
**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 December 31, 2011

or

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

For the transition period from _____ to _____.

Commission file number: 000-10030

APPLE INC.

(Exact name of Registrant as specified in its charter)

California
(State or other jurisdiction
of incorporation or organization)

94-2404110
(I.R.S. Employer Identification No.)

1 Infinite Loop
Cupertino, California
(Address of principal executive offices)

95014
(Zip Code)

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

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
Non-accelerated filer (Do not check if a smaller reporting company)

Accelerated filer
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

932,370,000 shares of common stock issued and outstanding as of January 13, 2012

PART I. FINANCIAL INFORMATION**Item 1. Financial Statements****APPLE INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**
(in millions, except share amounts which are reflected in thousands and per share amounts)

| | Three Months Ended | |
|--|----------------------|----------------------|
| | December 31, 2011 | December 25, 2010 |
| Net sales | \$ 46,333 | \$ 26,741 |
| Cost of sales | 25,630 | 16,443 |
| Gross margin | 20,703 | 10,298 |
| Operating expenses: | | |
| Research and development | 758 | 575 |
| Selling, general and administrative | 2,605 | 1,896 |
| Total operating expenses | 3,363 | 2,471 |
| Operating income | 17,340 | 7,827 |
| Other income and expense | 137 | 136 |
| Income before provision for income taxes | 17,477 | 7,963 |
| Provision for income taxes | 4,413 | 1,959 |
| Net income | <u>\$ 13,064</u> | <u>\$ 6,004</u> |
| Earnings per common share: | | |
| Basic | \$ 14.03 | \$ 6.53 |
| Diluted | \$ 13.87 | \$ 6.43 |
| Shares used in computing earnings per share: | | |
| Basic | 931,041 | 919,294 |
| Diluted | 941,572 | 933,154 |

See accompanying Notes to Condensed Consolidated Financial Statements.

APPLE INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)
(in millions, except number of shares which are reflected in thousands)

| | <u>December 31, 2011</u> | <u>September 24, 2011</u> |
|--|------------------------------|-------------------------------|
| ASSETS: | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 10,310 | \$ 9,815 |
| Short-term marketable securities | 19,846 | 16,137 |
| Accounts receivable, less allowances of \$78 and \$53, respectively | 8,930 | 5,369 |
| Inventories | 1,236 | 776 |
| Deferred tax assets | 1,937 | 2,014 |
| Vendor non-trade receivables | 7,554 | 6,348 |
| Other current assets | 4,958 | 4,529 |
| Total current assets | <u>54,771</u> | <u>44,988</u> |
| Long-term marketable securities | 67,445 | 55,618 |
| Property, plant and equipment, net | 7,816 | 7,777 |
| Goodwill | 896 | 896 |
| Acquired intangible assets, net | 3,472 | 3,536 |
| Other assets | 4,281 | 3,556 |
| Total assets | <u>\$ 138,681</u> | <u>\$ 116,371</u> |
| LIABILITIES AND SHAREHOLDERS' EQUITY: | | |
| Current liabilities: | | |
| Accounts payable | \$ 18,221 | \$ 14,632 |
| Accrued expenses | 11,500 | 9,247 |
| Deferred revenue | 4,886 | 4,091 |
| Total current liabilities | <u>34,607</u> | <u>27,970</u> |
| Deferred revenue – non-current | 2,187 | 1,686 |
| Other non-current liabilities | 11,833 | 10,100 |
| Total liabilities | <u>48,627</u> | <u>39,756</u> |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Common stock, no par value; 1,800,000 shares authorized; 932,214 and 929,277 shares issued and outstanding, respectively | 13,961 | 13,331 |
| Retained earnings | 75,709 | 62,841 |
| Accumulated other comprehensive income | 384 | 443 |
| Total shareholders' equity | <u>90,054</u> | <u>76,615</u> |
| Total liabilities and shareholders' equity | <u>\$ 138,681</u> | <u>\$ 116,371</u> |

See accompanying Notes to Condensed Consolidated Financial Statements.

APPLE INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(in millions)

| | Three Months Ended | |
|--|----------------------|----------------------|
| | December 31, 2011 | December 25, 2010 |
| Cash and cash equivalents, beginning of the period | \$ 9,815 | \$ 11,261 |
| Operating activities: | | |
| Net income | 13,064 | 6,004 |
| Adjustments to reconcile net income to cash generated by operating activities: | | |
| Depreciation, amortization and accretion | 721 | 356 |
| Share-based compensation expense | 420 | 299 |
| Deferred income tax expense | 1,456 | 823 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | (3,561) | (517) |
| Inventories | (460) | 166 |
| Vendor non-trade receivables | (1,206) | (433) |
| Other current and non-current assets | (962) | (558) |
| Accounts payable | 4,314 | 2,346 |
| Deferred revenue | 1,296 | 634 |
| Other current and non-current liabilities | 2,472 | 653 |
| Cash generated by operating activities | 17,554 | 9,773 |
| Investing activities: | | |
| Purchases of marketable securities | (40,175) | (19,575) |
| Proceeds from maturities of marketable securities | 3,038 | 3,279 |
| Proceeds from sales of marketable securities | 21,472 | 6,853 |
| Payments for acquisition of property, plant and equipment | (1,321) | (1,214) |
| Payments for acquisition of intangible assets | (108) | (49) |
| Other | (34) | (23) |
| Cash used in investing activities | (17,128) | (10,729) |
| Financing activities: | | |
| Proceeds from issuance of common stock | 91 | 208 |
| Excess tax benefits from equity awards | 333 | 454 |
| Taxes paid related to net share settlement of equity awards | (355) | (233) |
| Cash generated by financing activities | 69 | 429 |
| Increase/(decrease) in cash and cash equivalents | 495 | (527) |
| Cash and cash equivalents, end of the period | \$ 10,310 | \$ 10,734 |
| Supplemental cash flow disclosure: | | |
| Cash paid for income taxes, net | \$ 1,474 | \$ 826 |

See accompanying Notes to Condensed Consolidated Financial Statements.

Apple Inc.

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, peripherals, 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 iPhone, iPad, Macintosh (“Mac”), and iPod compatible products including application software, printers, storage devices, speakers, headphones, and various other accessories and supplies through its online and retail stores. The Company sells to consumers, small and mid-sized businesses, 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. 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. Prior period costs associated with the Company’s high-profile retail stores have been reclassified to conform to the current period’s presentation. Refer to Note 7, “Segment Information and Geographic Data,” of this Form 10-Q.

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 for the fiscal year ended September 24, 2011, included in its Annual Report on Form 10-K (the “2011 Form 10-K”). The Company’s fiscal year is the 52 or 53-week period that ends on the last Saturday of September. The Company’s fiscal year 2012 will include 53-weeks and ends on September 29, 2012. An additional week has been included in the first quarter of 2012 to realign the Company’s fiscal quarters more closely to calendar quarters. Unless otherwise stated, references to particular years or quarters refer to the Company’s fiscal years ended in September and the associated quarters of those fiscal years.

Earnings Per Common Share

Basic earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the potentially dilutive securities had been issued. Potentially dilutive securities include outstanding stock options, shares to be purchased under the employee stock purchase plan and unvested restricted stock units (“RSUs”). The dilutive effect of potentially dilutive securities is reflected in diluted earnings per common share by application of the treasury stock method. Under the treasury stock method, an increase in the fair market value of the Company’s common stock can result in a greater dilutive effect from potentially dilutive securities.

The following table shows the computation of basic and diluted earnings per common share for the three months ended December 31, 2011 and December 25, 2010 (in thousands, except net income in millions and per share amounts):

| | Three Months Ended | |
|-------------------------------------|----------------------|----------------------|
| | December 31, 2011 | December 25, 2010 |
| Numerator: | | |
| Net income | \$ 13,064 | \$ 6,004 |
| Denominator: | | |
| Weighted-average shares outstanding | 931,041 | 919,294 |
| Effect of dilutive securities | 10,531 | 13,860 |
| Weighted-average diluted shares | <u>941,572</u> | <u>933,154</u> |
| Basic earnings per common share | \$ 14.03 | \$ 6.53 |
| Diluted earnings per common share | \$ 13.87 | \$ 6.43 |

The number of potentially dilutive securities excluded from the computation of diluted earnings per common share because their effect would have been antidilutive was not significant for the three months ended December 31, 2011 and December 25, 2010.

Fair Value Measurements

Fair value is the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is estimated by applying the following hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Inputs that are generally unobservable and typically reflect management’s estimate of assumptions that market participants would use in pricing the asset or liability.

Note 2 – Financial Instruments

Cash, Cash Equivalents and Marketable Securities

The following tables summarize 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-term or long-term marketable securities as of December 31, 2011 and September 24, 2011 (in millions):

| | December 31, 2011 | | | | | | |
|---|-------------------|------------------|-------------------|------------------|---------------------------|----------------------------------|---------------------------------|
| | Adjusted Cost | Unrealized Gains | Unrealized Losses | Fair Value | Cash and Cash Equivalents | Short-Term Marketable Securities | Long-Term Marketable Securities |
| Cash | \$ 3,956 | \$ 0 | \$ 0 | \$ 3,956 | \$ 3,956 | \$ 0 | \$ 0 |
| Level 1: | | | | | | | |
| Money market funds | 3,495 | 0 | 0 | 3,495 | 3,495 | 0 | 0 |
| Mutual funds | 1,238 | 0 | (35) | 1,203 | 0 | 1,203 | 0 |
| Subtotal | 4,733 | 0 | (35) | 4,698 | 3,495 | 1,203 | 0 |
| Level 2: | | | | | | | |
| U.S. Treasury securities | 14,685 | 27 | (3) | 14,709 | 0 | 2,789 | 11,920 |
| U.S. agency securities | 20,000 | 18 | (11) | 20,007 | 363 | 4,279 | 15,365 |
| Non-U.S. government securities | 5,251 | 35 | (5) | 5,281 | 127 | 1,642 | 3,512 |
| Certificates of deposit and time deposits | 3,837 | 1 | 0 | 3,838 | 1,462 | 629 | 1,747 |
| Commercial paper | 1,518 | 0 | 0 | 1,518 | 863 | 655 | 0 |
| Corporate securities | 38,914 | 149 | (147) | 38,916 | 44 | 8,127 | 30,745 |
| Municipal securities | 4,078 | 53 | (1) | 4,130 | 0 | 522 | 3,608 |
| Asset-backed securities | 549 | 0 | (1) | 548 | 0 | 0 | 548 |
| Subtotal | 88,832 | 283 | (168) | 88,947 | 2,859 | 18,643 | 67,445 |
| Total | <u>\$ 97,521</u> | <u>\$ 283</u> | <u>\$ (203)</u> | <u>\$ 97,601</u> | <u>\$ 10,310</u> | <u>\$ 19,846</u> | <u>\$ 67,445</u> |

| | September 24, 2011 | | | | | | |
|---|--------------------|---------------------|----------------------|---------------|---------------------------------|--|---------------------------------------|
| | Adjusted Cost | Unrealized Gains | Unrealized Losses | Fair Value | Cash and Cash Equivalents | Short-Term Marketable Securities | Long-Term Marketable Securities |
| Cash | \$ 2,903 | \$ 0 | \$ 0 | \$ 2,903 | \$ 2,903 | \$ 0 | \$ 0 |
| Level 1: | | | | | | | |
| Money market funds | 1,911 | 0 | 0 | 1,911 | 1,911 | 0 | 0 |
| Mutual funds | 1,227 | 0 | (34) | 1,193 | 0 | 1,193 | 0 |
| Subtotal | 3,138 | 0 | (34) | 3,104 | 1,911 | 1,193 | 0 |
| Level 2: | | | | | | | |
| U.S. Treasury securities | 10,717 | 39 | (3) | 10,753 | 1,250 | 2,149 | 7,354 |
| U.S. agency securities | 13,467 | 24 | (3) | 13,488 | 225 | 1,818 | 11,445 |
| Non-U.S. government securities | 5,559 | 11 | (2) | 5,568 | 551 | 1,548 | 3,469 |
| Certificates of deposit and time deposits | 4,175 | 2 | (2) | 4,175 | 728 | 977 | 2,470 |
| Commercial paper | 2,853 | 0 | 0 | 2,853 | 2,237 | 616 | 0 |
| Corporate securities | 35,241 | 132 | (114) | 35,259 | 10 | 7,241 | 28,008 |
| Municipal securities | 3,411 | 56 | 0 | 3,467 | 0 | 595 | 2,872 |
| Subtotal | 75,423 | 264 | (124) | 75,563 | 5,001 | 14,944 | 55,618 |
| Total | \$ 81,464 | \$ 264 | \$ (158) | \$ 81,570 | \$ 9,815 | \$ 16,137 | \$ 55,618 |

The net unrealized gains as of December 31, 2011 and September 24, 2011 are related primarily to long-term marketable securities. 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 Company recognized no significant net realized gains or losses during the three months ended December 31, 2011 and December 25, 2010 related to such sales. The maturities of the Company's long-term marketable securities generally range from one to five years.

As of December 31, 2011 and September 24, 2011, gross unrealized losses related to individual securities that had been in a continuous loss position for 12 months or longer were not significant.

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 policy generally limits the amount of credit exposure to any one issuer. The Company's investment policy requires investments to generally 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, 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. During the three months ended December 31, 2011 and December 25, 2010, the Company did not recognize any significant impairment charges. As of December 31, 2011, the Company does not consider any of its investments to be other-than-temporarily impaired.

Derivative Financial Instruments

The Company uses derivatives to partially offset its business exposure to foreign currency exchange risk. The Company may enter into foreign currency forward and option contracts to offset some of the foreign exchange risk on expected future cash flows on certain forecasted revenue and cost of sales, on net investments in certain foreign subsidiaries, and on certain existing assets and liabilities.

To help protect gross margins from fluctuations in foreign currency exchange rates, certain of the Company's subsidiaries whose functional currency is the U.S. dollar hedge a portion of forecasted foreign currency revenue. The Company's subsidiaries whose functional currency is not the U.S. dollar and who sell in local currencies may hedge a portion of forecasted inventory purchases not denominated in the subsidiaries' functional currencies. The Company typically hedges portions of its forecasted foreign currency exposure associated with revenue and inventory purchases generally up to six months.

To help protect the net investment in a foreign operation from adverse changes in foreign currency exchange rates, the Company may enter into foreign currency forward and option contracts to offset the changes in the carrying amounts of these investments due to fluctuations in foreign currency exchange rates.

The Company may also enter into foreign currency forward and option contracts to partially offset the foreign currency exchange gains and losses generated by the re-measurement of certain assets and liabilities denominated in non-functional currencies. However, the Company may choose not to hedge certain foreign currency exchange exposures for a variety of reasons including, but not limited to, accounting considerations and the prohibitive economic cost of hedging particular exposures. There can be no assurance the hedges will offset more than a portion of the financial impact resulting from movements in foreign currency exchange rates.

The Company records all derivatives on the Condensed Consolidated Balance Sheets at fair value. The Company's accounting policies for these instruments are based on whether the instruments are designated as hedge or non-hedge instruments. The effective portions of cash flow hedges are recorded in accumulated other comprehensive income ("AOCI") until the hedged item is recognized in earnings. The effective portions of net investment hedges are recorded in other comprehensive income as a part of the cumulative translation adjustment. The ineffective portions of cash flow hedges and net investment hedges are recorded in other income and expense. Derivatives that are not designated as hedging instruments are adjusted to fair value through earnings in the financial statement line item the derivative relates to.

The Company had a net deferred gain associated with cash flow hedges of approximately \$223 million and \$290 million, net of taxes, recorded in AOCI as of December 31, 2011 and September 24, 2011, respectively. 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. Substantially all of the Company's hedged transactions as of December 31, 2011 are expected to occur within six months.

Derivative instruments designated as cash flow hedges must be de-designated as hedges when it is probable the forecasted hedged transaction will not occur in the initially identified time period or within a subsequent two-month time period. Deferred gains and losses in AOCI associated with such derivative instruments are reclassified immediately into other income and expense. Any subsequent changes in fair value of such derivative instruments are reflected in other income and expense unless they are re-designated as hedges of other transactions. The Company did not recognize any material net gains or losses related to the loss of hedge designation on discontinued cash flow hedges during the three months ended December 31, 2011 and December 25, 2010.

The Company's unrealized net gains and losses on net investment hedges, included in the cumulative translation adjustment account of AOCI, were not significant as of December 31, 2011 and September 24, 2011, respectively. The ineffective portions and amounts excluded from the effectiveness test of net investment hedges are recorded in other income and expense.

During the three months ended December 31, 2011 and December 25, 2010, the gain/loss recognized in other income and expense for foreign currency forward and option contracts not designated as hedging instruments was not significant. These amounts represent the net gain or loss on the derivative contracts and do not include changes in the related exposures, which generally offset a portion of the gain or loss on the derivative contracts.

The following table shows the notional principal amounts of the Company's outstanding derivative instruments and credit risk amounts associated with outstanding or unsettled derivative instruments as of December 31, 2011 and September 24, 2011 (in millions):

| | December 31, 2011 | | September 24, 2011 | |
|---|--------------------|---------------------|--------------------|---------------------|
| | Notional Principal | Credit Risk Amounts | Notional Principal | Credit Risk Amounts |
| Instruments qualifying as accounting hedges: | | | | |
| Foreign exchange contracts | \$ 12,323 | \$ 415 | \$ 13,705 | \$ 537 |
| Instruments other than accounting hedges: | | | | |
| Foreign exchange contracts | \$ 15,988 | \$ 85 | \$ 9,891 | \$ 56 |

The notional principal 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 exchange rates at each respective date. The Company's gross exposure on these transactions may be further mitigated by collateral received from certain counterparties. The Company's exposure to credit loss and market risk will vary over time as a function of currency exchange rates. Although the table above reflects the notional principal and credit risk amounts of the Company's foreign exchange instruments, it does not reflect the gains or losses associated with the exposures and transactions that the foreign exchange instruments are intended to hedge. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

The Company generally enters into master netting arrangements, which reduce credit risk by permitting net settlement of transactions with the same counterparty. To further limit credit risk, the Company generally enters into collateral security arrangements that provide for collateral to be received 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. The Company received cash collateral related to the derivative instruments under its collateral security arrangements of \$526 million and \$288 million as of December 31, 2011 and September 24, 2011, respectively. These amounts are classified as accrued expenses in the Condensed Consolidated Balance Sheets. The Company did not have any derivative instruments with credit risk-related contingent features that would require it to post additional collateral as of December 31, 2011 or September 24, 2011.

The following tables show the Company's derivative instruments measured at gross fair value as reflected in the Condensed Consolidated Balance Sheets as of December 31, 2011 and September 24, 2011 (in millions):

| | December 31, 2011 | | |
|------------------------------------|---|---|------------------|
| | Fair Value of Derivatives Designated as Hedge Instruments | Fair Value of Derivatives Not Designated as Hedge Instruments | Total Fair Value |
| Derivative assets (a): | | | |
| Foreign exchange contracts | \$ 358 | \$ 85 | \$ 443 |
| Derivative liabilities (b): | | | |
| Foreign exchange contracts | \$ 42 | \$ 45 | \$ 87 |

| | September 24, 2011 | | |
|-----------------------------|---|---|------------------|
| | Fair Value of Derivatives Designated as Hedge Instruments | Fair Value of Derivatives Not Designated as Hedge Instruments | Total Fair Value |
| Derivative assets (a): | | | |
| Foreign exchange contracts | \$ 460 | \$ 56 | \$ 516 |
| Derivative liabilities (b): | | | |
| Foreign exchange contracts | \$ 72 | \$ 37 | \$ 109 |

- (a) 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.
- (b) 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 effect of the Company's derivative instruments designated as cash flow and net investment hedges in the Condensed Consolidated Statements of Operations for the three months ended December 31, 2011 and December 25, 2010 (in millions):

| | Gains/(Losses) Recognized in OCI - Effective Portion (c) | | Gains/(Losses) Reclassified from AOCI into Income - Effective Portion (c) | | Gains/(Losses) Recognized – Ineffective Portion and Amount Excluded from Effectiveness Testing | | |
|----------------------------|--|-------------------|---|-----------------------|--|-------------------|-------------------|
| | December 31, 2011 | December 25, 2010 | December 31, 2011 (a) | December 25, 2010 (b) | Location | December 31, 2011 | December 25, 2010 |
| Cash flow hedges: | | | | | | | |
| Foreign exchange contracts | \$ 135 | \$ (66) | \$ 238 | \$ (449) | Other income and expense | \$ (69) | \$ 21 |
| Net investment hedges: | | | | | | | |
| Foreign exchange contracts | 7 | (3) | 0 | 0 | Other income and expense | 1 | 0 |
| Total | \$ 142 | \$ (69) | \$ 238 | \$ (449) | | \$ (68) | \$ 21 |

- (a) Includes gains/(losses) reclassified from AOCI into net income for the effective portion of cash flow hedges, of which \$187 million and \$51 million were recognized within net sales and cost of sales, respectively, within the Condensed Consolidated Statement of Operations for the three months ended December 31, 2011. There were no amounts reclassified from AOCI into net income for the effective portion of net investment hedges for the three months ended December 31, 2011.
- (b) Includes gains/(losses) reclassified from AOCI into net income for the effective portion of cash flow hedges, of which \$(257) million and \$(192) million were recognized within net sales and cost of sales, respectively, within the Condensed Consolidated Statement of Operations for the three months ended December 25, 2010. There were no amounts reclassified from AOCI into net income for the effective portion of net investment hedges for the three months ended December 25, 2010.
- (c) Refer to Note 5, "Shareholders' Equity and Share-based Compensation" of this Form 10-Q, which summarizes the activity in AOCI related to derivatives.

Accounts Receivable

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 December 31, 2011, one customer accounted for 12% of the Company's trade receivables. There were no customers that accounted for 10% or more of the Company's total trade receivables as of September 24, 2011. The Company's cellular network carriers accounted for 61% and 52% of trade receivables as of December 31, 2011 and September 24, 2011, respectively. Additionally, the Company has non-trade receivables from certain of its manufacturing vendors. Vendor non-trade receivables from two of the Company's vendors accounted for 59% and 20%, respectively, of non-trade receivables as of December 31, 2011 and two of the Company's vendors accounted for 53% and 29%, respectively, of non-trade receivables as of September 24, 2011.

Note 3 – Condensed Consolidated Financial Statement Details

The following tables show the Company's condensed consolidated financial statement details as of December 31, 2011 and September 24, 2011 (in millions):

Property, Plant and Equipment

| | December 31, 2011 | September 24, 2011 |
|--|-------------------|--------------------|
| Land and buildings | \$ 2,090 | \$ 2,059 |
| Machinery, equipment and internal-use software | 7,308 | 6,926 |
| Office furniture and equipment | 200 | 184 |
| Leasehold improvements | 2,742 | 2,599 |
| Gross property, plant and equipment | 12,340 | 11,768 |
| Accumulated depreciation and amortization | (4,524) | (3,991) |
| Net property, plant and equipment | \$ 7,816 | \$ 7,777 |

Accrued Expenses

| | December 31, 2011 | September 24, 2011 |
|--|-------------------|--------------------|
| Accrued taxes | \$ 2,520 | \$ 1,140 |
| Accrued warranty and related costs | 1,676 | 1,240 |
| Deferred margin on component sales | 1,545 | 2,038 |
| Accrued marketing and selling expenses | 591 | 598 |
| Accrued compensation and employee benefits | 563 | 590 |
| Other current liabilities | 4,605 | 3,641 |
| Total accrued expenses | \$ 11,500 | \$ 9,247 |

Non-Current Liabilities

| | December 31, 2011 | September 24, 2011 |
|-------------------------------------|-------------------|--------------------|
| Deferred tax liabilities | \$ 9,725 | \$ 8,159 |
| Other non-current liabilities | 2,108 | 1,941 |
| Total other non-current liabilities | \$ 11,833 | \$ 10,100 |

Note 4 – Income Taxes

As of December 31, 2011, the Company recorded gross unrecognized tax benefits of \$1.5 billion, of which \$618 million, if recognized, would affect the Company's effective tax rate. As of September 24, 2011, the total amount of gross unrecognized tax benefits was \$1.4 billion, of which \$563 million, if recognized, would affect 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 \$270 million and \$261 million of gross interest and penalties accrued as of December 31, 2011 and September 24, 2011, 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 tax in the period such resolution occurs. Although timing of the resolution and/or closure of audits is not certain, the Company does not believe it is reasonably possible that its unrecognized tax benefits would materially change in the next 12 months.

Note 5 – Shareholders' Equity and Share-based Compensation

Preferred Stock

The Company has five million shares of authorized preferred stock, none of which is issued or outstanding. Under the terms of the Company's Restated Articles of Incorporation, the Board of Directors is authorized to determine or alter the rights, preferences, privileges and restrictions of the Company's authorized but unissued shares of preferred stock.

Comprehensive Income

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

The following table presents the components of comprehensive income, net of taxes, during the three months ended December 31, 2011 and December 25, 2010 (in millions):

| | Three Months Ended | |
|---|--------------------|-------------------|
| | December 31, 2011 | December 25, 2010 |
| Net income | \$ 13,064 | \$ 6,004 |
| Other comprehensive income: | | |
| Change in unrecognized gains/losses on derivative instruments | (67) | 243 |
| Change in foreign currency translation | (6) | 16 |
| Change in unrealized gains/losses on marketable securities | 14 | (99) |
| Total comprehensive income | <u>\$ 13,005</u> | <u>\$ 6,164</u> |

The following table summarizes activity in other comprehensive income related to derivatives, net of taxes, held by the Company during the three months ended December 31, 2011 and December 25, 2010 (in millions):

| | Three Months Ended | |
|---|--------------------|-------------------|
| | December 31, 2011 | December 25, 2010 |
| Change in fair value of derivatives | \$ 87 | \$ (43) |
| Adjustment for net gains/losses realized and included in net income | (154) | 286 |
| Change in unrecognized gains/losses on derivative instruments | <u>\$ (67)</u> | <u>\$ 243</u> |

The following table shows the components of AOCI, net of taxes, as of December 31, 2011 and September 24, 2011 (in millions):

| | December 31, 2011 | September 24, 2011 |
|--|-------------------|--------------------|
| Net unrealized gains on marketable securities | \$ 144 | \$ 130 |
| Net unrecognized gains on derivative instruments | 223 | 290 |
| Cumulative foreign currency translation | 17 | 23 |
| Accumulated other comprehensive income | <u>\$ 384</u> | <u>\$ 443</u> |

Equity Awards

A summary of the Company's RSU activity and related information for the three months ended December 31, 2011, is as follows (in thousands, except per share amounts):

| | Number of RSUs | Weighted- Average Grant Date Fair Value | Aggregate Intrinsic Value |
|----------------------------------|-------------------|--|---------------------------------|
| Balance at September 24, 2011 | 14,446 | \$ 231.49 | |
| Restricted stock units granted | 6,130 | \$ 390.41 | |
| Restricted stock units vested | (2,397) | \$ 187.26 | |
| Restricted stock units cancelled | (490) | \$ 213.94 | |
| Balance at December 31, 2011 | <u>17,689</u> | <u>\$ 293.04</u> | <u>\$ 7,164,026</u> |

RSUs that vested during the three months ended December 31, 2011 and December 25, 2010 had a fair value of \$1.0 billion and \$659 million, respectively, as of the vesting date.

A summary of the Company's stock option activity and related information for the three months ended December 31, 2011, is as follows (in thousands, except per share amounts and contractual term in years):

| | Number of Options | Weighted- Average Exercise Price | Weighted- Average Remaining Contractual Term | Aggregate Intrinsic Value |
|--|----------------------|--|--|---------------------------------|
| Balance at September 24, 2011 | 11,866 | \$ 108.64 | | |
| Options granted | 0 | \$ 0 | | |
| Options cancelled | (12) | \$ 152.08 | | |
| Options exercised | (1,386) | \$ 65.66 | | |
| Balance at December 31, 2011 | <u>10,468</u> | <u>\$ 114.28</u> | 2.24 | <u>\$ 3,043,317</u> |
| Exercisable at December 31, 2011 | 10,172 | \$ 113.23 | 2.20 | \$ 2,967,830 |
| Expected to vest after December 31, 2011 | 296 | \$ 150.19 | 3.54 | \$ 75,487 |

Aggregate intrinsic value represents the value of the Company's closing stock price on the last trading day of the fiscal period in excess of the weighted-average exercise price multiplied by the number of options outstanding or exercisable. The total intrinsic value of options at the time of exercise was \$457 million and \$944 million for the three-months ended December 31, 2011 and December 25, 2010, respectively.

The Company had approximately 39.8 million shares reserved for future issuance under the Company's stock plans as of December 31, 2011. RSUs granted are deducted from the shares available for grant under the Company's stock plans utilizing a factor of two times the number of RSUs granted. Similarly, RSUs cancelled are added back to the shares available for grant under the Company's stock plans utilizing a factor of two times the number of RSUs cancelled.

Share-based Compensation

Share-based compensation cost for RSUs is measured based on the closing fair market value of the Company's common stock on the date of grant. Share-based compensation cost for stock options and employee stock purchase plan rights ("stock purchase rights") is estimated at the grant date and offering date, respectively, based on the fair-value as calculated by the Black-Scholes Merton ("BSM") option-pricing model. The BSM option-pricing model incorporates various assumptions including expected volatility, expected life and interest rates. The expected volatility is based on the historical volatility of the Company's common stock over the most recent period commensurate with the estimated expected life of the Company's stock options and other relevant factors including implied volatility in market traded options on the Company's common stock. The Company bases its expected life assumption on its historical experience and on the terms and conditions of the stock awards it grants to employees. The Company recognizes share-based compensation cost as expense on a straight-line basis over the requisite service period.

The Company did not grant any stock options during the three months ended December 31, 2011 and December 25, 2010. The weighted-average fair value of stock purchase rights per share was \$88.72 and \$61.22 during the three months ended December 31, 2011 and December 25, 2010, respectively.

The following table provides a summary of the share-based compensation expense included in the Condensed Consolidated Statements of Operations for the three months ended December 31, 2011 and December 25, 2010 (in millions):

| | Three Months Ended | |
|--|----------------------|----------------------|
| | December 31, 2011 | December 25, 2010 |
| Cost of sales | \$ 63 | \$ 52 |
| Research and development | 160 | 113 |
| Selling, general and administrative | 197 | 134 |
| Total share-based compensation expense | <u>\$ 420</u> | <u>\$ 299</u> |

The income tax benefit related to share-based compensation expense was \$145 million and \$96 million for the three months ended December 31, 2011 and December 25, 2010, respectively. As of December 31, 2011, the total unrecognized compensation cost related to outstanding stock options and RSUs expected to vest was \$4.4 billion, which the Company expects to recognize over a weighted-average period of 3.74 years.

Employee Benefit Plans

Rule 10b5-1 Trading Plans

During the three months ended December 31, 2011, executive officers Timothy D. Cook, Peter Oppenheimer, D. Bruce Sewell, Philip W. Schiller, and Jeffrey E. Williams, and director Arthur D. Levinson had trading plans pursuant to Rule 10b5-1(c)(1) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). A trading plan is a written document that pre-establishes the amounts, prices and dates (or formula for determining the amounts, prices and dates) of future purchases or sales of the Company's stock, including the exercise and sale of employee stock options and shares acquired pursuant to the Company's employee stock purchase plan and upon vesting of RSUs.

Note 6 – Commitments and Contingencies

Accrued Warranty and Indemnification

The following table presents changes in the Company's accrued warranties and related costs for the three months ended December 31, 2011 and December 25, 2010 (in millions):

| | Three Months Ended | |
|--|----------------------|----------------------|
| | December 31, 2011 | December 25, 2010 |
| Beginning accrued warranty and related costs | \$ 1,240 | \$ 761 |
| Cost of warranty claims | (401) | (253) |
| Accruals for product warranty | 837 | 396 |
| Ending accrued warranty and related costs | <u>\$ 1,676</u> | <u>\$ 904</u> |

The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against it or an indemnified third-party and, in the opinion of management, does not have a potential liability related to unresolved infringement claims subject to indemnification that would materially adversely affect its financial condition or operating results. Therefore, the Company did not record a liability for infringement costs as of either December 31, 2011 or September 24, 2011.

The Company has entered into indemnification agreements with its directors and executive officers. Under these agreements, the Company has agreed to indemnify such individuals to the fullest extent permitted by law against liabilities that arise by reason of their status as directors or officers and to advance expenses incurred by such individuals in connection with related legal proceedings. It is not possible to determine the maximum potential amount of payments the Company could be required to make under these agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each claim. However, the Company maintains directors and officers liability insurance coverage to reduce its exposure to such obligations, and payments made under these agreements historically have not been material.

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, which subjects the Company to significant supply and pricing risks. Many components that are available from multiple sources are at times subject to industry-wide shortages and significant commodity pricing fluctuations. In addition, the Company has entered into various agreements for the supply of 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 can materially adversely affect its financial condition and operating results.

The Company and other participants in the mobile communication and media device, and personal computer industries also compete for various components with other industries that have experienced increased demand for their products. The Company also uses some custom components that are not common to the rest of these industries, 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.

Substantially all of the Company's hardware products are manufactured by outsourcing partners that are primarily located 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 manufacturer 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.

Long-Term Supply Agreements

The Company has entered into long-term agreements to secure the supply of certain inventory components. These agreements generally expire between 2012 and 2022. As of December 31, 2011, the Company had a total of \$2.9 billion of inventory component prepayments outstanding, of which \$871 million is classified as other current assets and \$2.0 billion is classified as other assets in the Condensed Consolidated Balance Sheets. The Company had a total of \$2.3 billion of inventory component prepayments outstanding as of September 24, 2011. The Company's outstanding prepayments will be applied to certain inventory component purchases made during the term of each respective agreement.

Other Off-Balance Sheet Commitments

The Company leases various equipment and facilities, including retail space, under noncancelable operating lease arrangements. The Company does not currently utilize any other off-balance sheet financing arrangements. The major facility leases are typically for terms not exceeding 10 years and generally provide renewal options for terms not exceeding five additional years. 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 December 31, 2011, the Company's total future minimum lease payments under noncancelable operating leases were \$3.3 billion, of which \$2.6 billion related to leases for retail space.

Additionally, as of December 31, 2011, the Company had outstanding off-balance sheet commitments for outsourced manufacturing and component purchases of \$13.4 billion. Other outstanding obligations were \$2.7 billion as of December 31, 2011, and were comprised mainly of commitments under long-term supply agreements to make additional inventory component prepayments and to acquire capital equipment, commitments to acquire product tooling and manufacturing process equipment and commitments related to advertising, research and development, Internet and telecommunications services and other obligations.

Contingencies

The Company is subject to various legal proceedings and claims that have arisen in the ordinary course of business and have not been fully adjudicated, which are discussed in Part II, Item 1 of this Form 10-Q under the heading "Legal Proceedings" and in Part II Item 1A 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. 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 the same reporting period for amounts in excess of management's expectations, the Company's condensed consolidated financial statements of a particular reporting period could be materially adversely affected.

Note 7 – Segment Information and Geographic Data

The Company reports segment information based on the "management" approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of the Company's reportable segments.

The Company manages its business primarily on a geographic basis. Accordingly, the Company determined its reportable operating segments, which are generally based on the nature and location of its customers, to be the Americas, Europe, Japan, Asia-Pacific and Retail operations. The results of the Americas, Europe, Japan and Asia-Pacific reportable segment do not include results of the Retail segment. The Americas segment includes both North and South America. The Europe segment includes European countries, as well as the Middle East and Africa. The Asia-Pacific segment includes Australia and Asian countries, other than Japan. The Retail segment operates Apple retail stores in 11 countries, including the U.S. Each reportable operating segment provides similar hardware and software products and similar services. The accounting policies of the various segments are the same as those described in Note 1, “Summary of Significant Accounting Policies” of this Form 10-Q and in the Notes to Consolidated Financial Statements in the Company’s 2011 Form 10-K.

The Company evaluates the performance of its operating segments based on net sales and operating income. Net sales for geographic segments are generally based on the location of customers, while Retail segment net sales are based on sales from the Company’s retail stores. Operating income for each segment includes net sales to third parties, related cost of sales and operating expenses directly attributable to the segment. Advertising expenses are generally included in the geographic segment in which the expenditures are incurred. Operating income for each segment excludes other income and expense and certain expenses managed outside the operating segments. Costs excluded from segment operating income include various corporate expenses such as manufacturing costs and variances not included in standard costs, research and development, corporate marketing expenses, share-based compensation expense, income taxes, various nonrecurring charges, and other separately managed general and administrative costs. Prior to 2012, the Company allocated to corporate expenses certain costs associated with its high-profile retail stores that have been designed and built to promote brand awareness and serve as vehicles for corporate sales and marketing activities. Beginning in 2012, the Company no longer allocates these costs to corporate expenses and reclassified \$24 million of such costs from corporate to Retail segment expenses for the three months ended December 25, 2010. The Company does not include intercompany transfers between segments for management reporting purposes. Segment assets exclude corporate assets, such as cash and cash equivalents, short-term and long-term marketable securities, other long-term investments, manufacturing and corporate facilities, product tooling and manufacturing process equipment, miscellaneous corporate infrastructure, goodwill and other acquired intangible assets. Except for the Retail segment, capital asset purchases for long-lived assets are not reported to management by segment.

The following table shows information by operating segment for the three months ended December 31, 2011 and December 25, 2010 (in millions):

| | Three Months Ended | |
|----------------------|----------------------|----------------------|
| | December 31, 2011 | December 25, 2010 |
| Americas: | | |
| Net sales | \$ 17,714 | \$ 9,218 |
| Operating income | \$ 7,261 | \$ 2,899 |
| Europe: | | |
| Net sales | \$ 11,256 | \$ 7,256 |
| Operating income | \$ 4,668 | \$ 2,756 |
| Japan: | | |
| Net sales | \$ 3,550 | \$ 1,433 |
| Operating income | \$ 1,997 | \$ 572 |
| Asia-Pacific: | | |
| Net sales | \$ 7,697 | \$ 4,987 |
| Operating income | \$ 3,304 | \$ 2,042 |
| Retail: | | |
| Net sales | \$ 6,116 | \$ 3,847 |
| Operating income | \$ 1,854 | \$ 1,006 |

A reconciliation of the Company's segment operating income to the condensed consolidated financial statements for the three months ended December 31, 2011 and December 25, 2010 is as follows (in millions):

| | Three Months Ended | |
|-----------------------------------|------------------------------|------------------------------|
| | December 31, 2011 | December 25, 2010 |
| Segment operating income | \$ 19,084 | \$ 9,275 |
| Share-based compensation expense | (420) | (299) |
| Other corporate expenses, net (a) | (1,324) | (1,149) |
| Total operating income | <u>\$ 17,340</u> | <u>\$ 7,827</u> |

(a) Other corporate expenses include research and development, corporate marketing expenses, manufacturing costs and variances not included in standard costs, and other separately managed general and administrative expenses.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

This section and other parts of this Form 10-Q contain forward-looking statements that involve risks and uncertainties. Forward-looking statements can be identified by words such as “anticipates,” “expects,” “believes,” “plans,” “predicts,” and similar terms. Forward-looking statements are not guarantees of future performance and the Company’s actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in Part II, Item 1A, “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 24, 2011 (the “2011 Form 10-K”) filed with the U.S. Securities and Exchange Commission (“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 in this report to particular years or quarters refer to the Company’s fiscal years ended in September and the associated quarters of those fiscal years. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Available Information

The Company’s Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended (“Exchange Act”) are filed with the SEC. Such reports and other information filed by the Company with the SEC are available on the Company’s website at <http://www.apple.com/investor> when such reports are available on the SEC website. The public may read and copy any materials filed by the Company with the SEC at the SEC’s Public Reference Room at 100 F Street, NE, Room 1580, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy, and information statements and other information regarding issuers that file electronically with the SEC at <http://www.sec.gov>. The contents of these websites are not incorporated into this filing. Further, the Company’s references to the URLs for these websites are intended to be inactive textual references only.

Executive Overview

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, peripherals, networking solutions, and third-party digital content and applications. The Company’s products and services include iPhone®, iPad®, Mac®, iPod®, Apple TV®, a portfolio of consumer and professional software applications, the iOS and Mac OS® X operating systems, iCloud®, and a variety of accessory, service and support offerings. The Company also sells and delivers digital content and applications through the iTunes Store®, App Store™, iBookstore™, and Mac App Store. 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 iPhone, iPad, Mac and iPod compatible products, including application software, printers, storage devices, speakers, headphones, and various other accessories and peripherals through its online and retail stores. The Company sells to consumers, small and mid-sized businesses, and education, enterprise and government customers.

The Company is committed to bringing the best user experience to its customers through its innovative hardware, software, peripherals, 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 new products and solutions with superior ease-of-use, seamless integration, and innovative design. As part of its strategy, the Company continues to expand its platform for the discovery and delivery of third-party digital content and applications through the iTunes Store. As part of the iTunes Store, the Company’s App Store and iBookstore allow customers to discover and download applications and books through either a Mac or Windows-based computer or through “iOS devices,” namely iPhone, iPad and iPod touch. In January 2011, the Company opened the Mac App Store to allow customers to easily discover, download and install Mac applications. 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’s strategy also includes expanding its distribution network to effectively reach more customers and provide them with a high-quality sales and post-sales support experience.

The Company participates in several highly competitive markets, including mobile communications and media devices with its iPhone, iPad and iPod product families; personal computers with its Mac computers; and distribution of third-party digital content and applications through the iTunes Store, App Store, iBookstore, and Mac App Store. While the Company is widely recognized as a leading innovator in the markets where it competes, these markets are highly competitive and subject to aggressive pricing. To remain competitive, the Company believes that continual investment in research and development and marketing and advertising is critical to the development and sale of innovative products and technologies. The Company's research and development spending is focused on investing in new hardware and software products, and in further developing its existing products, including iPhone, iPad, Mac, and iPod hardware; iOS and Mac OS X operating systems; and a variety of application software and online services.

The Company uses a variety of direct and indirect distribution channels, such as its retail stores, online stores, and direct sales force, and third-party cellular network carriers, wholesalers, retailers, and value-added resellers. The Company believes that sales of its innovative and differentiated products are enhanced by knowledgeable salespersons who can convey the value of the hardware and software integration, and demonstrate the unique solutions that are available on its products. The Company further believes providing direct contact with its targeted customers is an effective way to demonstrate the advantages of its products over those of its competitors and providing a high-quality sales and after-sales support experience is critical to attracting new and retaining existing customers. To ensure a high-quality buying experience for its products in which service and education are emphasized, the Company continues to expand and improve its distribution capabilities by expanding the number of its own retail stores worldwide. Additionally, the Company has invested in programs to enhance reseller sales by placing high quality Apple fixtures, merchandising materials and other resources within selected third-party reseller locations. Through the Apple Premium Reseller Program, certain third-party resellers focus on the Apple platform by providing a high level of integration and support services, and product expertise.

Products

The Company offers a range of mobile communication and media devices, personal computing products, and portable digital music players, as well as a variety of related software, services, peripherals, networking solutions and various third-party hardware and software products. In addition, the Company offers its own software products, including iOS, the Company's proprietary mobile operating system; Mac OS X, the Company's proprietary operating system software for its Mac computers; server software; and application software for consumer, education, and business customers.

A detailed discussion of the Company's other products may be found in Part I, Item 1, "Business," of the Company's 2011 Form 10-K.

Thailand Flooding

In recent months several regions of Thailand have experienced severe flooding, causing damage to infrastructure, housing and factories. A number of the Company's suppliers are located in Thailand. To the extent that component production has been affected, the Company will work to obtain alternative sources of supply or implement other measures. Based on its current assessment of the situation, the Company does not believe this event will have a material impact on its operations in the second quarter of 2012; however, because the situation in Thailand is still evolving uncertainty remains regarding the ultimate impact of this event on the Company.

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. Note 1, "Summary of Significant Accounting Policies" of this Form 10-Q and in the Notes to Consolidated Financial Statements in the Company's 2011 Form 10-K describes the significant accounting policies and methods used in the preparation of the Company's condensed consolidated financial statements. Management bases its estimates on historical experience and on various other assumptions it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates and such differences may be material.

Management believes the Company's critical accounting policies and estimates are those related to revenue recognition, valuation and impairment of marketable securities, inventory valuation and inventory purchase commitments, warranty costs, income taxes, and legal and other contingencies. Management considers these policies critical because they are both important to the portrayal of the Company's financial condition and operating results, and they require management to make judgments and estimates about inherently uncertain matters. The Company's senior management has reviewed these critical accounting policies and related disclosures with the Audit and Finance Committee of the Company's Board of Directors.

Revenue Recognition

Net sales consist primarily of revenue from the sale of hardware, software, digital content and applications, peripherals, and service and support contracts. The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection is probable. Product is considered delivered to the customer once it has been shipped and title and risk of loss have been transferred. For most of the Company's product sales, these criteria are met at the time the product is shipped. For online sales to individuals, for some sales to education customers in the U.S., and for certain other sales, the Company defers recognition of revenue until the customer receives the product because the Company retains a portion of the risk of loss on these sales during transit. The Company recognizes revenue from the sale of hardware products, software bundled with hardware that is essential to the functionality of the hardware, and third-party digital content sold on the iTunes Store in accordance with general revenue recognition accounting guidance. The Company recognizes revenue in accordance with industry specific software accounting guidance for the following types of sales transactions: (i) standalone sales of software products, (ii) sales of software upgrades and (iii) sales of software bundled with hardware not essential to the functionality of the hardware.

For multi-element arrangements that include hardware products containing software essential to the hardware product's functionality, undelivered software elements that relate to the hardware product's essential software, and undelivered non-software services, the Company allocates revenue to all deliverables based on their relative selling prices. In such circumstances, the Company uses a hierarchy to determine the selling price to be used for allocating revenue to deliverables: (i) vendor-specific objective evidence of fair value ("VSOE"), (ii) third-party evidence of selling price ("TPE") and (iii) best estimate of the selling price ("ESP"). VSOE generally exists only when the Company sells the deliverable separately and is the price actually charged by the Company for that deliverable. ESPs reflect the Company's best estimates of what the selling prices of elements would be if they were sold regularly on a stand-alone basis.

For sales of iPhone, iPad, Apple TV, for sales of iPod touch beginning in June 2010, and for sales of Mac beginning in June 2011, the Company has indicated it may from time-to-time provide future unspecified software upgrades and features free of charge to customers. In June 2011, the Company announced it would begin providing various non-software services to owners of qualifying versions of iOS devices and Mac. Because the Company has neither VSOE nor TPE for these unspecified software upgrade rights or the non-software services, revenue is allocated to these rights and services based on the Company's ESPs. Amounts allocated to the unspecified software upgrade rights and non-software services are deferred and recognized on a straight-line basis over the estimated lives of each of these devices, which range from 24 to 48 months. The Company's process for determining ESPs involves management's judgment. The Company's process considers multiple factors that may vary over time depending upon the unique facts and circumstances related to each deliverable. If the facts and circumstances underlying the factors considered change, including the estimated or actual costs incurred to provide non-software services or the estimated lives of the related devices, or should future facts and circumstances lead the Company to consider additional factors, the Company's ESP for software upgrades and non-software services related to future sales of these devices could change. If the estimated life of one or more of the devices should change, the future rate of amortization of the revenue allocated to the software upgrade rights would also change.

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end-user rebates, and other sales programs and volume-based incentives. For transactions involving price protection, the Company recognizes revenue net of the estimated amount to be refunded, provided the refund amount can be reasonably and reliably estimated and the other conditions for revenue recognition have been met. The Company's policy requires that, if refunds cannot be reliably estimated, revenue is not recognized until reliable estimates can be made or the price protection lapses. For customer incentive programs, the estimated cost of these programs is recognized at the later of the date at which the Company has sold the product

or the date at which the program is offered. The Company also records reductions to revenue for expected future product returns based on the Company's historical experience. Future market conditions and product transitions may require the Company to increase customer incentive programs and incur incremental price protection obligations that could result in additional reductions to revenue at the time such programs are offered. Additionally, certain customer incentive programs require management to estimate the number of customers who will actually redeem the incentive. Management's estimates are based on historical experience and the specific terms and conditions of particular incentive programs. If a greater than estimated proportion of customers redeem such incentives, the Company would be required to record additional reductions to revenue, which would have a negative impact on the Company's results of operations.

Valuation and Impairment of Marketable Securities

The Company's investments in available-for-sale securities are reported at fair value. Unrealized gains and losses related to changes in the fair value of securities are recognized in accumulated other comprehensive income, net of tax, in the Company's Condensed Consolidated Balance Sheets. Changes in the fair value of available-for-sale securities impact the Company's net income only when such securities are sold or an other-than-temporary impairment is recognized. Realized gains and losses on the sale of securities are determined by specific identification of each security's cost basis. The Company regularly reviews its investment portfolio to determine if any security is other-than-temporarily impaired, which would require the Company to record an impairment charge in the period any such determination is made. In making this judgment, the Company evaluates, among other things, the duration and extent to which the fair value of a security is less than its cost, the financial condition of the issuer and any changes thereto, and the Company's intent to sell, or whether it is more likely than not it will be required to sell, the security before recovery of the its amortized cost basis. The Company's assessment on whether a security is other-than-temporarily impaired, could change in the future due to new developments or changes in assumptions related to any particular security.

Inventory Valuation and Inventory Purchase Commitments

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

The Company records accruals for estimated cancellation fees related to component orders that have been cancelled or are expected to be cancelled. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. These commitments typically cover the Company's requirements for periods up to 150 days. If there is an abrupt and substantial decline in demand for one or more of the Company's products or an unanticipated change in technological requirements for any of the Company's products, the Company may be required to record additional accruals for cancellation fees that would negatively affect its results of operations in the period when the cancellation fees are identified and recorded.

Warranty Costs

The Company provides for the estimated cost of hardware and software warranties at the time the related revenue is recognized based on historical and projected warranty claim rates, historical and projected cost-per-claim, and knowledge of specific product failures that are outside of the Company's typical experience. Each quarter, the Company reevaluates its estimates to assess the adequacy of its recorded warranty liabilities considering the size of the installed base of products subject to warranty protection and adjusts the amounts as necessary. If actual product failure rates or repair costs differ from estimates, revisions to the estimated warranty liability would be required and could materially affect the Company's results of operations.

Income Taxes

The Company records a tax provision for the anticipated tax consequences of the reported results of operations. The provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. The Company records a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized.

The Company recognizes tax benefits from uncertain tax positions only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement.

Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with future reversals of existing taxable temporary differences, will be sufficient to fully recover the deferred tax assets. In the event that the Company determines all or part of the net deferred tax assets are not realizable in the future, the Company will make an adjustment to the valuation allowance that would be charged to earnings in the period such determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of GAAP and complex tax laws. Resolution of these uncertainties in a manner inconsistent with management's expectations could have a material impact on the Company's financial condition and operating results.

Legal and Other Contingencies

As discussed in Part II, Item 1 of this Form 10-Q under the heading "Legal Proceedings" and in Note 6, "Commitments and Contingencies" in Notes to Condensed Consolidated Financial Statements, the Company is subject to various legal proceedings and claims that arise in the ordinary course of business. The Company records a liability when it is probable that a loss has been incurred and the amount is reasonably estimable. There is significant judgment required in both the probability determination and as to whether an exposure can be reasonably estimated. In 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. However, the outcome of legal proceedings and claims brought against the Company are 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 the same reporting period for amounts in excess of management's expectations, the Company's condensed consolidated financial statements of a particular reporting period could be materially adversely affected.

Fiscal Period

The Company's fiscal year is the 52 or 53-week period that ends on the last Saturday of September. The Company's fiscal year 2012 will include 53-weeks and will end on September 29, 2012. A 14th week has been included in the first quarter of 2012, as is done approximately every six years to realign the Company's fiscal quarters more closely to calendar quarters. Inclusion of the 14th week increased the Company's overall net sales and operating expenses for the first quarter of 2012. The first quarter of 2011 spanned 13 weeks.

Net Sales

The following table summarizes net sales by operating segment and net sales and unit sales by product during the three months ended December 31, 2011 and December 25, 2010 (in millions, except unit sales in thousands):

| | Three Months Ended | | |
|---|----------------------|----------------------|--------|
| | December 31, 2011 | December 25, 2010 | Change |
| Net Sales by Operating Segment: | | | |
| Americas net sales | \$ 17,714 | \$ 9,218 | 92% |
| Europe net sales | 11,256 | 7,256 | 55% |
| Japan net sales | 3,550 | 1,433 | 148% |
| Asia-Pacific net sales | 7,697 | 4,987 | 54% |
| Retail net sales | 6,116 | 3,847 | 59% |
| Total net sales | <u>\$ 46,333</u> | <u>\$ 26,741</u> | 73% |
| Net Sales by Product: | | | |
| Mac Desktops (a)(i) | \$ 1,936 | \$ 1,731 | 12% |
| Mac Portables (b)(i) | 4,662 | 3,699 | 26% |
| Total Mac net sales | 6,598 | 5,430 | 22% |
| iPod (c)(i) | 2,528 | 3,425 | (26%) |
| Other music related products and services (d) | 2,027 | 1,431 | 42% |
| iPhone and related products and services (e)(i) | 24,417 | 10,468 | 133% |
| iPad and related products and services (f)(i) | 9,153 | 4,608 | 99% |
| Peripherals and other hardware (g) | 766 | 593 | 29% |
| Software, service and other sales (h) | 844 | 786 | 7% |
| Total net sales | <u>\$ 46,333</u> | <u>\$ 26,741</u> | 73% |
| Unit Sales by Product: | | | |
| Mac Desktops | 1,479 | 1,227 | 21% |
| Mac Portables | 3,719 | 2,907 | 28% |
| Total Mac unit sales | <u>5,198</u> | <u>4,134</u> | 26% |
| iPod unit sales | 15,397 | 19,446 | (21%) |
| iPhone unit sales | 37,044 | 16,235 | 128% |
| iPad unit sales | 15,434 | 7,331 | 111% |

(a) Includes revenue from iMac, Mac mini and Mac Pro sales.

(b) Includes revenue from MacBook, MacBook Air and MacBook Pro sales.

(c) Includes revenue from iPod sales.

(d) Includes revenue from sales from the iTunes Store, App Store, and iBookstore in addition to sales of iPod services and Apple-branded and third-party iPod accessories.

(e) Includes revenue from sales of iPhone, iPhone services, and Apple-branded and third-party iPhone accessories.

(f) Includes revenue from sales of iPad, iPad services, and Apple-branded and third-party iPad accessories.

(g) Includes revenue from sales of displays, networking products, and other hardware.

(h) Includes revenue from sales of Apple-branded and third-party Mac software, and services.

(i) Includes amortization of related revenue deferred for non-software services and embedded software upgrade rights.

Net sales during the first quarter of 2012 increased \$19.6 billion or 73% compared to the same quarter in 2011. Several factors contributed positively to this increase, including the addition of the 14th week in the first quarter of 2012 as well as the following:

- Net sales of iPhone and related products and services were \$24.4 billion in the first quarter of 2012 representing an increase of \$13.9 billion or 133% compared to the first quarter of 2011. iPhone unit sales totaled 37 million in the first quarter of 2012, which represents an increase of 20.8 million units or 128% compared to the same period in 2011. iPhone year-over-year growth reflects strong demand for iPhone in all of the Company's operating segments primarily due to the launch of iPhone 4S in many countries and expanded distribution with new carriers and resellers. Net sales of iPhone and related products and services accounted for 53% of the Company's total net sales for the first quarter of 2012 compared to 39% in the first quarter of 2011.
- Net sales of iPad and related products and services were \$9.2 billion in the first quarter of 2012 representing an increase of \$4.5 billion or 99% compared to the first quarter of 2011. Unit sales of iPad were 15.4 million during the first quarter of 2012, an increase of 111% compared to the same period in 2011. The year-over-year increase in net sales and unit sales were driven by strong iPad demand in all of the Company's operating segments and expanded distribution with resellers and new carriers. The Company distributes iPad through its direct channels, certain cellular network carriers' distribution channels and certain third-party resellers. Net sales of iPad and related products and services accounted for 20% of the Company's total net sales for the first quarter of 2012 compared to 17% in the first quarter of 2011.
- Mac net sales were \$6.6 billion in the first quarter of 2012 representing an increase of \$1.2 billion or 22% compared to the first quarter of 2011. Mac unit sales increased by 1.1 million or 26% in the first quarter of 2012 compared to the same period in 2011. During the first quarter of 2012, net sales and unit sales of Mac portable systems increased by 26% and 28%, respectively, primarily attributable to strong demand for MacBook Pro and MacBook Air. Net sales and unit sales of Mac desktop systems increased by 12% and 21%, respectively, primarily attributable to strong demand for iMac and Mac mini. Mac net sales accounted for 14% of the Company's total net sales in the first quarter of 2012 compared to 20% in the first quarter of 2011.
- Net sales of other music related products and services were \$2.0 billion in the first quarter of 2012 representing an increase of \$596 million or 42% compared to the first quarter of 2011. This increase was due primarily to growth of the iTunes Store which generated total net sales of \$1.7 billion for the first quarter of 2012. The results of the iTunes Store reflect growth of the iTunes App Store, continued growth in the installed base of iPhone, iPad, and iPod customers, and the expansion of third-party audio, video and book content available for sale or rent via the iTunes Store. The Company continues to expand its iTunes content and applications offerings around the world. Net sales of other music related products and services accounted for 4% of the Company's total net sales for the first quarter of 2012 compared to 5% in the first quarter of 2011.

Partially offsetting the positive factors contributing to the overall increase in net sales was a decrease in iPod net sales of \$897 million or 26% compared to the first quarter of 2011. Unit sales of iPod decreased by 21% during the first quarter of 2012 compared to the same period in 2011. Net sales of iPods accounted for 5% of the Company's total net sales for the first quarter of 2012 compared to 13% in the first quarter of 2011.

Segment Operating Performance

The Company manages its business primarily on a geographic basis. The Company's reportable operating segments consist of the Americas, Europe, Japan, Asia-Pacific and Retail operations. The results of the Americas, Europe, Japan and Asia-Pacific reportable segments do not include the results of the Retail segment. The Americas segment includes both North and South America. The Europe segment includes European countries, as well as the Middle East and Africa. The Asia-Pacific segment includes Australia and Asian countries, other than Japan. The Retail segment operates Apple retail stores in 11 countries. Each reportable operating segment provides similar hardware and software products and similar services. Further information regarding the Company's operating segments may be found in Note 7, "Segment Information and Geographic Data" in Notes to Condensed Consolidated Financial Statements of this Form 10-Q.

Americas

During the first quarter of 2012, net sales in the Americas increased \$8.5 billion or 92% compared to the first quarter of 2011. This increase in net sales was driven by the launch of iPhone 4S and the expanded distribution of iPhone with new carriers, strong demand for iPad and higher sales from the iTunes store, partially offset by decreased sales of iPod. The Americas segment represented 38% and 35% of the Company's total net sales in the first quarter of 2012 and 2011, respectively.

Europe

During the first quarter of 2012, net sales in Europe increased \$4.0 billion or 55% compared to the first quarter of 2011. The growth in net sales was due mainly to the launch of iPhone 4S and increased sales of iPad and Mac. The Europe segment represented 24% and 27% of the Company's total net sales in the first quarter of 2012 and 2011, respectively.

Japan

During the first quarter of 2012, net sales in Japan increased \$2.1 billion or 148% compared to the first quarter in 2011. The growth in net sales was mainly due to the launch of iPhone 4S, expanded distribution with a new iPhone carrier, increased sales of iPad, and to lesser extent strength in the Japanese Yen relative to the U.S. dollar. Partially offsetting the net sales increase was a decline in net sales of iPod. The Japan segment represented 8% and 5% of the Company's total net sales in the first quarter of 2012 and 2011, respectively.

Asia-Pacific

Net sales in Asia-Pacific increased \$2.7 billion during the first quarter of 2012 compared to the first quarter of 2011. This increase was primarily due to strong demand for iPhone, iPad and Mac. Although net sales in Asia-Pacific grew 54%, the growth rate was lower than the Company's overall net sales growth of 73% primarily because iPhone 4S was launched later in most countries in the Asia-Pacific segment than it was in countries in other operating segments. The Company began selling iPhone 4S in Mainland China in the second quarter of 2012. The Asia-Pacific segment represented 17% and 19% of the Company's total net sales for the first quarter of 2012 and 2011, respectively.

Retail

Retail net sales increased \$2.3 billion or 59% during the first quarter of 2012 compared to the first quarter of 2011. The increase in net sales was driven primarily by the launch of iPhone 4S and higher sales of iPad and Mac. The Company opened four new retail stores during the first quarter of 2012, three of which were international stores, ending the quarter with 361 stores open compared to 323 stores at the end of the first quarter of 2011. With an average of 358 stores and 321 stores opened during the first quarter of 2012 and 2011, respectively, average revenue per store increased to \$17.1 million in the first quarter of 2012, compared to \$12.0 million in the first quarter of 2011. The Retail segment represented 13% and 14% of the Company's total net sales in the first quarter of 2012 and 2011, respectively.

The Retail segment reported operating income of \$1.9 billion during the first quarter of 2012 as compared to \$1.0 billion during the first quarter of 2011. The year-over-year increase in Retail operating income during the first quarter of 2012 was primarily attributable to higher overall net sales.

Expansion of the Retail segment has required and will continue to require a substantial investment in fixed assets and related infrastructure, operating lease commitments, personnel, and other operating expenses. Capital asset purchases associated with the Retail segment since its inception totaled approximately \$3.0 billion through the first quarter of 2012.

As of December 31, 2011, the Retail segment had approximately 41,800 full-time equivalent employees and had outstanding lease commitments associated with retail space and related facilities of \$2.6 billion. The Company would incur substantial costs if it were to close multiple retail stores, and such costs could adversely affect the Company's financial condition and operating results.

Gross Margin

Gross margin for the three months ended December 31, 2011 and December 25, 2010 was as follows (in millions, except gross margin percentages):

| | Three Months Ended | |
|-------------------------|----------------------|----------------------|
| | December 31, 2011 | December 25, 2010 |
| Net sales | \$ 46,333 | \$ 26,741 |
| Cost of sales | 25,630 | 16,443 |
| Gross margin | <u>\$ 20,703</u> | <u>\$ 10,298</u> |
| Gross margin percentage | 44.7% | 38.5% |

The gross margin percentage in the first quarter of 2012 was 44.7% compared to 38.5% in the first quarter of 2011. The year-over-year increase in gross margin was largely driven by a more favorable sales mix towards products with higher gross margins, particularly iPhone, and to a lesser extent lower commodity and other product costs and leverage on fixed costs of higher net sales.

The Company expects to experience decreases in its gross margin percentage in future periods, as compared to levels achieved during the first quarter of 2012, largely due to a higher mix of new and innovative products with flat or reduced pricing that have higher cost structures and deliver greater value to customers and a stronger U.S. dollar, and potential future component cost and other cost increases.

The foregoing statements regarding the Company's expected gross margin percentage are forward-looking and could differ from anticipated levels because of several factors including, but not limited to certain of those set forth below in Part II, Item 1A, "Risk Factors" under the subheading "*Future operating results depend upon the Company's ability to obtain components in sufficient quantities*," which is incorporated herein by reference. In general, gross margins and margins on individual products will remain under downward pressure due to a variety of factors, including continued industry wide global product pricing pressures, increased competition, compressed product life cycles, product transitions and potential increases in the cost of components, as well as potential increases in the costs of outside manufacturing services and a potential shift in the Company's sales mix towards products with lower gross margins. In response to these competitive pressures, the Company expects it will continue to take product pricing actions, which would adversely affect gross margins. Gross margins could also be affected by the Company's ability to manage product quality and warranty costs effectively and to stimulate demand for certain of its products. Due to the Company's significant international operations, financial results can be significantly affected in the short-term by fluctuations in exchange rates.

Operating Expenses

Operating expenses for the three months ended December 31, 2011 and December 25, 2010, were as follows (in millions, except for percentages):

| | Three Months Ended | |
|-------------------------------------|----------------------|----------------------|
| | December 31, 2011 | December 25, 2010 |
| Research and development | \$ 758 | \$ 575 |
| Percentage of net sales | 1.6% | 2.2% |
| Selling, general and administrative | \$ 2,605 | \$ 1,896 |
| Percentage of net sales | 5.6% | 7.1% |

Research and Development Expense (“R&D”)

R&D expense increased 32% or \$183 million to \$758 million in the first quarter of 2012 compared to \$575 million in the first quarter of 2011. This increase was due primarily to an increase in headcount and related expenses to support expanded R&D activities. Although total R&D expense increased 32% during the first quarter of 2012, it declined as a percentage of net sales, due to the 73% year-over-year increase in net sales.

The Company continues to believe that focused investments in R&D are critical to its future growth and competitive position in the marketplace and are directly related to timely development of new and enhanced products that are central to the Company’s core business strategy. As such, the Company expects to make further investments in R&D to remain competitive.

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

SG&A expense increased \$709 million or 37% to \$2.6 billion in the first quarter of 2012 compared to \$1.9 billion in the first quarter of 2011. The year-over-year increase in SG&A expense was due primarily to the Company’s continued expansion of its Retail segment, increased headcount and related costs, higher spending on professional services, marketing and advertising programs, and increased variable costs associated with the overall growth of the Company’s net sales.

Other Income and Expense

Total other income and expense remained relatively flat during the first quarter of 2012 compared to the first quarter of 2011. The Company realized higher interest and dividend income as a result of higher yields and higher cash, cash equivalents and marketable securities balances largely offset by higher premium expenses on foreign exchange option contracts during the first quarter of 2012 as compared to the first quarter of 2011. The weighted-average interest rate earned by the Company on its cash, cash equivalents and marketable securities was 1.02% and 0.75% in the first quarter of 2012 and 2011, respectively.

Provision for Income Taxes

The Company’s effective tax rate during the first quarter of 2012 was approximately 25.3% compared with approximately 24.6% for the first quarter of 2011. The Company’s effective rate for both periods differs from the statutory federal income tax rate of 35% due primarily to certain undistributed foreign earnings for which no U.S. taxes are provided because such earnings are intended to be indefinitely reinvested outside the U.S. The higher effective tax rate during the first quarter of 2012 as compared to the same quarter of 2011 is due primarily to a lower proportion of foreign earnings in the current year and the recognition of a tax benefit in the first quarter of 2011 as a result of legislation enacted retroactively reinstating the research and development tax credit.

The Internal Revenue Service (the “IRS”) has completed its field audit of the Company’s federal income tax returns for the years 2004 through 2006 and proposed certain adjustments. The Company has contested certain of these adjustments through the IRS Appeals Office. The IRS is currently examining the years 2007 through 2009. All IRS audit issues for years prior to 2004 have been resolved. 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.

Liquidity and Capital Resources

The following table presents selected financial information and statistics as of December 31, 2011 and September 24, 2011 (in millions):

| | <u>December 31, 2011</u> | <u>September 24, 2011</u> |
|--|--------------------------|---------------------------|
| Cash, cash equivalents and marketable securities | \$ 97,601 | \$ 81,570 |
| Accounts receivable, net | \$ 8,930 | \$ 5,369 |
| Inventory | \$ 1,236 | \$ 776 |
| Working capital | \$ 20,164 | \$ 17,018 |

As of December 31, 2011, the Company had \$97.6 billion in cash, cash equivalents and marketable securities, an increase of \$16.0 billion from September 24, 2011. The principal component of this net increase was the cash generated by operating activities of \$17.6 billion, which was partially offset by payments made for acquisition of property, plant and equipment and intangible assets of \$1.4 billion.

The Company's marketable securities investment portfolio is invested primarily in highly rated securities and its policy generally limits the amount of credit exposure to any one issuer. The Company's investment policy requires investments to generally be investment grade with the objective of minimizing the potential risk of principal loss. As of December 31, 2011 and September 24, 2011, \$64.0 billion and \$54.3 billion, respectively, of the Company's cash, cash equivalents and marketable securities were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S. The Company believes its existing balances of cash, cash equivalents and marketable securities will be sufficient to satisfy its working capital needs, capital asset purchases, outstanding commitments and other liquidity requirements associated with its existing operations over the next 12 months.

Capital Assets

The Company's capital expenditures were \$597 million during the first quarter of 2012 consisting of approximately \$152 million for retail store facilities and \$445 million for other capital expenditures, including product tooling and manufacturing process equipment, and other corporate facilities and infrastructure. The Company's actual cash payments for capital expenditures during the first quarter of 2012 were \$1.3 billion, of which \$182 million relates to retail store facilities.

The Company anticipates utilizing approximately \$8.0 billion for capital expenditures during 2012, including approximately \$900 million for retail store facilities and approximately \$7.1 billion for product tooling and manufacturing process equipment, and corporate facilities and infrastructure, including information systems hardware, software and enhancements.

During 2012, the Company expects to open about 40 new stores, approximately three quarters of which will be located outside of the U.S.

Off-Balance Sheet Arrangements and Contractual Obligations

The Company has not entered into any transactions with unconsolidated entities whereby the Company has financial guarantees, subordinated retained interests, derivative instruments, or other contingent arrangements that expose the Company to material continuing risks, contingent liabilities, or any other obligation under a variable interest in an unconsolidated entity that provides financing, liquidity, market risk, or credit risk support to the Company.

Lease Commitments

The Company's major facility leases are typically for terms not exceeding 10 years and generally provide renewal options for terms not exceeding five additional years. 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 December 31, 2011, the Company's total future minimum lease payments under noncancelable operating leases were \$3.3 billion, of which \$2.6 billion related to leases for retail space.

Purchase Commitments with Outsourcing Partners and Component Suppliers

The Company utilizes several outsourcing partners to manufacture sub-assemblies for the Company's products and to perform final assembly and test 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. As of December 31, 2011, the Company had outstanding off-balance sheet third-party manufacturing commitments and component purchase commitments of \$13.4 billion.

Other Obligations

Other outstanding obligations were \$2.7 billion as of December 31, 2011, and were comprised mainly of commitments under long-term supply agreements to make additional inventory component prepayments and to acquire capital equipment, commitments to acquire product tooling and manufacturing process equipment, and commitments related to advertising, research and development, Internet and telecommunications services and other obligations.

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 December 31, 2011, the Company had non-current deferred tax liabilities of \$9.7 billion. Additionally, as of December 31, 2011, the Company had gross unrecognized tax benefits of \$1.5 billion and an additional \$270 million 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 in individual years 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. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against it or an indemnified third-party. 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 did not record a liability for infringement costs related to indemnification as of December 31, 2011 or September 24, 2011.

The Company has entered into indemnification agreements with its directors and executive officers. Under these agreements, the Company has agreed to indemnify such individuals to the fullest extent permitted by law against liabilities that arise by reason of their status as directors or officers and to advance expenses incurred by such individuals in connection with related legal proceedings. It is not possible to determine the maximum potential amount of payments the Company could be required to make under these agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each claim. However, the Company maintains directors and officers liability insurance coverage to reduce its exposure to such obligations, and payments made under these agreements historically have not been material.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's market risk profile has not changed significantly during the first three months of 2012.

Interest Rate and Foreign Currency Risk Management

The Company regularly reviews its foreign exchange forward and option positions, both on a stand-alone basis and in conjunction with its underlying foreign currency and interest rate related exposures. Given the effective horizons of the Company's risk management activities and the anticipatory nature of the exposures, there can be no assurance these positions will offset more than a portion of the financial impact resulting from movements in either foreign exchange or interest rates. Further, the recognition timing of gains and losses related to these instruments for any given period may not coincide with the timing of gains and losses related to the underlying economic exposures and, therefore, may adversely affect the Company's financial condition and operating results.

Interest Rate Risk

While the Company is exposed to interest rate fluctuations in many of the world's leading industrialized countries, the Company's interest income and expense is most sensitive to fluctuations in U.S. interest rates. Changes in U.S. interest rates affect the interest earned on the Company's cash, cash equivalents and marketable securities, the fair value of those securities, as well as costs associated with hedging.

The Company's investment policy and strategy are focused on preservation of capital and supporting the liquidity requirements of the Company. A portion of the Company's cash is managed by external managers within the guidelines of the Company's investment policy and to objective market benchmarks. The Company's internal portfolio is benchmarked against external manager performance.

The Company's exposure to changes in interest rates relates primarily to the Company's investment portfolio. The Company typically invests in highly rated securities and its policy generally limits the amount of credit exposure to any one issuer. The Company's investment policy generally requires investments to be investment grade, with the objective of minimizing the potential risk of principal loss.

Foreign Currency Risk

In general, the Company is a net receiver of currencies other than the U.S. dollar. Accordingly, changes in exchange rates, and in particular a strengthening of the U.S. dollar, will negatively affect the Company's net sales and gross margins as expressed in U.S. dollars. There is a risk that the Company will have to adjust local currency product pricing due to competitive pressures when there have been significant volatility in foreign currency exchange rates.

The Company may enter into foreign currency forward and option contracts with financial institutions to protect against foreign exchange risks associated with certain existing assets and liabilities, certain firmly committed transactions, forecasted future cash flows, and net investments in foreign subsidiaries. Generally, the Company's practice is to hedge a majority of its material foreign exchange exposures, typically for up to six months. However, the Company may choose not to hedge certain foreign exchange exposures for a variety of reasons, including but not limited to accounting considerations and the prohibitive economic cost of hedging particular exposures.

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 Securities Exchange Act of 1934, as amended were effective as of December 31, 2011 to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the first quarter of 2012, 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

As of December 31, 2011, the end of the quarterly period covered by this report, the Company was subject to the various legal proceedings and claims discussed below, as well as certain other legal proceedings and claims that have not been fully resolved and that have arisen in the ordinary course of business. In the opinion of management, 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. However, the outcome of legal proceedings and claims brought against the Company are 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 the same reporting period for amounts in excess of management's expectations, the Company's condensed consolidated financial statements of a particular reporting period could be materially adversely affected. See the risk factors "*The Company's future results could be materially adversely affected if it is found to have infringed on intellectual property rights.*" and "*Unfavorable results of legal proceedings could materially adversely affect the Company.*" in Part II, Item 1A of this Quarterly Report on Form 10-Q under the heading "Risk Factors." The Company settled certain matters during the first quarter of 2012 that did not individually or in the aggregate have a material impact on the Company's financial condition and results of operations.

In re Apple & AT&T Antitrust Litigation (brought on behalf of named plaintiffs Kliegerman, Holman, Rivello, Smith, Lee, Macasaddu, Morikawa, Scotti and Sesso)

This is a purported class action filed against the Company and AT&T Mobility in the United States District Court for the Northern District of California. The Consolidated Complaint alleges that the Company and AT&T Mobility violated the federal antitrust laws by monopolizing and/or attempting to monopolize the “aftermarket for voice and data services” for the iPhone and that the Company monopolized and/or attempted to monopolize the “aftermarket for software applications for iPhones.” Plaintiffs are seeking unspecified compensatory and punitive damages for the class, treble damages, injunctive relief and attorneys fees. On July 8, 2010 the Court granted in part plaintiffs’ motion for class certification. Following a favorable Supreme Court ruling for AT&T Mobility in its case against Conception, defendants have filed Motions to Compel Arbitration and to Decertify the Class. On December 1, 2011, the Court granted defendants motion to dismiss the complaint and decertify the class, then it closed the case finding that plaintiffs would have to pursue any claim in an arbitration proceeding.

The Apple iPod iTunes Antitrust Litigation (formerly Charoensak v. Apple Computer, Inc. and Tucker v. Apple Computer, Inc.); Somers v. Apple Inc.

These related cases have been filed on January 3, 2005, July 21, 2006 and December 31, 2007 in the United States District Court for the Northern District of California on behalf of a purported class of direct and indirect purchasers of iPods and iTunes Store content, alleging various claims including alleged unlawful tying of music and video purchased on the iTunes Store with the purchase of iPods and unlawful acquisition or maintenance of monopoly market power and unlawful acquisition or maintenance of monopoly market power under §§1 and 2 of the Sherman Act, the Cartwright Act, California Business & Professions Code §17200 (unfair competition), the California Consumer Legal Remedies Act and California monopolization law. Plaintiffs are seeking unspecified compensatory and punitive damages for the class, treble damages, injunctive relief, disgorgement of revenues and/or profits and attorneys fees. Plaintiffs are also seeking DRM free versions of any songs downloaded from iTunes or an order requiring the Company to license its DRM to all competing music players. The cases are currently pending.

Item 1A. Risk Factors

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

Global economic conditions could materially adversely affect the Company.

The Company's operations and performance depend significantly on worldwide economic conditions. Uncertainty about global economic conditions poses a risk as consumers and businesses postpone spending in response to tighter credit, unemployment, negative financial news and/or declines in income or asset values, which could have a material negative effect on demand for the Company's products and services. Demand also could differ materially from the Company's expectations because the Company generally raises prices on goods and services sold outside the U.S. to offset the effect of a strengthening of the U.S. dollar. Other factors that could influence demand include increases 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 and the Company's financial condition and operating results.

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 a new or incremental 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; and failure of derivative counterparties and other financial institutions. Other income and expense also could vary materially from expectations depending on gains or losses realized on the sale or exchange of financial instruments; impairment charges resulting from revaluations of debt and equity securities and other investments; interest rates; cash balances; and changes in fair value of derivative instruments. Increased volatility in the financial markets and overall economic uncertainty would increase the risk of the actual amounts realized in the future on the Company's financial instruments differing significantly from the fair values currently assigned to them.

Global markets for the Company's products and services are highly competitive and subject to rapid technological change. If the Company is unable to compete effectively in these markets, its financial condition and operating results could be materially adversely affected.

The Company's products and services compete in highly competitive global markets characterized by aggressive price cutting, with resulting downward pressure on gross margins, frequent introduction of new products, short product life cycles, evolving industry standards, continual improvement in product price/performance characteristics, rapid adoption of technological and product advancements by competitors, and price sensitivity on the part of consumers.

The Company's ability to compete successfully depends heavily on its ability to ensure a continuing and timely introduction of innovative new products and technologies to the marketplace. The Company believes it is unique in that it designs and develops nearly the entire solution for its products, including the hardware, operating system, numerous software applications, and related services. As a result, the Company must make significant investments in research and development and as such, the Company currently holds a significant number of patents and copyrights and has registered and/or has applied to register numerous patents, trademarks and service marks. By contrast, many of the Company's competitors seek to compete primarily through aggressive pricing and very low cost structures. If the Company is unable to continue to develop and sell innovative new products with attractive margins or if other companies infringe on the Company's intellectual property, the Company's ability to maintain a competitive advantage could be negatively affected and its financial condition and operating results could be materially adversely affected.

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. 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 also competes with illegitimate ways to obtain third-party digital content and applications. The Company has entered the mobile communications and media device markets, and some of its competitors in these markets 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 such products and services at little or no profit or even at a loss. The Company also expects competition to intensify as competitors attempt to imitate the Company's approach to providing these components seamlessly within their individual offerings or work collaboratively to offer integrated solutions. 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 Mac OS X, which has a minority market share in the personal computer market. This market is dominated by computer makers using competing operating systems, most notably Windows. In the market for personal computers and peripherals, the Company faces a significant number of competitors, many of which have broader product lines, lower priced products, and a larger installed customer base. Consolidation in this market has resulted in larger and potentially stronger competitors. Price competition has been particularly intense as competitors selling Windows-based personal computers have aggressively cut prices and lowered product margins. An increasing number of Internet devices that include software applications and are smaller and simpler than traditional personal computers compete for market share with the Company's existing products. The Company's financial condition and operating results depend substantially 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, and effectively stimulate customer demand for new and upgraded products. The success of new product introductions depends on a number of factors including but not limited to timely and successful product development, market acceptance, the Company's ability to manage the risks associated with new products and production ramp issues, the availability of application software for new products, the effective management of purchase commitments and inventory levels in line with anticipated product demand, the availability of products in appropriate quantities and costs to meet anticipated demand, and the risk that new products may have quality or other defects in the early stages of introduction. Accordingly, the Company cannot determine in advance the ultimate effect of new product introductions and transitions on its financial condition and operating results.

The Company faces substantial inventory and other asset risk 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 for impairment whenever events or changed circumstances indicate the carrying amount of an asset may not be recoverable. If the Company determines that impairment has occurred, it records a write-down equal to the amount by which the carrying value of the assets exceeds its fair market value. Although the Company believes its provisions related to inventory, 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. Such charges could materially adversely affect the Company's financial condition and operating results.

The Company must order components for its products and build inventory in advance of product announcements and shipments. Consistent with industry practice, components are normally acquired through a combination of purchase orders, supplier contracts, open orders and, where appropriate, inventory component prepayments, in each case based on projected demand. Such 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. The Company's financial condition and operating results have been in the past and could be in the future materially adversely affected by the Company's ability to manage its inventory levels and respond to short-term shifts in customer demand patterns.

Future operating results depend upon the Company's ability to obtain 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 that are available from multiple sources are at times subject to industry-wide shortages and significant commodity pricing fluctuations. The Company has entered into various agreements for the supply of components; there can be no guarantee that the Company will be able to extend or renew these agreements on similar terms, or at all. The follow-on effects from the credit crisis on the Company's suppliers, referred to in "*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 that could materially adversely affect the Company's financial condition and operating results. The Company expects to experience decreases in its gross margin percentage in future periods, as compared to levels achieved during the first quarter of 2012, largely due to a higher mix of new and innovative products with flat or reduced pricing that have higher cost structures and deliver greater value to customers and a stronger U.S. dollar, and potential future component cost and other cost increases.

The Company and other participants in the mobile communication and media device, and personal computer industries compete for various components with other industries that have experienced increased demand for their products. The Company uses some custom components that are not common to the rest of 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 if those suppliers decided to concentrate on the production of common components instead of components customized to meet the Company's requirements. If the supply of components for a new or existing product were delayed or constrained, or if a key manufacturing vendor delayed shipments of completed products to the Company, the Company's financial condition and operating results could be materially adversely affected.

The Company depends on component and product manufacturing and logistical services provided by outsourcing partners, many of whom 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 primarily located 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. The Company also relies on its partners to adhere to the Company's supplier code of conduct. Any unanticipated product defect or warranty liability, whether pursuant to arrangements with outsourcing partners or otherwise, or material violations of the supplier code of conduct, could materially adversely affect the Company's reputation, financial condition and operating results.

The supply and manufacture of many critical components is performed by sole-sourced outsourcing partners in the U.S., Asia and Europe. Single-sourced outsourcing partners in Asia perform final assembly of substantially all of the Company's hardware products. If manufacturing or logistics in these locations is disrupted for any reason including, but not limited to, natural and man-made disasters, information technology system failures, military actions or economic, business, labor, environmental, public health, or political issues, the Company's financial condition and operating results could be materially adversely affected.

The Company relies on third-party intellectual property and digital content, 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 could be obtained on reasonable terms. There is however no assurance that the necessary licenses could be obtained on acceptable terms or at all. If the Company is unable to obtain or renew critical licenses on reasonable terms, its financial condition and operating results may be materially adversely affected.

The Company also contracts with third parties to offer their digital content through the iTunes Store. The licensing arrangements with these third parties are short-term and do not guarantee the continuation or renewal of these arrangements on reasonable terms, if at all. Some third-party content providers currently or in the future may offer competing products and services, and could take action to make it more difficult or impossible for the Company to license their content in the future. Other content owners, providers or distributors may seek to limit the Company's access to, or increase the cost of, such content. If the Company is unable to continue to offer a wide variety of content at reasonable prices with acceptable usage rules, or continue to expand its geographic reach, the Company's financial condition and operating results may be materially adversely affected.

Many third-party content providers require the Company to provide digital rights management ("DRM") and other security solutions. If these requirements change, the Company may have to develop or license new technology to provide these solutions. There is no assurance the Company will be able to develop or license such solutions at a reasonable cost and in a timely manner. In addition, certain countries have passed or may propose legislation that would force the Company to license its DRM, which could lessen the protection of content and subject it to piracy and also could affect arrangements with the Company's content providers.

The Company's future results could be materially adversely affected if it is found to have infringed on intellectual property rights.

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 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 Europe and Asia. 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, it may be required to pay substantial damages. If there is a temporary or permanent injunction prohibiting the Company from marketing or selling certain products or a successful claim of infringement against the Company requiring it to pay royalties to a third-party, its financial condition and operating results could be materially adversely affected, regardless of whether it can develop non-infringing technology.

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.

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. 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 the same reporting period for amounts in excess of management's expectations, the Company's condensed consolidated financial statements of a particular reporting period could be materially adversely affected.

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, which could materially adversely affect the Company's financial condition and operating results.

With respect to its Mac products, the Company believes the availability of third-party software applications and services depends in part on the developers' perception and analysis of the relative benefits of developing, maintaining, and upgrading such software for the Company's products compared to Windows-based products. This analysis may be based on factors such as the perceived strength of the Company and its products, the anticipated revenue that may be generated, continued acceptance by customers of Mac OS X, and the costs of developing such applications and services. If the Company's minority share of the global personal computer market causes developers to question the Company's prospects, developers could be less inclined to develop or upgrade software for the Company's products and more inclined to devote their resources to developing and upgrading software for the larger Windows market.

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. The absence of multiple distribution channels, which are available for competing platforms, may limit the availability and acceptance of third-party applications by the Company's customers, thereby causing developers to reduce or curtail development for the iOS platform. In addition, 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 software for the Company's products rather than its competitors' products, including devices that use competing platforms. If developers focus their efforts on these competing platforms, the availability and quality of applications for the Company's devices may suffer.

The Company's future operating performance depends on the performance of distributors, carriers and other resellers.

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

Carriers providing cellular network service for iPhone typically subsidize users' purchase 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 negatively affected in the past by weak economic conditions. Some resellers have perceived the expansion of the Company's direct sales as conflicting with their business interests as distributors and resellers of the Company's products. Such a perception could discourage resellers from investing resources in the distribution and sale of the Company's products or lead them to limit or cease distribution of those products. The Company has invested and will continue to invest in programs to enhance reseller sales, including staffing selected resellers' stores with Company employees and contractors and improving product placement displays. These programs could require a substantial investment while providing no assurance of return or incremental revenue. The Company's financial condition and operating results could be materially adversely affected if the financial condition of these resellers weakens, if resellers stopped distributing the Company's products, or if uncertainty regarding demand for the Company's products caused resellers to reduce their ordering and marketing of the Company's products.

The Company's Retail business has required and will continue to require a substantial investment and commitment of resources and is subject to numerous risks and uncertainties.

The Company's retail stores have required substantial fixed investment in equipment and leasehold improvements, information systems, inventory and personnel. The Company also has entered into substantial operating lease commitments for retail space. Certain stores have been designed and built to serve as high-profile venues to promote brand awareness and serve as vehicles for corporate sales and marketing activities. Because of their unique design elements, locations and size, these stores require substantially more investment than the Company's more typical retail stores. Due to the high fixed cost structure associated with the Retail segment, a decline in sales or the closure or poor performance of individual or multiple stores could result in significant lease termination costs, write-offs of equipment and leasehold improvements, and severance costs that could materially adversely affect the Company's financial condition and operating results.

Many factors unique to retail operations, some of which are beyond the Company's control, pose risks and uncertainties that could materially adversely affect the Company's financial condition and operating results. These risks and uncertainties include, but are not limited to, macro-economic factors that could have a negative effect on general retail activity, as well as the Company's inability to manage costs associated with store construction and operation, inability to sell third-party products at adequate margins, failure to manage relationships with its existing retail channel partners, more challenging environment in managing retail operations outside the U.S., costs associated with unanticipated fluctuations in the value of retail inventory, and inability to obtain and renew leases in quality retail locations at a reasonable cost.

Investment in new business strategies and initiatives could disrupt the Company's ongoing business and present risks not originally contemplated.

The Company has invested, and in the future may invest, in new business strategies or acquisitions. Such endeavors may involve significant risks and uncertainties, including distraction of management from current operations, insufficient revenue to offset liabilities assumed and expenses associated with the strategy, inadequate return of capital, and unidentified issues not discovered in the Company's due diligence. These new ventures are inherently risky and may not be successful. They may materially adversely affect the Company's financial condition and operating results.

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

The Company sells 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, harm to reputation, and significant warranty and other expenses, and could have a material adverse impact on the Company's financial condition and operating results.

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

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, areas of labor, advertising, content, consumer protection, real estate, billing, e-commerce, promotions, quality of services, telecommunications, mobile, 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 the device, locking the device to a carrier's network, or mandating the use of the device 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, delays in product shipment dates, or 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. This increases the costs of doing business, and 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, cause the Company to change or limit its business practices, or affect the Company's financial condition and operating results. The Company has implemented policies and procedures designed to ensure compliance with these laws and regulations, but there can be no assurance that the Company's employees, contractors, or agents will not violate such laws and regulations or the Company's policies. Any such violations could individually or in the aggregate materially adversely affect the Company's financial condition or operating results.

The Company's success depends largely on the continued service and availability of key personnel.

Much of the Company's future success depends on the continued availability and service of key personnel, including its CEO, its executive team and highly skilled employees. Experienced personnel in the technology industry are in high demand and competition for their talents is intense, especially in the Silicon Valley, where most of the Company's key personnel are located.

Political events, war, terrorism, public health issues, natural disasters and other circumstances could materially adversely affect the Company.

War, terrorism, geopolitical uncertainties, public health issues, and other business interruptions have caused and could cause damage or disruption to international commerce and the global economy, and thus could have a strong negative effect on the Company, its suppliers, logistics providers, manufacturing vendors and customers, including channel partners. The Company's business operations are subject to interruption by natural disasters, fire, power shortages, 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 negatively affected by more stringent employee travel restrictions, additional limitations in freight services, governmental actions limiting the movement of products between regions, delays in production ramps of new products, and disruptions in the operations of the Company's manufacturing vendors and component suppliers. The majority of the Company's research and development activities, its corporate headquarters, information technology systems, and other critical business operations, including certain component suppliers and manufacturing vendors, are in locations that could be affected by natural disasters. In the event of a natural disaster, losses, significant recovery time and substantial expenditures could be required to resume operations and the Company's financial condition and operating results could be materially adversely affected.

Please also refer to the discussion of risks related to the recent flooding in Thailand in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” under the subheading “Thailand Flooding,” which is incorporated herein by reference.

The Company may be subject to information technology system failures or network disruptions that could damage the Company’s reputation, business operations, and financial conditions.

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 similar 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 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.

The Company may be subject to breaches of its information technology systems, which could damage the Company’s reputation, business partner and customer relationships, and access to online stores and services. Such breaches could 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 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 may be at a relatively greater risk of being targeted because of its high profile and the amount of PII managed.

The Company requires user names and passwords in order to access its information technology systems. The Company also uses encryption and authentication technologies to secure the transmission and storage of data. These security measures may be compromised as a result of third-party security breaches, employee error, malfeasance, faulty password management, or other irregularity, and result in persons obtaining unauthorized access to Company data or accounts. 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. The Company may experience a breach of its systems and may be unable to protect sensitive data. 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 and use of the Company’s products and services could decrease. The Company would also be exposed to a risk of loss or litigation and possible liability, which could result in a material adverse effect on the Company’s business, results of operations and financial condition.

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 to transfers of information between the Company and its subsidiaries, and among the Company, its subsidiaries and other parties with which the Company has commercial relations. Several jurisdictions have passed new 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 penalties or significant legal liability.

The Company's privacy policies and practices concerning the use and disclosure of data are posted on its website. Any failure by the Company, its suppliers or other parties with whom the Company does business to comply with its posted privacy policies 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, which could have a material adverse effect on the Company's business, results of operations and financial condition.

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 the cost of 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 expects its quarterly revenue and operating results to fluctuate.

The Company's profit margins vary among its products and its distribution channels. The Company's software, accessories, and service and support contracts generally have higher gross margins than certain of the Company's other products. Gross margins on the Company's hardware products vary across product lines and can change over time as a result of product transitions, pricing and configuration changes, and component, warranty, and other cost fluctuations. The Company's direct sales generally have higher associated gross margins than its indirect sales through its channel partners. In addition, the Company's gross margin and operating margin percentages, as well as overall profitability, may be materially adversely impacted as a result of a shift in product, geographic or channel mix, new products, component cost increases, strengthening U.S. dollar, or price competition. The Company has typically experienced greater net sales in the first fiscal quarter compared to other fiscal quarters due to increased holiday seasonal demand. Furthermore, the Company sells more products from time-to-time during the third month of a quarter than it does during either of the first two months. Developments late in a quarter, such as lower-than-anticipated demand for the Company's products, issues with new product introductions, an internal systems failure, or failure of one of the Company's logistics, components supply, or manufacturing partners, could have a material adverse impact on the Company's financial condition and operating results.

The Company's stock price is subject to volatility.

The Company's stock continues to experience substantial price volatility. Additionally, the stock market as a whole has experienced extreme price and volume fluctuations that have affected the stock price of many technology companies in ways that may have been unrelated to these companies' operating performance. The Company believes its stock price reflects high future growth and profitability expectations. If the Company fails to meet these expectations its stock price may significantly decline, which could have a material adverse impact on investor confidence and employee retention.

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. The consequences of such violations could individually or in the aggregate materially adversely affect the Company's financial condition or operating results.

The Company's financial condition and operating results also could be significantly affected by other risks associated with international activities including, but not limited to, economic and labor conditions, increased duties, taxes and other costs, political instability, and changes in the value of the U.S. dollar versus local currencies. Margins on sales of the Company's products in foreign countries, and on sales of products that include components

obtained from foreign suppliers, could be materially adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including duties, tariffs and antidumping penalties. The Company is also exposed to credit and collectability risk on its trade receivables with customers in certain international markets. There can be no assurance it can effectively limit its credit risk and avoid losses, which could materially adversely affect the Company's financial condition and operating results.

The Company's primary exposure to movements in foreign currency exchange rates relate to non-U.S. dollar denominated sales and operating expenses worldwide. Weakening of foreign currencies relative to the U.S. dollar will adversely affect the U.S. dollar value of the Company's foreign currency-denominated sales and earnings, and generally will lead the Company to raise international pricing, potentially reducing demand for the Company's products. In some circumstances, due to competition or other reasons, the Company may decide not to raise local prices to the full extent of the dollar's strengthening, or at all, which would adversely affect the U.S. dollar value of the Company's foreign currency denominated sales and earnings. Conversely, a strengthening of foreign currencies, while generally beneficial to the Company's foreign currency-denominated sales and earnings, could cause the Company to reduce international pricing 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 has used derivative instruments, such as foreign currency forward and option contracts, to hedge certain exposures to fluctuations in foreign currency exchange rates. The use of such hedging activities may not offset any or more than a portion of the adverse financial effects of unfavorable movements in foreign exchange rates over the limited time the hedges are in place.

The Company is exposed to credit risk and fluctuations in the market values of its investment portfolio.

Although the Company has not recognized any significant losses to date on its cash, cash equivalents and marketable securities, any significant declines in their market values could materially adversely affect the Company's financial condition and operating results. Given the global nature of its business, the Company has both domestic and international investments. Credit ratings and pricing of these 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 could decline and result in a significant impairment, which could materially adversely affect the Company's financial condition and operating results.

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

The Company distributes its products through third-party cellular network carriers, wholesalers, retailers and value-added resellers. A substantial majority of the Company's outstanding trade receivables are not covered by collateral 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. Cellular network carriers accounted for a significant portion of the Company's trade receivables as of December 31, 2011. 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. Two vendors accounted for a significant portion of the Company's non-trade receivables as of December 31, 2011. In addition, the Company has made prepayments associated with long-term supply agreements to secure supply of inventory components. 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, which could materially adversely affect the Company's financial condition and operating results.

Unfavorable results of legal proceedings could materially adversely affect the Company.

The Company is subject to various legal proceedings and claims that have not yet been fully resolved and that have arisen in the ordinary conduct of business, and additional claims may arise in the future. Results of legal proceedings are subject to significant uncertainty and, regardless of the merit of the 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.

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 the same reporting period for amounts in excess of management's expectations, the Company's condensed consolidated financial statements of a particular 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.

Changes in the Company's tax rates, the adoption of new U.S. or international tax legislation or exposure to additional tax liabilities could affect its future results.

The Company is subject to taxes in the U.S. and numerous foreign jurisdictions. The Company's future effective tax rates could be affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, or changes in tax laws or their interpretation. Any of these changes could have a material adverse effect on the Company's profitability. The Company is also subject to the continual examination of its income tax returns by the Internal Revenue Service and other tax authorities. The Company regularly assesses the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of its provision for taxes. There can be no assurance that the outcomes from these examinations will not materially adversely affect the Company's financial condition and operating results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 5. Other Information

None.

Item 6. Exhibits**(a) Index to Exhibits**

| <u>Exhibit Number</u> | <u>Exhibit Description</u> | <u>Incorporated by Reference</u> | |
|-----------------------|---|----------------------------------|------------------------------------|
| | | <u>Form</u> | <u>Filing Date/Period End Date</u> |
| 3.1 | Restated Articles of Incorporation, filed with the Secretary of State of the State of California on July 10, 2009. | 10-Q | 6/27/09 |
| 3.2 | By-Laws of the Registrant, as amended through April 20, 2011. | 10-Q | 3/26/11 |
| 4.1 | Form of Stock Certificate of the Registrant. | 10-Q | 12/30/06 |
| 10.1* | Employee Stock Purchase Plan, as amended through March 8, 2010. | 10-Q | 3/27/10 |
| 10.2* | Form of Indemnification Agreement between the Registrant and each director and executive officer of the Registrant. | 10-Q | 6/27/09 |
| 10.3* | 1997 Director Stock Plan, as amended through February 25, 2010. | 10-Q | 3/1/10 |
| 10.4* | 2003 Employee Stock Plan, as amended through February 25, 2010. | 8-K | 3/1/10 |
| 10.5* | Form of Restricted Stock Unit Award Agreement effective as of August 28, 2007. | 10-K | 9/29/07 |
| 10.6* | Form of Restricted Stock Unit Award Agreement effective as of November 11, 2008. | 10-Q | 12/27/08 |
| 10.7* | Form of Restricted Stock Unit Award Agreement effective as of November 16, 2010. | 10-Q | 12/25/10 |
| 10.8* | Business Conduct Policy of the Registrant dated July 2011. | 10-K | 9/24/11 |
| 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.

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.

January 25, 2012

APPLE INC.

By: /s/ Peter Oppenheimer

Peter Oppenheimer
Senior Vice President,
Chief Financial Officer

CERTIFICATIONS

I, Timothy D. Cook, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Apple Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: January 25, 2012

By: /s/ Timothy D. Cook

Timothy D. Cook
Chief Executive Officer

CERTIFICATIONS

I, Peter Oppenheimer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Apple Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: January 25, 2012

By: /s/ Peter Oppenheimer
Peter Oppenheimer
Senior Vice President,
Chief Financial Officer

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Timothy D. Cook, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Apple Inc. on Form 10-Q for the period ended December 31, 2011 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Form 10-Q fairly presents in all material respects the financial condition and results of operations of Apple Inc.

Date: January 25, 2012

By: /s/ Timothy D. Cook
Timothy D. Cook
Chief Executive Officer

I, Peter Oppenheimer, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Apple Inc. on Form 10-Q for the period ended December 31, 2011 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Form 10-Q fairly presents in all material respects the financial condition and results of operations of Apple Inc.

Date: January 25, 2012

By: /s/ Peter Oppenheimer
Peter Oppenheimer
Senior Vice President,
Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to Apple Inc. and will be retained by Apple Inc. and furnished to the Securities and Exchange Commission or its staff upon request.