manages its business primarily on a geographic basis. The Company's reportable operating segments consist of the Americas, Europe, Greater China, Japan and Rest of Asia Pacific. The Americas segment includes both North and South America. The Europe segment includes European countries, as well as India, the Middle East and Africa. The Greater China segment includes China, Hong Kong and Taiwan. The Rest of Asia Pacific segment includes Australia and those Asian countries not included in the Company's other reportable operating segments. Although, the reportable operating segments provide similar hardware and software products and similar services, each one is managed separately to better align with the location of the Company's customers and distribution partners and the unique market dynamics of each geographic region. Further information regarding the Company's reportable operating segments can be found in Part I, Item 1 of this Form 10-Q in the Notes to Condensed Consolidated Financial Statements, in Note 11, Segment Information and Geographic Data.

Americas

The following table presents Americas net sales information for the three- and six-month periods ended March 26, 2016 and March 28, 2015 (dollars in millions):

	Three Months Ended			Six Months Ended		
	March 26, 2016	March 28, 2015	Change	March 26, 2016	March 28, 2015	Change
Net sales	\$ 19,096	\$ 21,316	(10)%	\$ 48,421	\$ 51,882	(7)%
Percentage of total net sales	38%	37%		38%	39%	

Americas net sales decreased during the second quarter and first six months of 2016 compared to the same periods in 2015 due primarily to lower net sales of iPhone and the effect of weakness in foreign currencies relative to the U.S. dollar.

Europe

The following table presents Europe net sales information for the three- and six-month periods ended March 26, 2016 and March 28, 2015 (dollars in millions):

	Three Months Ended			Six Months Ended		
	March 26, 2016	March 28, 2015	Change	March 26, 2016	March 28, 2015	Change
Net sales	\$ 11,535	\$ 12,204	(5)%	\$ 29,467	\$ 29,418	0%
Percentage of total net sales	23%	21%		23%	22%	

Europe net sales decreased during the second quarter of 2016 compared to the same period in 2015 due primarily to the effect of weakness in foreign currencies relative to the U.S. dollar. Year-over-year Europe net sales were flat during the first six months of 2016 due primarily to the effect of weakness in foreign currencies relative to the U.S. dollar, offset by higher unit sales of iPhone.

Table of Contents*Greater China*

The following table presents Greater China net sales information for the three- and six-month periods ended March 26, 2016 and March 28, 2015 (dollars in millions):

	Three Months Ended			Six Months Ended		
	March 26, 2016	March 28, 2015	Change	March 26, 2016	March 28, 2015	Change
Net sales	\$ 12,486	\$ 16,823	(26)%	\$ 30,859	\$ 32,967	(6)%
Percentage of total net sales	25%	29%		24%	25%	

Greater China net sales decreased during the second quarter and first six months of 2016 compared to the same periods in 2015 due primarily to lower net sales of iPhone and the effect of weakness in foreign currencies relative to the U.S. dollar.

Japan

The following table presents Japan net sales information for the three- and six-month periods ended March 26, 2016 and March 28, 2015 (dollars in millions):

	Three Months Ended			Six Months Ended		
	March 26, 2016	March 28, 2015	Change	March 26, 2016	March 28, 2015	Change
Net sales	\$ 4,281	\$ 3,457	24%	\$ 9,075	\$ 8,905	2%
Percentage of total net sales	8%	6%		7%	7%	

Japan net sales increased during the second quarter of 2016 compared to the same period in 2015 due primarily to higher net sales of iPhone and Services. The year-over-year increase in Japan net sales during the first six months of 2016 was due primarily to higher sales of Services, partially offset by the effect of weakness in the Japanese Yen relative to the U.S. dollar.

Rest of Asia Pacific

The following table presents Rest of Asia Pacific net sales information for the three- and six-month periods ended March 26, 2016 and March 28, 2015 (dollars in millions):

	Three Months Ended			Six Months Ended		
	March 26, 2016	March 28, 2015	Change	March 26, 2016	March 28, 2015	Change
Net sales	\$ 3,159	\$ 4,210	(25)%	\$ 8,607	\$ 9,437	(9)%
Percentage of total net sales	6%	7%		7%	7%	

Rest of Asia Pacific net sales decreased during the second quarter and first six months of 2016 compared to the same periods in 2015 due primarily to lower net sales of iPhone and the effect of weakness in foreign currencies relative to the U.S. dollar.

Table of Contents**Gross Margin**

Gross margin for the three- and six-month periods ended March 26, 2016 and March 28, 2015 was as follows (dollars in millions):

	Three Months Ended		Six Months Ended	
	March 26, 2016	March 28, 2015	March 26, 2016	March 28, 2015
Net sales	\$ 50,557	\$ 58,010	\$ 126,429	\$ 132,609
Cost of sales	30,636	34,354	76,085	79,212
Gross margin	\$ 19,921	\$ 23,656	\$ 50,344	\$ 53,397
Gross margin percentage	39.4%	40.8%	39.8%	40.3%

The gross margin percentage decreased during the second quarter of 2016 and the first six months of 2016 compared to the same periods in 2015 due primarily to the effect of weakness in foreign currencies relative to the U.S. dollar and unfavorable leverage on fixed costs from lower net sales, partially offset by a favorable shift in mix to products and services with higher margins.

The Company anticipates gross margin during the third quarter of 2016 to be between 37.5% and 38.0%. The foregoing statement regarding the Company's expected gross margin percentage in the third quarter of 2016 is forward-looking and could differ from actual results. The Company's future gross margins can be impacted by multiple factors including, but not limited to, those set forth in Part II, Item 1A of this Form 10-Q under the heading "Risk Factors" and those described in this paragraph. In general, the Company believes gross margins 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, potential increases in the cost of components, and potential strengthening of the U.S. dollar, 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 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, its financial condition and operating results, including gross margins, could be significantly affected by fluctuations in exchange rates.

Operating Expenses

Operating expenses for the three- and six-month periods ended March 26, 2016 and March 28, 2015 were as follows (dollars in millions):

Three Months Ended		Six Months Ended	
March 26, 2016	March 28, 2015	March 26, 2016	March 28, 2015

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Research and development	\$	2,511	\$	1,918	\$	4,915	\$	3,813
Percentage of total net sales		5.0%		3.3%		3.9%		2.9%
Selling, general and administrative	\$	3,423	\$	3,460	\$	7,271	\$	7,060
Percentage of total net sales		6.8%		6.0%		5.8%		5.3%
Total operating expenses	\$	5,934	\$	5,378	\$	12,186	\$	10,873
Percentage of total net sales		11.7%		9.3%		9.6%		8.2%

Research and Development

The year-over-year increase in R&D expense during the second quarter and first six months of 2016 compared to the same periods in 2015 was driven primarily by an increase in headcount and related expenses, including share-based compensation costs, and material costs to support expanded R&D activities. 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 updated products that are central to the Company's core business strategy.

Selling, General and Administrative

The year-over-year decrease in selling, general and administrative expense during the second quarter of 2016 compared to the same period in 2015 was due primarily to a decrease in advertising and related programs, partially offset by an increase in headcount and related expenses. The year-over-year increase in selling, general and administrative expense during the first six months of 2016 compared to the same period in 2015 was due primarily to increased headcount and related expenses.

Table of Contents**Other Income/(Expense), Net**

Other income/(expense), net for the three- and six-month periods ended March 26, 2016 and March 28, 2015 was as follows (dollars in millions):

	Three Months Ended			Six Months Ended		
	March 26, 2016	March 28, 2015	Change	March 26, 2016	March 28, 2015	Change
Interest and dividend income	\$ 986	\$ 675		\$ 1,927	\$ 1,329	
Interest expense	(321)	(163)		(597)	(294)	
Other expense, net	(510)	(226)		(773)	(579)	
Total other income/(expense), net	\$ 155	\$ 286	(46)%	\$ 557	\$ 456	22%

The decrease in other income/(expense), net during the second quarter of 2016 compared to the same period in 2015 was due primarily to higher interest expense on debt and higher expenses associated with foreign exchange activity, partially offset by higher interest income. The increase in other income/(expense), net during the first six months of 2016 compared to the same period in 2015 was due primarily to higher interest income, partially offset by higher interest expense on debt and losses on marketable securities. The weighted-average interest rate earned by the Company on its cash, cash equivalents and marketable securities was 1.74% and 1.43% in the second quarter of 2016 and 2015, respectively, and 1.70% and 1.42% in the first six months of 2016 and 2015, respectively.

Provision for Income Taxes

Provision for income taxes and effective tax rates for the three- and six-month periods ended March 26, 2016 and March 28, 2015 were as follows (dollars in millions):

	Three Months Ended		Six Months Ended	
	March 26, 2016	March 28, 2015	March 26, 2016	March 28, 2015
Provision for income taxes	\$ 3,626	\$ 4,995	\$ 9,838	\$ 11,387
Effective tax rate	25.6%	26.9%	25.4%	26.5%

The Company's effective tax rates during the second quarter of 2016 and 2015 differ from the statutory federal income tax rate of 35% due primarily to certain undistributed foreign earnings, a substantial portion of which was generated by subsidiaries organized in Ireland, for which no U.S. taxes are provided when such earnings are intended to be indefinitely reinvested outside the U.S. The lower effective tax rate during the second quarter and first six months of 2016 compared to the same periods in 2015 was due primarily to a different geographic mix of earnings.

The U.S. Internal Revenue Service is currently examining the years 2010 through 2012, and all years prior to 2010 are closed. In addition, the Company is 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. 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.

On June 11, 2014, the European Commission issued an opening decision initiating a formal investigation against Ireland for alleged state aid to the Company. The opening decision concerns the allocation of profits for taxation purposes of the Irish branches of two subsidiaries of the Company. The Company believes the European Commission's assertions are without merit. If the European Commission were to conclude against Ireland, the European Commission could require Ireland to recover from the Company past taxes covering a period of up to 10 years reflective of the disallowed state aid. While such amount could be material, as of March 26, 2016 the Company is unable to estimate the impact.

Recent Accounting Pronouncements

Stock Compensation

In March 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-09, Compensation - Stock Compensation (Topic 718) (ASU 2016-09), which simplified certain aspects of the accounting for share-based payment transactions, including income taxes, classification of awards and classification in the statement of cash flows. ASU 2016-09 will be effective for the Company beginning in its first quarter of 2018. The Company is currently evaluating the impact of adopting the new stock compensation standard on its consolidated financial statements.

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Leases

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) (ASU 2016-02), which modified lease accounting for both lessees and lessors to increase transparency and comparability by recognizing lease assets and lease liabilities by lessees for those leases classified as operating leases under previous accounting standards and disclosing key information about leasing arrangements. ASU 2016-02 will be effective for the Company beginning in its first quarter of 2020 and early adoption is permitted. The Company is currently evaluating the timing of its adoption and the impact of adopting the new lease standard on its consolidated financial statements.

Financial Instruments

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments – Overall (Subtopic 825-10) (ASU 2016-01), which updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments. ASU 2016-01 will be effective for the Company beginning in its first quarter of 2019. The Company does not believe the adoption of the new financial instruments standard will have a material impact on its consolidated financial statements.

Revenue Recognition

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09), which amends the existing accounting standards for revenue recognition. ASU 2014-09 is based on principles that govern the recognition of revenue at an amount an entity expects to be entitled when products are transferred to customers.

The original effective date for ASU 2014-09 would have required the Company to adopt beginning in its first quarter of 2018. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606) Deferral of the Effective Date, which defers the effective date of ASU 2014-09 for one year and permits early adoption as early as the original effective date of ASU 2014-09. Accordingly, the Company may adopt the standard in either its first quarter of 2018 or 2019.

In March 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606) – Principal versus Agent Considerations (ASU 2016-08), which clarifies the implementation guidance for principal versus agent considerations in ASU 2014-09. In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606) – Identifying Performance Obligations and Licensing (ASU 2016-10), which amends the guidance in ASU 2014-09 related to identifying performance obligations and accounting for licenses of intellectual property. The Company must adopt ASU 2016-08 and ASU 2016-10 with ASU 2014-09.

The new revenue standard may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. The Company is currently evaluating the timing of its adoption and the impact of adopting the new revenue standard on its consolidated financial statements.

Liquidity and Capital Resources

The following tables present selected financial information and statistics as of March 26, 2016 and September 26, 2015 and for the first six months of 2016 and 2015 (in millions):

	March 26, 2016	September 26, 2015
Cash, cash equivalents and marketable securities	\$ 232,928	\$ 205,666
Property, plant and equipment, net	\$ 23,203	\$ 22,471
Commercial paper	\$ 7,998	\$ 8,499
Total term debt	\$ 71,874	\$ 55,963
Working capital	\$ 19,327	\$ 8,768

	Six Months Ended	
	March 26, 2016	March 28, 2015
Cash generated by operating activities	\$ 39,064	\$ 52,803
Cash used in investing activities	\$ (34,110)	\$ (43,496)
Cash used in financing activities	\$ (4,560)	\$ (8,662)

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. The Company currently anticipates the cash used for future dividends, the share repurchase program and debt repayments will come from its current domestic cash, cash generated from on-going U.S. operating activities and from borrowings.

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As of March 26, 2016 and September 26, 2015, the Company's cash, cash equivalents and marketable securities held by foreign subsidiaries were \$208.9 billion and \$186.9 billion, respectively, 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 marketable securities investment portfolio is invested primarily in highly-rated securities and its investment policy generally limits the amount of credit exposure to any one issuer. The policy requires investments generally to be investment grade with the objective of minimizing the potential risk of principal loss.

During the six months ended March 26, 2016, cash generated from operating activities of \$39.1 billion was a result of \$28.9 billion of net income, non-cash adjustments to net income of \$10.6 billion and a decrease in the net change in operating assets and liabilities of \$0.5 billion. Cash used in investing activities of \$34.1 billion during the six months ended March 26, 2016 consisted primarily of cash used for purchases of marketable securities, net of sales and maturities, of \$27.0 billion and cash used to acquire property, plant and equipment of \$5.9 billion. Cash used in financing activities of \$4.6 billion during the six months ended March 26, 2016 consisted primarily of cash used to repurchase common stock of \$13.5 billion, and cash used to pay dividends and dividend equivalents of \$5.9 billion, partially offset by proceeds from issuance of term debt, net of \$15.6 billion.

During the six months ended March 28, 2015, cash generated from operating activities of \$52.8 billion was a result of \$31.6 billion of net income, non-cash adjustments to net income of \$8.7 billion and an increase in the net change in operating assets and liabilities of \$12.5 billion. Cash used in investing activities of \$43.5 billion during the six months ended March 28, 2015 consisted primarily of cash used for purchases of marketable securities, net of sales and maturities, of \$37.7 billion and cash used to acquire property, plant and equipment of \$5.6 billion. Cash used in financing activities of \$8.7 billion during the six months ended March 28, 2015 consisted primarily of cash used to repurchase common stock of \$12.0 billion, cash used to pay dividends and dividend equivalents of \$5.5 billion and cash used for repayments of commercial paper, net of \$2.5 billion, partially offset by proceeds from the issuance of term debt, net of \$11.3 billion.

Capital Assets

The Company's capital expenditures were \$2.8 billion during the first six months of 2016. The Company anticipates utilizing approximately \$15.0 billion for capital expenditures during 2016, which includes product tooling and manufacturing process equipment; data centers; corporate facilities and infrastructure, including information systems hardware, software and enhancements; and retail store facilities.

Debt

The Company issues unsecured short-term promissory notes (Commercial Paper) pursuant to a commercial paper program. The Company uses the net proceeds from the commercial paper program for general corporate purposes, including dividends and share repurchases. As of March 26, 2016, the Company had \$8.0 billion of Commercial Paper outstanding, with a weighted-average interest rate of 0.39% and maturities generally less than nine months.

As of March 26, 2016, the Company has outstanding floating- and fixed-rate notes for an aggregate principal amount of \$71.3 billion (collectively the Notes). The Company has entered, and in the future may enter, into interest rate swaps to manage interest rate risk on the Notes. In addition, the Company has entered, and in the future may enter, into currency swaps to manage foreign currency risk on the Notes.

Further information regarding the Company's debt issuances and related hedging activity can be found in Part I, Item 1 of this Form 10-Q in the Notes to Condensed Consolidated Financial Statements, in Note 2, Financial Instruments and

Note 6, Debt.

Capital Return Program

In April 2015, the Company's Board of Directors increased the share repurchase program authorization from \$90 billion to \$140 billion of the Company's common stock, increasing the expected total size of the capital return program to \$200 billion. As of March 26, 2016, \$117 billion of the share repurchase program has been utilized. The Company's share repurchase program does not obligate it to acquire any specific number of shares. Under the program, shares may be repurchased in privately negotiated or open market transactions, including under plans complying with Rule 10b5-1 under the Exchange Act.

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The following table presents the Company's dividends, dividend equivalents, share repurchases and net share settlement activity from the start of the capital return program in August 2012 through March 26, 2016 (in millions):

	Dividends and Dividend Equivalents Paid	Accelerated Share Repurchases	Open Market Share Repurchases	Taxes Related to Settlement of Equity Awards	Total
Q2 2016	\$ 2,902	\$ 0	\$ 7,000	\$ 154	\$ 10,056
Q1 2016	2,969	3,000	3,000	597	9,566
2015	11,561	6,000	30,026	1,499	49,086
2014	11,126	21,000	24,000	1,158	57,284
2013	10,564	13,950	9,000	1,082	34,596
2012	2,488	0	0	56	2,544
Total	\$ 41,610	\$ 43,950	\$ 73,026	\$ 4,546	\$ 163,132

On April 26, 2016, the Company announced that the Board of Directors increased the total capital return program from \$200 billion to \$250 billion, which includes an increase in the share repurchase authorization from \$140 billion to \$175 billion. The Company expects to execute its capital return program by the end of March 2018 by paying dividends and dividend equivalents, repurchasing shares and remitting withheld taxes related to net share settlement of restricted stock units. The Company plans to continue to access the domestic and international debt markets to assist in funding its capital return program.

Additionally, the Company announced on April 26, 2016 that the Board of Directors raised the cash dividend by 10% to \$0.57 per share, beginning with the dividend to be paid during the third quarter of 2016. The Company intends to increase its dividend on an annual basis subject to declaration by the Board of Directors.

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, or engages in leasing, hedging, or R&D services with the Company.

Operating Leases

The Company's major facility leases are typically for terms not exceeding 10 years and generally contain multi-year renewal options. As of March 26, 2016, the Company had a total of 475 retail stores. Leases for retail space are for terms ranging from five to 20 years, the majority of which are for 10 years, and often contain multi-year renewal options. As of March 26, 2016, the Company's total future minimum lease payments under noncancelable operating leases were \$6.8 billion, of which \$3.9 billion related to leases for retail space.

Purchase Commitments

The Company utilizes several outsourcing partners to manufacture sub-assemblies for the Company's products and to perform final assembly and testing of finished products. These outsourcing partners acquire components and build product based on demand information supplied by the Company, which typically covers periods up 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. Where appropriate, the purchases are applied to inventory component prepayments that are outstanding with the respective supplier. As of March 26, 2016, the Company had outstanding off-balance sheet third-party manufacturing commitments and component purchase commitments of \$15.5 billion.

Other Obligations

In addition to the commitments mentioned above, the Company had other off-balance sheet obligations of \$7.2 billion as of March 26, 2016 that consisted of commitments to acquire capital assets, including product tooling and manufacturing process equipment, and commitments related to inventory prepayments, advertising, licensing, R&D, internet and telecommunications services, energy and other obligations. Subsequent to March 26, 2016, the Company entered into an additional other off-balance sheet obligation of \$4.0 billion.

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The Company's other non-current liabilities in the Condensed Consolidated Balance Sheets consist primarily of deferred tax liabilities, gross unrecognized tax benefits and the related gross interest and penalties. As of March 26, 2016, the Company had non-current deferred tax liabilities of \$23.0 billion. Additionally, as of March 26, 2016, the Company had gross unrecognized tax benefits of \$7.5 billion and an additional \$1.5 billion for gross interest and penalties classified as non-current liabilities. At this time, the Company is unable to make a reasonably reliable estimate of the timing of payments due to uncertainties in the timing of tax audit outcomes.

Indemnification

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. In the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss with respect to indemnification of end-users of its operating system or application software for infringement of third-party intellectual property rights.

The Company offers an iPhone Upgrade Program, which is available to customers who purchase an iPhone 6s and 6s Plus in one of its U.S. physical retail stores and activate the purchased iPhone with one of the four national carriers. The iPhone Upgrade Program provides customers the right to trade in that iPhone for a new iPhone, provided certain conditions are met. One of the conditions of this program requires the customer to finance the initial purchase price of the iPhone with a third-party lender. Upon exercise of the trade-in right and purchase of a new iPhone, the Company satisfies the customer's outstanding balance due to the third-party lender on the original device. The Company accounts for the trade-in right as a guarantee liability and recognizes arrangement revenue net of the fair value of such right with subsequent changes to the guarantee liability recognized within revenue.

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.

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 condensed consolidated financial statements and accompanying notes. 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.

Note 1, Summary of Significant Accounting Policies in Part I, Item 1 of this Form 10-Q and in the Notes to Consolidated Financial Statements in Part II, Item 8 of the 2015 Form 10-K, and Critical Accounting Policies and Estimates in Part I, Item 7 of the 2015 Form 10-K describe the significant accounting policies and methods used in the preparation of the Company's condensed consolidated financial statements. There have been no material changes to the

Company's critical accounting policies and estimates since the 2015 Form 10-K.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes to the Company's market risk during the second quarter of 2016. For a discussion of the Company's exposure to market risk, refer to the Company's market risk disclosures set forth in Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk of the 2015 Form 10-K.

Item 4. 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 March 26, 2016 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 SEC 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.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the second quarter of 2016, 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.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

The Company is subject to the 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, there was not at least a reasonable possibility the Company may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies for asserted legal and other claims. However, the outcome of legal proceedings and claims brought against the Company is subject to significant uncertainty. Therefore, although management considers the likelihood of such an outcome to be remote, if one or more of these legal matters were resolved against the Company in a reporting period for amounts in excess of management's expectations, the Company's consolidated financial statements for that reporting period could be materially adversely affected. See the risk factor *The Company could be impacted by unfavorable results of legal proceedings, such as being found to have infringed on intellectual property rights* in Part II, Item 1A of this Form 10-Q under the heading Risk Factors. The Company settled certain matters during the second quarter of 2016 that did not individually or in the aggregate have a material impact on the Company's financial condition or operating results.

Apple eBooks Antitrust Litigation (United States of America v. Apple Inc., et al.)

On April 11, 2012, the U.S. Department of Justice filed a civil antitrust action against the Company and five major book publishers in the U.S. District Court for the Southern District of New York, alleging an unreasonable restraint of interstate trade and commerce in violation of §1 of the Sherman Act and seeking, among other things, injunctive

relief, the District Court's declaration that the Company's agency agreements with the publishers are null and void and/or the District Court's reformation of such agreements. On July 10, 2013, the District Court found, following a bench trial, that the Company conspired to restrain trade in violation of §1 of the Sherman Act and relevant state statutes to the extent those laws are congruent with §1 of the Sherman Act. The District Court entered a permanent injunction, which took effect on October 6, 2013 and will be in effect for five years. The Company has taken the necessary steps to comply with the terms of the District Court's order, including renegotiating agreements with the five major eBook publishers, updating its antitrust training program and completing a two-year monitorship with a court-appointed antitrust compliance monitor, whose appointment the District Court ended in October 2015. The Company appealed the District Court's decision. Following the exhaustion of all appeals, the Company paid \$450 million in April 2016 pursuant to a settlement agreement reached in June 2014.

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The following description of risk factors includes any material changes to, and supersedes the description of, risk factors associated with the Company's business previously disclosed in Part I, Item 1A of the 2015 Form 10-K and in Part II, Item 1A of the Form 10-Q for the quarter ended December 26, 2015, in each case under the heading "Risk Factors." The business, financial condition and operating results of the Company can be affected by a number of factors, whether currently known or unknown, including but not limited to those described below, any one or more of which could, directly or indirectly, cause the Company's actual financial condition and operating results to vary materially from past, or from anticipated future, financial condition and operating results. Any of these factors, in whole or in part, could materially and adversely affect the Company's business, financial condition, operating results and stock price.

The following discussion of risk factors contains forward-looking statements. These risk factors may be important to understanding other statements in this Form 10-Q. The following information should be read in conjunction with the condensed consolidated financial statements and related notes in Part I, Item 1, "Financial Statements" and Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Form 10-Q.

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.

Global and regional economic conditions could materially adversely affect the Company.

The Company's operations and performance depend significantly on global and regional economic conditions. Uncertainty about global and regional economic conditions poses a risk as consumers and businesses may postpone spending in response to tighter credit, higher unemployment, financial market volatility, government austerity programs, negative financial news, declines in income or asset values and/or other factors. These worldwide and regional economic conditions could have a material adverse effect on demand for the Company's products and services. Demand also could differ materially from the Company's expectations as a result of currency fluctuations because the Company generally raises prices on goods and services sold outside the U.S. to correspond with the effect of a strengthening of the U.S. dollar. Other factors that could influence worldwide or regional demand include changes in fuel and other energy costs, conditions in the real estate and mortgage markets, unemployment, 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.

In the event of 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 tightening in the credit markets, low liquidity and extreme volatility in fixed income, credit, currency and equity markets. This could have a number of effects on the Company's business, including the insolvency or financial instability of outsourcing partners or 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; failure of derivative counterparties and other financial institutions; and restrictions on the Company's ability to issue new debt. 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; changes in interest rates; increases or decreases in cash balances; volatility in foreign exchange rates; 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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Global markets for the Company's products and services are highly competitive and subject to rapid technological change, and the Company may be unable to compete effectively in these markets.

The Company's products and services compete in highly competitive global markets characterized by aggressive price cutting and 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, services and technologies to the marketplace. The Company believes it is unique in that it designs and develops nearly the entire solution for its products, including the hardware, operating system, numerous software applications and related services. As a result, the Company must make significant investments in R&D. 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. In contrast, many of the Company's competitors seek to compete primarily through aggressive pricing and very low cost structures, and emulating the Company's products and infringing on its intellectual property. If the Company is unable to continue to develop and sell innovative new products with attractive margins or if competitors infringe on the Company's intellectual property, the Company's ability to maintain a competitive advantage could be adversely affected.

The Company markets certain mobile communication and media devices based on the iOS mobile operating system and also markets related third-party digital content and applications. The Company faces substantial competition in these markets from companies that have significant technical, marketing, distribution and other resources, as well as established hardware, software and digital content supplier relationships; and the Company has a minority market share in the global smartphone market. Additionally, the Company faces significant price competition as competitors reduce their selling prices and attempt to imitate the Company's product features and applications within their own products or, alternatively, collaborate with each other to offer solutions that are more competitive than those they currently offer. The Company competes with business models that provide content to users for free. The Company also competes with illegitimate means to obtain third-party digital content and applications. Some of the Company's competitors have greater experience, product breadth and distribution channels than the Company. Because some current and potential competitors have substantial resources and/or experience and a lower cost structure, they may be able to provide 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 components seamlessly within their individual offerings or work collaboratively to offer integrated solutions. The Company's financial condition and operating results depend substantially on the Company's ability to continually improve iOS and iOS devices in order to maintain their functional and design advantages.

The Company is the only authorized maker of hardware using OS X, which has a minority market share in the personal computer market. This market has been contracting and is dominated by computer makers using competing operating systems, most notably Windows. In the market for personal computers and accessories, the Company faces a significant number of competitors, many of which have broader product lines, lower priced products and a larger installed customer base. Historically, consolidation in this market has resulted in larger competitors. Price competition has been particularly intense as competitors selling Windows-based personal computers have aggressively cut prices and lowered product margins. An increasing number of internet-enabled 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's financial condition and operating results also depend on its ability to continually improve the Mac platform to maintain its functional and design advantages.

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 industries in which the Company competes, the Company must continually introduce new products, services and technologies, enhance existing products and services, effectively stimulate customer demand for new and upgraded products and successfully manage the transition to these 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 product production ramp-up 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 at expected costs to meet anticipated demand and the risk that new products may have quality or other defects or deficiencies in the early stages of introduction. Accordingly, the Company cannot determine in advance the ultimate effect of new product introductions and transitions.

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The Company depends on the performance of distributors, carriers and other resellers.

The Company distributes its products through cellular network carriers, wholesalers, national and regional retailers and value-added resellers, many of whom distribute products from competing manufacturers. The Company also sells its products and third-party products in most of its major markets directly to education, enterprise and government customers and consumers and small and mid-sized businesses through its online and retail stores.

Carriers providing cellular network service for iPhone typically subsidize users' purchases of the device. 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.

Many resellers have narrow operating margins and have been adversely 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 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 financial condition of these resellers could weaken, these resellers could stop distributing the Company's products, or uncertainty regarding demand for some or all of the Company's products could cause resellers to reduce their ordering and marketing of the Company's products.

The Company faces substantial inventory and other asset risk in addition to purchase commitment cancellation 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, including capital assets held at its suppliers' facilities and inventory prepayments, for impairment whenever events or 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 value. Although the Company believes its provisions related to inventory, capital assets, inventory prepayments and other assets and purchase commitments are currently adequate, no assurance can be given that the Company will not incur additional related charges given the rapid and unpredictable pace of product obsolescence in the industries in which the Company competes.

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, in each case based on projected demand. Where appropriate, the purchases are applied to inventory component prepayments that are outstanding with the respective supplier. Purchase commitments typically cover forecasted component and manufacturing requirements for periods up 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 amounts of components or products, or not fully utilize firm purchase commitments.

Future operating results depend upon the Company's ability to obtain components in sufficient quantities.

Because the Company currently obtains components from single or limited sources, the Company is subject to significant supply and pricing risks. Many components, including those that are available from multiple sources, are at

times subject to industry-wide shortages and significant commodity pricing fluctuations. While the Company has entered into agreements for the supply of many components, there can be no assurance that the Company will be able to extend or renew these agreements on similar terms, or at all. A number of suppliers of components may suffer from poor financial conditions, which can lead to business failure for the supplier or consolidation within a particular industry, further limiting the Company's ability to obtain sufficient quantities of components. The effects of global or regional economic conditions on the Company's suppliers, described in *Global and regional economic conditions could materially adversely affect the Company* above, also could affect the Company's ability to obtain components. Therefore, the Company remains subject to significant risks of supply shortages and price increases.

The Company and other participants in the markets for mobile communication and media devices and personal computers 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 these industries. The Company's new products often utilize custom components available from only one source. 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 for any number of reasons, including if those suppliers decide to concentrate on the production of common components instead of components customized to meet the Company's requirements. The supply of components for a new or existing product could be delayed or constrained, or a key manufacturing vendor could delay shipments of completed products to the Company.

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The Company depends on component and product manufacturing and logistical services provided by outsourcing partners, many of which are located outside of the U.S.

Substantially all of the Company's manufacturing is performed in whole or in part by a few outsourcing partners located primarily in Asia. 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. Although arrangements with these partners may contain provisions for warranty expense reimbursement, the Company may remain responsible to the consumer for warranty service in the event of product defects and could experience an unanticipated product defect or warranty liability. While the Company relies on its partners to adhere to its supplier code of conduct, material violations of the supplier code of conduct could occur.

The Company relies on sole-sourced outsourcing partners in the U.S., Asia and Europe to supply and manufacture many critical components, and on outsourcing partners primarily located in Asia, for final assembly of substantially all of the Company's hardware products. Any failure of these partners to perform may have a negative impact on the Company's cost or supply of components or finished goods. In addition, manufacturing or logistics in these locations or transit to final destinations may be disrupted for a variety of reasons including, but not limited to, natural and man-made disasters, information technology system failures, commercial disputes, military actions or economic, business, labor, environmental, public health, or political issues.

The Company has invested in manufacturing process equipment, much of which is held at certain of its outsourcing partners, and has made prepayments to certain of its suppliers associated with long-term supply agreements. While these arrangements help ensure the supply of components and finished goods, if these outsourcing partners or suppliers experience severe financial problems or other disruptions in their business, such continued supply could be reduced or terminated and the net realizable value of these assets could be negatively impacted.

The Company's products and services may experience quality problems from time to time that can result in decreased sales and operating margin and harm to the Company's reputation.

The Company sells complex hardware and software products and services that can contain design and manufacturing defects. 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. The Company's online services may from time to time experience outages, service slowdowns, or errors. 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, significant warranty and other expenses and harm to the Company's reputation.

The Company relies on access to third-party digital content, which may not be available to the Company on commercially reasonable terms or at all.

The Company contracts with numerous third parties to offer their digital content to customers. This includes the right to sell currently available music, movies, TV shows and books. The licensing or other distribution arrangements with these third parties are for relatively short terms and do not guarantee the continuation or renewal of these arrangements on reasonable terms, if at all. Some third-party content providers and distributors 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 or otherwise distribute their content in the future. Other content owners, providers or distributors may seek to limit the Company's access to, or increase the cost of, such content. The Company may be unable to

continue to offer a wide variety of content at reasonable prices with acceptable usage rules, or continue to expand its geographic reach. Failure to obtain the right to make available third-party digital content, or to make available such content on commercially reasonable terms, could have a material adverse impact on the Company's financial condition and operating results.

Some third-party digital content providers require the Company to provide digital rights management and other security solutions. If 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 and adopt legislation that would force the Company to license its digital rights management, which could lessen the protection of content and subject it to piracy and also could negatively affect arrangements with the Company's content providers.

The Company's future performance depends in part on support from third-party software developers.

The Company believes decisions by customers to purchase its hardware products depend in part on the availability of third-party software applications and services. There is no assurance that third-party developers will continue to develop and maintain software applications and services for the Company's products. 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.

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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 market position of the Company and its products, the anticipated revenue that may be generated, expected future growth of Mac sales 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 Mac's prospects, developers could be less inclined to develop or upgrade software for the Company's Mac products and more inclined to devote their resources to developing and upgrading software for the larger Windows market.

With respect to iOS devices, the Company relies on the continued availability and development of compelling and innovative software applications, which are distributed through a single distribution channel, the App Store. iOS devices are subject to rapid technological change, and, if third-party developers are unable to or choose not to keep up with this pace of change, third-party applications might not successfully operate and may result in dissatisfied customers. 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, maintaining or upgrading software for the Company's iOS devices rather than its competitors' platforms, such as Android. If developers focus their efforts on these competing platforms, the availability and quality of applications for the Company's iOS devices may suffer.

The Company relies on access to third-party intellectual property, which may not be available to the Company on commercially reasonable terms or at all.

Many of the Company's products include third-party intellectual property, which requires licenses from those third parties. Based on past experience and industry practice, the Company believes such licenses generally can be obtained on reasonable terms. There is, however, no assurance that the necessary licenses can be obtained on acceptable terms or at all. Failure to obtain the right to use third-party intellectual property, or to use such intellectual property on commercially reasonable terms, could preclude the Company from selling certain products or otherwise have a material adverse impact on the Company's financial condition and operating results.

The Company could be impacted by unfavorable results of legal proceedings, such as being found to have infringed on intellectual property rights.

The Company is subject to various legal proceedings and claims that have not yet been fully resolved and that have arisen in the ordinary course of business, and additional claims may arise in the future.

For example, technology companies, including many of the Company's competitors, frequently enter into litigation based on allegations of patent infringement or other violations of intellectual property rights. In addition, patent holding companies seek to monetize patents they have purchased or otherwise obtained. As the Company has grown, the intellectual property rights claims against it have increased and may continue to increase. In particular, the Company's cellular enabled products compete with products from mobile communication and media device companies that hold significant patent portfolios, and the number of patent claims against the Company has significantly increased. The Company is vigorously defending infringement actions in courts in a number of U.S. jurisdictions and before the U.S. International Trade Commission, as well as internationally in various countries. The plaintiffs in these actions frequently seek injunctions and substantial damages.

Regardless of the scope or validity of such patents or other intellectual property rights, or the merits of any claims by potential or actual litigants, the Company may have to engage in protracted litigation. If the Company is found to infringe one or more patents or other intellectual property rights, regardless of whether it can develop non-infringing

technology, it may be required to pay substantial damages or royalties to a third-party, or it may be subject to a temporary or permanent injunction prohibiting the Company from marketing or selling certain products.

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. These licenses may also significantly increase the Company's operating expenses.

Regardless of the merit of particular claims, litigation may be expensive, time-consuming, disruptive to the Company's operations and distracting to management. In recognition of these considerations, the Company may enter into arrangements to settle litigation.

In management's opinion, there is not at least a reasonable possibility the Company may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies, including matters related to infringement of intellectual property rights. However, the outcome of litigation is inherently uncertain.

Although management considers the likelihood of such an outcome to be remote, if one or more legal matters were resolved against the Company in a reporting period for amounts in excess of management's expectations, the Company's consolidated financial statements for that reporting period could be materially adversely affected. Further, such an outcome could result in significant compensatory, punitive or trebled monetary damages, disgorgement of revenue or profits, remedial corporate measures or injunctive relief against the Company that could materially adversely affect its financial condition and operating results.

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The Company is subject to laws and regulations worldwide, changes to which could increase the Company's costs and individually or in the aggregate adversely affect the Company's business.

The Company is subject to laws and regulations affecting its domestic and international operations in a number of areas. These U.S. and foreign laws and regulations affect the Company's activities including, but not limited to, in areas of labor, advertising, digital content, consumer protection, real estate, billing, e-commerce, promotions, quality of services, telecommunications, mobile communications and media, television, intellectual property ownership and infringement, tax, import and export requirements, anti-corruption, foreign exchange controls and cash repatriation restrictions, data privacy requirements, anti-competition, environmental, health and safety.

By way of example, laws and regulations related to mobile communications and media devices in the many jurisdictions in which the Company operates are extensive and subject to change. Such changes could include, among others, restrictions on the production, manufacture, distribution and use of devices, locking devices to a carrier's network, or mandating the use of devices on more than one carrier's network. These devices are also 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, or could preclude the Company from selling certain products.

Compliance with these laws, regulations and similar requirements may be onerous and expensive, and they may be inconsistent from jurisdiction to jurisdiction, further increasing the cost of compliance and doing business. Any such costs, which may rise in the future as a result of changes in these laws and regulations or in their interpretation, could individually or in the aggregate make the Company's products and services less attractive to the Company's customers, delay the introduction of new products in one or more regions, or cause the Company to change or limit its business practices. The Company has implemented policies and procedures designed to ensure compliance with applicable 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 and procedures.

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

The Company derives a significant portion of its revenue and earnings from its international operations. Compliance with applicable U.S. and foreign laws and regulations, such as import and export requirements, anti-corruption laws, tax laws, foreign exchange controls and cash repatriation restrictions, data privacy requirements, environmental laws, labor laws and anti-competition regulations, increases the costs of doing business in foreign jurisdictions. Although the Company has implemented policies and procedures to comply with these laws and regulations, a violation by the Company's employees, contractors, or agents could nevertheless occur. In some cases, compliance with the laws and regulations of one country could violate the laws and regulations of another country. Violations of these laws and regulations could materially adversely affect the Company's brand, international growth efforts and business.

The Company also could be significantly affected by other risks associated with international activities including, but not limited to, economic and labor conditions, increased duties, taxes and other costs and political instability. 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 international trade regulations, including duties, tariffs and antidumping penalties. The Company is also exposed to credit and collectability risk on its trade receivables with customers in certain international markets. There can be no assurance the Company can effectively limit its credit risk and avoid losses.

The Company's retail stores have required and will continue to require a substantial investment and commitment of resources and are subject to numerous risks and uncertainties.

The Company's retail stores have required substantial investment in equipment and leasehold improvements, information systems, inventory and personnel. The Company also has entered into substantial operating lease commitments for retail space. 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 cost structure associated with the Company's retail stores, 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.

Many factors unique to retail operations, some of which are beyond the Company's control, pose risks and uncertainties. These risks and uncertainties include, but are not limited to, macro-economic factors that could have an adverse effect on general retail activity, as well as the Company's inability to manage costs associated with store construction and operation, the Company's failure to manage relationships with its existing retail partners, more challenging environments in managing retail operations outside the U.S., costs associated with unanticipated fluctuations in the value of retail inventory, and the Company's inability to obtain and renew leases in quality retail locations at a reasonable cost.

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Investment in new business strategies and acquisitions 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, greater than expected liabilities and expenses, inadequate return of capital and unidentified issues not discovered in the Company's due diligence. These new ventures are inherently risky and may not be successful.

The Company's business and reputation may be impacted by information technology system failures or network disruptions.

The Company may be subject to information technology system failures and network disruptions. These may be caused by natural disasters, accidents, power disruptions, telecommunications failures, acts of terrorism or war, computer viruses, physical or electronic break-ins, or other events or disruptions. System redundancy may be ineffective or inadequate, and the Company's disaster recovery planning may not be sufficient for all eventualities. Such failures or disruptions could, among other things, prevent access to the Company's online stores and services, preclude retail store transactions, compromise Company or customer data, and result in delayed or cancelled orders. System failures and disruptions could also impede the manufacturing and shipping of products, delivery of online services, transactions processing and financial reporting.

There may be breaches of the Company's information technology systems that materially damage business partner and customer relationships, curtail or otherwise adversely impact access to online stores and services, or subject the Company to significant reputational, financial, legal and operational consequences.

The Company's business requires it to use and store customer, employee and business partner personally identifiable information (PII). This may include, among other information, names, addresses, phone numbers, email addresses, contact preferences, tax identification numbers and payment account information. Although malicious attacks to gain access to PII affect many companies across various industries, the Company is at a relatively greater risk of being targeted because of its high profile and the amount of PII it manages.

The Company requires user names and passwords in order to access its information technology systems. The Company also uses encryption and authentication technologies designed to secure the transmission and storage of data and prevent access to Company data or accounts. As with all companies, these security measures are subject to third-party security breaches, employee error, malfeasance, faulty password management, or other irregularities. For example, third parties may attempt to fraudulently induce employees or customers into disclosing user names, passwords or other sensitive information, which may in turn be used to access the Company's information technology systems. To help protect customers and the Company, the Company monitors accounts and systems for unusual activity and may freeze accounts under suspicious circumstances, which may result in the delay or loss of customer orders.

The Company devotes significant resources to network security, data encryption and other security measures to protect its systems and data, but these security measures cannot provide absolute security. To the extent the Company was to experience a breach of its systems and was unable to protect sensitive data, such a breach could materially damage business partner and customer relationships, and curtail or otherwise adversely impact access to online stores and services. Moreover, if a computer security breach affects the Company's systems or results in the unauthorized release of PII, the Company's reputation and brand could be materially damaged, use of the Company's products and services could decrease, and the Company could be exposed to a risk of loss or litigation and possible liability. While the Company maintains insurance coverage that, subject to policy terms and conditions and subject to a significant

self-insured retention, is designed to address certain aspects of cyber risks, such insurance coverage may be insufficient to cover all losses or all types of claims that may arise in the continually evolving area of cyber risk.

The Company is also subject to payment card association rules and obligations under its contracts with payment card processors. Under these rules and obligations, if information is compromised, the Company could be liable to payment card issuers for associated expenses and penalties. In addition, if the Company fails to follow payment card industry security standards, even if no customer information is compromised, the Company could incur significant fines or experience a significant increase in payment card transaction costs.

The Company's business is subject to a variety of U.S. and international laws, rules, policies and other obligations regarding data protection.

The Company is subject to federal, state and international laws relating to the collection, use, retention, security and transfer of PII. In many cases, these laws apply not only to third-party transactions, but also may restrict transfers of PII among the Company and its international subsidiaries. Several jurisdictions have passed laws in this area, and other jurisdictions are considering imposing additional restrictions. These laws continue to develop and may be inconsistent from jurisdiction to jurisdiction. Complying with emerging and changing international requirements may cause the Company to incur substantial costs or require the Company to change its business practices. Noncompliance could result in significant penalties or legal liability.

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The Company makes statements about its use and disclosure of PII through its privacy policy, information provided on its website and press statements. Any failure by the Company to comply with these public statements or with other federal, state or international privacy-related or data protection laws and regulations could result in proceedings against the Company by governmental entities or others. Penalties could include ongoing audit requirements or significant legal liability.

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 Chief Executive Officer, executive team and other highly skilled employees. Experienced personnel in the technology industry are in high demand and competition for their talents is intense, especially in Silicon Valley, where most of the Company's key personnel are located.

The Company's business may be impacted by political events, war, terrorism, public health issues, natural disasters and other business interruptions.

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 material adverse 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, among others, natural disasters, whether as a result of climate change or otherwise, fire, power shortages, nuclear power plant accidents, 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 adversely 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 R&D activities, its corporate headquarters, information technology systems and other critical business operations, including certain component suppliers and manufacturing vendors, are in locations that could be affected by natural disasters. In the event of a natural disaster, the Company could incur significant losses, require substantial recovery time and experience significant expenditures in order to resume operations.

The Company expects its quarterly revenue and operating results to fluctuate.

The Company's profit margins vary across its products and 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, component cost increases, the strengthening U.S. dollar, price competition, or the introduction of new products, including those that have higher cost structures with flat or reduced pricing.

The Company has typically experienced higher net sales in its first quarter compared to other quarters due in part to seasonal holiday demand. Additionally, new product introductions can significantly impact net sales, product costs

and operating expenses. Further, the Company generates a majority of its net sales from a single product and a decline in demand for that product could significantly impact quarterly net sales. The Company could also be subject to unexpected developments late in a quarter, such as lower-than-anticipated demand for the Company's products, issues with new product introductions, an internal systems failure, or failure of one of the Company's logistics, components supply, or manufacturing partners.

The Company's stock price is subject to volatility.

The Company's stock price has experienced substantial price volatility in the past and may continue to do so in the future. Additionally, the Company, the technology industry and the stock market as a whole have experienced extreme stock price and volume fluctuations that have affected stock prices in ways that may have been unrelated to these companies' operating performance. Price volatility over a given period may cause the average price at which the Company repurchases its own stock to exceed the stock's price at a given point in time. The Company believes its stock price should reflect expectations of future growth and profitability. The Company also believes its stock price should reflect expectations that its cash dividend will continue at current levels or grow and that its current share repurchase program will be fully consummated. Future dividends are subject to declaration by the Company's Board of Directors, and the Company's share repurchase program does not obligate it to acquire any specific number of shares. If the Company fails to meet expectations related to future growth, profitability, dividends, share repurchases or other market expectations, its stock price may decline significantly, which could have a material adverse impact on investor confidence and employee retention.

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The Company's financial performance is subject to risks associated with changes in the value of the U.S. dollar versus local currencies.

The Company's primary exposure to movements in foreign currency exchange rates relates to non-U.S. dollar-denominated sales and operating expenses worldwide. Weakening of foreign currencies relative to the U.S. dollar adversely affects the U.S. dollar value of the Company's foreign currency-denominated sales and earnings, and generally leads the Company to raise international pricing, potentially reducing demand for the Company's products. 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. In some circumstances, for competitive or other reasons, the Company may decide not to raise local prices to fully offset 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 relative to the U.S. dollar, while generally beneficial to the Company's foreign currency-denominated sales and earnings, could cause the Company to reduce international pricing and incur losses on its foreign currency derivative instruments, 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 uses 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.

Given the global nature of its business, the Company has both domestic and international investments. Credit ratings and pricing of the Company's investments can be negatively affected by liquidity, credit deterioration, financial results, economic risk, political risk, sovereign risk or other factors. As a result, the value and liquidity of the Company's cash, cash equivalents and marketable securities may fluctuate substantially. Therefore, although the Company has not realized any significant losses on its cash, cash equivalents and marketable securities, future fluctuations in their value could result in a significant realized loss.

The Company is exposed to credit risk on its trade accounts receivable, vendor non-trade receivables and prepayments related to long-term supply agreements, and this risk is heightened during periods when economic conditions worsen.

The Company distributes its products through third-party cellular network carriers, wholesalers, retailers and value-added resellers. The Company also sells its products directly to small and mid-sized businesses and education, enterprise and government customers. A substantial majority of the Company's outstanding trade receivables are not covered by collateral, third-party financing arrangements or credit insurance. The Company's exposure to credit and collectability risk on its trade receivables is higher in certain international markets and its ability to mitigate such risks may be limited. The Company also has unsecured vendor non-trade receivables resulting from purchases of components by outsourcing partners 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 inventory components. As of March 26, 2016, a significant portion of the Company's trade receivables was concentrated within cellular network carriers, and its vendor non-trade receivables and prepayments related to long-term supply agreements were concentrated among a few individual vendors located primarily in Asia. While the Company has procedures to monitor and limit exposure to credit risk on its trade and vendor 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 could be subject to changes in its tax rates, the adoption of new U.S. or international tax legislation or exposure to additional tax liabilities.

The Company is subject to taxes in the U.S. and numerous foreign jurisdictions, including Ireland, where a number of the Company's subsidiaries are organized. Due to economic and political conditions, tax rates in various jurisdictions may be subject to significant change. The Company's 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, including in the U.S. and Ireland. For example, in June 2014, the European Commission opened a formal investigation of Ireland to examine whether decisions by the tax authorities with regard to the corporate income tax to be paid by two of the Company's Irish subsidiaries comply with European Union rules on state aid. If the European Commission were to conclude against Ireland, it could require Ireland to recover from the Company past taxes covering a period of up to 10 years reflective of the disallowed state aid, and such amount could be material.

The Company is also subject to the examination of its tax returns and other tax matters by the Internal Revenue Service and other tax authorities and governmental bodies. The Company regularly assesses the likelihood of an adverse outcome resulting from these examinations to determine the adequacy of its provision for taxes. There can be no assurance as to the outcome of these examinations. If the Company's effective tax rates were to increase, particularly in the U.S. or Ireland, or if the ultimate determination of the Company's taxes owed is for an amount in excess of amounts previously accrued, the Company's financial condition, operating results and cash flows could be adversely affected.

Table of Contents**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

Share repurchase activity during the three months ended March 26, 2016 was as follows (in millions, except number of shares, which are reflected in thousands, and per share amounts):

Periods	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs ⁽¹⁾
December 27, 2015 to January 30, 2016:				
Open market and privately negotiated purchases	5,270	\$ 94.87	5,270	
January 31, 2016 to February 27, 2016:				
Open market and privately negotiated purchases	47,132	\$ 95.48	47,132	
February 28, 2016 to March 26, 2016:				
Open market and privately negotiated purchases	19,364	\$ 103.28	19,364	
Total	71,766			\$ 23,024

⁽¹⁾ In 2012, the Company's Board of Directors authorized a program to repurchase up to \$10 billion of the Company's common stock beginning in 2013. The Company's Board of Directors increased the authorization to repurchase the Company's common stock to \$60 billion in April 2013, to \$90 billion in April 2014 and to \$140 billion in April 2015. As of March 26, 2016, \$117 billion of the \$140 billion had been utilized. The remaining \$23 billion in the table represents the amount available to repurchase shares under the authorized repurchase program as of March 26, 2016. The Company's share repurchase program does not obligate it to acquire any specific number of shares. Under the program, shares may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 under the Exchange Act.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Table of Contents**Item 6. Exhibits
Index to Exhibits**

Exhibit Number	Exhibit Description	Incorporated by		
		Form	Exhibit	Reference Filing Date/ Period End Date
4.1	Officer's Certificate of the Registrant, dated as of February 23, 2016, including forms of global notes representing the Floating Rate Notes due 2019, Floating Rate Notes due 2021, 1.30% Notes due 2018, 1.70% Notes due 2019, 2.25% Notes due 2021, 2.85% Notes due 2023, 3.25% Notes due 2026, 4.50% Notes due 2036 and 4.65% Notes due 2046.	8-K	4.1	2/23/16
4.2	Supplement No. 1 to the Officer's Certificate of the Registrant, dated as of March 24, 2016.	8-K	4.1	3/24/16
10.8*	2014 Employee Stock Plan, as amended and restated as of February 26, 2016.	8-K	10.1	3/1/16
10.16 *, **	Form of Restricted Stock Unit Award Agreement under 2014 Employee Stock Plan effective as of October 5, 2015.			
10.17 *, **	Form of Performance Award Agreement under 2014 Employee Stock Plan effective as of October 5, 2015.			
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.

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SIGNATURE

Pursuant to the requirements 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.

April 27, 2016

Apple Inc.

By: /s/ Luca Maestri
Luca Maestri

Senior Vice President,

Chief Financial Officer

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