

APPLE INC
Form 10-Q
January 30, 2019

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 29, 2018
or

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

For the transition period from _____ to _____
Commission File Number: 001-36743

Apple Inc.
(Exact name of Registrant as specified in its charter)

California 94-2404110
(State or other jurisdiction (I.R.S. Employer Identification No.)
of incorporation or organization)

One Apple Park Way 95014
Cupertino, California
(Address of principal executive offices) (Zip Code)
(408) 996-1010
(Registrant’s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the Registrant has submitted electronically every Interactive Data File required to be submitted 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 such files).

Yes No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the Registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

4,715,280,000 shares of common stock, par value \$0.00001 per share, issued and outstanding as of January 18, 2019

Apple Inc.

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For the Fiscal Quarter Ended December 29, 2018

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

Apple Inc.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

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

	Three Months Ended	
	December 29, 2018	December 30, 2017
Net sales:		
Products	\$73,435	\$ 79,164
Services	10,875	9,129
Total net sales	84,310	88,293
Cost of sales:		
Products	48,238	50,575
Services	4,041	3,806
Total cost of sales	52,279	54,381
Gross margin	32,031	33,912
Operating expenses:		
Research and development	3,902	3,407
Selling, general and administrative	4,783	4,231
Total operating expenses	8,685	7,638
Operating income	23,346	26,274
Other income/(expense), net	560	756
Income before provision for income taxes	23,906	27,030
Provision for income taxes	3,941	6,965
Net income	\$19,965	\$ 20,065
Earnings per share:		
Basic	\$4.22	\$ 3.92
Diluted	\$4.18	\$ 3.89

Shares used in computing earnings per share:

Basic	4,735,820	5,112,877
Diluted	4,773,252	5,157,787

See accompanying Notes to Condensed Consolidated Financial Statements.

Apple Inc.
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)
 (In millions)

	Three Months Ended		
	December 2018	December 30, 2017	
Net income	\$19,965	\$ 20,065	
Other comprehensive income/(loss):			
Change in foreign currency translation, net of tax	(78) 40	
Change in unrealized gains/losses on derivative instruments, net of tax:			
Change in fair value of derivatives	(334) 88	
Adjustment for net (gains)/losses realized and included in net income	42	102	
Total change in unrealized gains/losses on derivative instruments	(292) 190	
Change in unrealized gains/losses on marketable securities, net of tax:			
Change in fair value of marketable securities	110	(846)
Adjustment for net (gains)/losses realized and included in net income	37	(75)
Total change in unrealized gains/losses on marketable securities	147	(921)
Total other comprehensive income/(loss)	(223) (691)
Total comprehensive income	\$19,742	\$ 19,374	
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 and par value)

	December 29, 2018	September 29, 2018
ASSETS:		
Current assets:		
Cash and cash equivalents	\$ 44,771	\$ 25,913
Marketable securities	41,656	40,388
Accounts receivable, net	18,077	23,186
Inventories	4,988	3,956
Vendor non-trade receivables	18,904	25,809
Other current assets	12,432	12,087
Total current assets	140,828	131,339
Non-current assets:		
Marketable securities	158,608	170,799
Property, plant and equipment, net	39,597	41,304
Other non-current assets	34,686	22,283
Total non-current assets	232,891	234,386
Total assets	\$ 373,719	\$ 365,725
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	\$ 44,293	\$ 55,888
Other current liabilities	36,703	33,327
Deferred revenue	5,546	5,966
Commercial paper	11,969	11,964
Term debt	9,772	8,784
Total current liabilities	108,283	115,929
Non-current liabilities:		
Term debt	92,989	93,735
Other non-current liabilities	54,555	48,914
Total non-current liabilities	147,544	142,649
Total liabilities	255,827	258,578
Commitments and contingencies		
Shareholders' equity:		
Common stock and additional paid-in capital, \$0.00001 par value: 12,600,000 shares authorized; 4,729,803 and 4,754,986 shares issued and outstanding, respectively	40,970	40,201
Retained earnings	80,510	70,400
Accumulated other comprehensive income/(loss)	(3,588)	(3,454)
Total shareholders' equity	117,892	107,147
Total liabilities and shareholders' equity	\$ 373,719	\$ 365,725
See accompanying Notes to Condensed Consolidated Financial Statements.		

Apple Inc.

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (Unaudited)

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

	Three Months Ended	
	December 2018	December 30, 2017
Total shareholders' equity, beginning balances	\$107,147	\$ 134,047
Common stock and additional paid-in capital:		
Beginning balances	40,201	35,867
Shares withheld related to net share settlement of equity awards, net	(822)	(738)
Share-based compensation	1,591	1,318
Ending balances	40,970	36,447
Retained earnings:		
Beginning balances	70,400	98,330
Net income	19,965	20,065
Dividends and dividend equivalents declared	(3,526)	(3,300)
Shares withheld related to net share settlement of equity awards, net	(594)	(393)
Common stock repurchased	(8,236)	(10,109)
Cumulative effect of changes in accounting principles	2,501	—
Ending balances	80,510	104,593
Accumulated other comprehensive income/(loss):		
Beginning balances	(3,454)	(150)
Other comprehensive income/(loss)	(223)	(691)
Cumulative effect of changes in accounting principles	89	—
Ending balances	(3,588)	(841)
Total shareholders' equity, ending balances	\$117,892	\$ 140,199
Dividends and dividend equivalents declared per share or RSU	\$0.73	\$ 0.63

See accompanying Notes to Condensed Consolidated Financial Statements.

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Apple Inc.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
 (In millions)

	Three Months Ended	
	December 2018	December 30, 2017
Cash and cash equivalents, beginning balances	\$25,913	\$ 20,289
Operating activities:		
Net income	19,965	20,065
Adjustments to reconcile net income to cash generated by operating activities:		
Depreciation and amortization	3,395	2,745
Share-based compensation expense	1,559	1,296
Deferred income tax expense/(benefit)	53	(33,737)
Other	(54)	(11)
Changes in operating assets and liabilities:		
Accounts receivable, net	5,130	(5,570)
Inventories	(1,076)	434
Vendor non-trade receivables	6,905	(9,660)
Other current and non-current assets	(886)	(197)
Accounts payable	(8,501)	12,602
Deferred revenue	(370)	569
Other current and non-current liabilities	570	39,757
Cash generated by operating activities	26,690	28,293
Investing activities:		
Purchases of marketable securities	(7,077)	(41,272)
Proceeds from maturities of marketable securities	7,203	14,048
Proceeds from sales of marketable securities	9,723	16,801
Payments for acquisition of property, plant and equipment	(3,355)	(2,810)
Payments made in connection with business acquisitions, net	(167)	(173)
Purchases of non-marketable securities	(427)	(141)
Other	(56)	(43)
Cash generated by/(used in) investing activities	5,844	(13,590)
Financing activities:		
Payments for taxes related to net share settlement of equity awards	(1,318)	(1,038)
Payments for dividends and dividend equivalents	(3,568)	(3,339)
Repurchases of common stock	(8,796)	(10,095)
Proceeds from issuance of term debt, net	—	6,969
Change in commercial paper, net	6	2
Cash used in financing activities	(13,676)	(7,501)
Increase/(Decrease) in cash and cash equivalents	18,858	7,202
Cash and cash equivalents, ending balances	\$44,771	\$ 27,491
Supplemental cash flow disclosure:		
Cash paid for income taxes, net	\$4,916	\$ 3,551
Cash paid for interest	\$836	\$ 623

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 and personal computers, and sells a variety of related software, services, accessories and third-party digital content and applications. The Company’s products and services include iPhone®, Mac®, iPad®, Apple Watch®, AirPods®, Apple TV®, HomePod™, a portfolio of consumer and professional software applications, iOS, macOS®, watchOS® and tvOS® operating systems, iCloud®, Apple Pay® and a variety of accessory, service and support offerings. The Company sells and delivers digital content and applications through the iTunes Store®, App Store®, Mac App Store, TV App Store, Book Store and Apple Music® (collectively “Digital Content and Services”). The Company sells its products worldwide through its retail stores, online stores and direct sales force, as well as through third-party cellular network carriers, wholesalers, retailers and resellers. In addition, the Company sells a variety of third-party Apple-compatible products, including application software and various accessories, through its retail and online stores. The Company sells to consumers, small and mid-sized businesses and education, enterprise and government customers.

Basis of Presentation and Preparation

The accompanying condensed consolidated financial statements include the accounts of the Company. Intercompany accounts and transactions have been eliminated. In the opinion of the Company’s management, the condensed consolidated financial statements reflect all adjustments, which are normal and recurring in nature, necessary for fair financial statement presentation. The preparation of these condensed consolidated financial statements and accompanying notes in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported. Actual results could differ materially from those estimates. Certain prior period amounts in the condensed consolidated financial statements and accompanying notes have been reclassified to conform to the current period’s presentation. These condensed consolidated financial statements and accompanying notes should be read in conjunction with the Company’s annual consolidated financial statements and the notes thereto included in its Annual Report on Form 10-K for the fiscal year ended September 29, 2018 (the “2018 Form 10-K”).

The Company’s fiscal year is the 52- or 53-week period that ends on the last Saturday of September. A 14th week is included in the first fiscal quarter every five or six years to realign the Company’s fiscal quarters with calendar quarters. The Company’s fiscal years 2019 and 2018 span 52 weeks each. Unless otherwise stated, references to particular years, quarters, months and periods refer to the Company’s fiscal years ended in September and the associated quarters, months and periods of those fiscal years.

Recently Adopted Accounting Pronouncements

Revenue Recognition

In the first quarter of 2019, the Company adopted the Financial Accounting Standards Board’s (the “FASB”) Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers (Topic 606) (“ASU 2014-09”), and additional ASUs issued to clarify the guidance in ASU 2014-09 (collectively the “new revenue standard”), which amends the existing accounting standards for revenue recognition. The Company adopted the new revenue standard utilizing the full retrospective transition method. The Company did not restate total net sales in the prior periods presented, as adoption of the new revenue standard did not have a material impact on previously reported amounts. Additionally, beginning in the first quarter of 2019, the Company classified the amortization of the deferred value of Maps, Siri® and free iCloud services, which are bundled in the sales price of iPhone, Mac, iPad and certain other products, in Services net sales. Historically, the Company classified the amortization of these amounts in Products net sales consistent with its management reporting framework. As a result, Products and Services net sales information for the first quarter of 2018 was reclassified to conform to the 2019 presentation.

Financial Instruments

In the first quarter of 2019, the Company adopted FASB ASU No. 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities (“ASU 2016-01”), which updates certain aspects of the recognition, measurement, presentation and disclosure of financial instruments. The adoption of ASU 2016-01 did not have a material impact on the Company’s condensed consolidated financial statements.

Income Taxes

In the first quarter of 2019, the Company adopted FASB ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory (“ASU 2016-16”), which requires the recognition of the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs. The Company adopted ASU 2016-16 utilizing the modified retrospective transition method. Upon adoption, the Company recorded \$2.7 billion of net deferred tax assets, reduced other non-current assets by \$128 million, and increased retained earnings by \$2.6 billion on its Condensed Consolidated Balance Sheet. The Company will recognize incremental deferred income tax expense as these net deferred tax assets are utilized.

Earnings Per Share

The following table shows the computation of basic and diluted earnings per share for the three months ended December 29, 2018 and December 30, 2017 (net income in millions and shares in thousands):

	Three Months Ended	
	December 29, 2018	December 30, 2017
Numerator:		
Net income	\$ 19,965	\$ 20,065
Denominator:		
Weighted-average basic shares outstanding	4,735,820	5,112,877
Effect of dilutive securities	37,432	44,910
Weighted-average diluted shares	4,773,252	5,157,787
Basic earnings per share	\$ 4.22	\$ 3.92
Diluted earnings per share	\$ 4.18	\$ 3.89

Potentially dilutive securities representing 28.8 million shares of common stock were excluded from the computation of diluted earnings per share for the three months ended December 29, 2018 because their effect would have been antidilutive.

Note 2 – Revenue Recognition

Net sales consist of revenue from the sale of iPhone, Mac, iPad, services and other products. The Company recognizes revenue at the amount to which it expects to be entitled when control of the products or services is transferred to its customers. Control is generally transferred when the Company has a present right to payment and title and the significant risks and rewards of ownership of products or services are transferred to its customers. For most of the Company’s products net sales, control transfers when products are shipped. For the Company’s services net sales, control transfers over time as services are delivered. Payment for products and services net sales is collected within a short period of time following transfer of control or commencement of delivery of services, as applicable.

The Company records reductions to products net sales related to future product returns, price protection and other customer incentive programs based on the Company’s expectations and historical experience.

For arrangements with multiple performance obligations, which represent promises within an arrangement that are capable of being distinct, the Company allocates revenue to all distinct performance obligations based on their relative stand-alone selling prices (“SSP”). When available, the Company uses observable prices to determine the SSP. When observable prices are not available, SSPs are established that reflect the Company’s best estimates of what the selling prices of the performance obligations would be if they were sold regularly on a stand-alone basis. The Company’s process for estimating SSPs without observable prices considers multiple factors that may vary depending upon the unique facts and circumstances related to each performance obligation including, where applicable, prices charged by the Company for similar offerings, market trends in the pricing for similar offerings, product-specific business objectives and the estimated cost to provide the performance obligation.

The Company has identified up to three performance obligations regularly included in arrangements involving the sale of iPhone, Mac, iPad and certain other products. The first performance obligation, which represents the substantial portion of the allocated sales price, is the hardware and bundled software delivered at the time of sale. The second performance obligation is the right to receive certain product-related bundled services, which include iCloud, Siri and Maps. The third performance obligation is the right to receive, on a when-and-if-available basis, future unspecified software upgrades relating to the software bundled with each device. The Company allocates revenue and any related discounts to these performance obligations based on their relative SSPs. Because the Company lacks observable prices for the undelivered performance obligations, the allocation of revenue is based on the Company's estimated SSPs. Revenue allocated to the delivered hardware and bundled software is recognized when control has transferred to the customer, which generally occurs when the product is shipped. Revenue allocated to the product-related bundled services and unspecified software upgrade rights is deferred and recognized on a straight-line basis over the estimated period they are expected to be provided. Cost of sales related to delivered hardware and bundled software, including estimated warranty costs, are recognized at the time of sale. Costs incurred to provide product-related bundled services and unspecified software upgrade rights are recognized as cost of sales as incurred.

For certain long-term service arrangements, the Company has performance obligations for services it has not yet delivered. For these arrangements, the Company does not have a right to bill for the undelivered services. The Company has determined that any unbilled consideration relates entirely to the value of the undelivered services. Accordingly, the Company has not recognized revenue, and has elected not to disclose amounts, related to these undelivered services.

For the sale of third-party products where the Company obtains control of the product before transferring it to the customer, the Company recognizes revenue based on the gross amount billed to customers. The Company considers multiple factors when determining whether it obtains control of third-party products including, but not limited to, evaluating if it has the ability to establish the price of the product, retains inventory risk for tangible products or has the responsibility for ensuring acceptability of the product. For third-party applications sold through the App Store, Mac App Store and TV App Store and certain digital content sold through the iTunes Store, the Company does not obtain control of the product before transferring it to the customer. Therefore, the Company accounts for such sales on a net basis by recognizing in services net sales only the commission it retains.

The Company has elected to record revenue net of taxes collected from customers that are remitted to governmental authorities, with the collected taxes recorded within other current liabilities until remitted to the relevant government authority.

Deferred Revenue

As of December 29, 2018 and September 29, 2018, the Company had total deferred revenue of \$8.4 billion and \$8.8 billion, respectively. As of December 29, 2018, the Company expects 66% of total deferred revenue to be realized in less than a year, 27% within one-to-two years, 6% within two-to-three years and 1% in greater than three years.

Disaggregated Revenue

Net sales disaggregated by significant products and services for the three months ended December 29, 2018 and December 30, 2017 were as follows (in millions):

	Three Months Ended	
	December 29, 2018	December 30, 2017
iPhone ⁽¹⁾	\$51,982	\$ 61,104
Mac ⁽¹⁾	7,416	6,824
iPad ⁽¹⁾	6,729	5,755
Wearables, Home and Accessories ⁽¹⁾⁽²⁾	7,308	5,481
Services ⁽³⁾	10,875	9,129
Total net sales ⁽⁴⁾	\$84,310	\$ 88,293

(1) Products net sales include amortization of the deferred value of unspecified software upgrade rights, which are bundled in the sales price of the respective product.

(2) Wearables, Home and Accessories net sales include sales of AirPods, Apple TV, Apple Watch, Beats® products, HomePod, iPod touch® and Apple-branded and third-party accessories.

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Services net sales include sales from Digital Content and Services, AppleCare®, Apple Pay, licensing and other (3) services. Services net sales also include amortization of the deferred value of Maps, Siri and free iCloud services, which are bundled in the sales price of certain products.

(4) Includes \$2.4 billion and \$2.0 billion of revenue recognized in the three months ended December 29, 2018 and December 30, 2017, respectively, that was included in deferred revenue at the beginning of each respective period.

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The Company's proportion of net sales by disaggregated revenue source was generally consistent for each reportable segment in Note 11, "Segment Information and Geographic Data" for the three months ended December 29, 2018 and December 30, 2017.

Note 3 – Financial Instruments

Cash, Cash Equivalents and Marketable Securities

The Company's investments in marketable debt securities have been classified and accounted for as available-for-sale. The Company classifies its marketable debt securities as either short-term or long-term based on each instrument's underlying contractual maturity date. Unrealized gains and losses on marketable debt securities classified as available-for-sale are recognized in other comprehensive income/(loss) ("OCI").

The Company's investments in mutual funds represent its only marketable equity securities and are classified as short-term based on the nature of the securities and their availability for use in current operations. The Company's marketable equity securities are measured at fair value with gains and losses recognized in other income/(expense), net.

The following tables show the Company's cash and marketable securities by significant investment category as of December 29, 2018 and September 29, 2018 (in millions):

	December 29, 2018						
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short-Term Marketable Securities	Long-Term Marketable Securities
Cash	\$9,489	\$ —	\$ —	\$9,489	\$ 9,489	\$ —	\$ —
Level 1 ⁽¹⁾ :							
Money market funds	6,424	—	—	6,424	6,424	—	—
Mutual funds	682	—	—	682	—	682	—
Subtotal	7,106	—	—	7,106	6,424	682	—
Level 2 ⁽²⁾ :							
U.S. Treasury securities	46,191	6	(729)	45,468	3,923	6,415	35,130
U.S. agency securities	9,731	—	(31)	9,700	7,552	597	1,551
Non-U.S. government securities	23,460	48	(289)	23,219	1,895	4,129	17,195
Certificates of deposit and time deposits	5,349	—	—	5,349	3,705	1,348	296
Commercial paper	11,953	—	—	11,953	11,679	274	—
Corporate debt securities	117,260	32	(2,387)	114,905	104	27,134	87,667
Municipal securities	953	1	(7)	947	—	187	760
Mortgage- and asset-backed securities	17,320	7	(428)	16,899	—	890	16,009
Subtotal	232,217	94	(3,871)	228,440	28,858	40,974	158,608
Total ⁽³⁾	\$248,812	\$ 94	\$ (3,871)	\$245,035	\$ 44,771	\$ 41,656	\$ 158,608

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	September 29, 2018				Cash and	Short-Term	Long-Term
	Adjusted	Unrealized	Unrealized	Fair	Cash	Marketable	Marketable
	Cost	Gains	Losses	Value	Equivalents	Securities	Securities
Cash	\$11,575	\$ —	\$ —	\$11,575	\$ 11,575	\$ —	\$ —
Level 1 ⁽¹⁾ :							
Money market funds	8,083	—	—	8,083	8,083	—	—
Mutual funds	799	—	(116)	683	—	683	—
Subtotal	8,882	—	(116)	8,766	8,083	683	—
Level 2 ⁽²⁾ :							
U.S. Treasury securities	47,296	—	(1,202)	46,094	1,613	7,606	36,875
U.S. agency securities	4,127	—	(48)	4,079	1,732	360	1,987
Non-U.S. government securities	21,601	49	(250)	21,400	—	3,355	18,045
Certificates of deposit and time deposits	3,074	—	—	3,074	1,247	1,330	497
Commercial paper	2,573	—	—	2,573	1,663	910	—
Corporate debt securities	123,001	152	(2,038)	121,115	—	25,162	95,953
Municipal securities	946	—	(12)	934	—	178	756
Mortgage- and asset-backed securities	18,105	8	(623)	17,490	—	804	16,686
Subtotal	220,723	209	(4,173)	216,759	6,255	39,705	170,799
Total ⁽³⁾	\$241,180	\$ 209	\$(4,289)	\$237,100	\$ 25,913	\$ 40,388	\$ 170,799

(1) Level 1 fair value estimates are based on quoted prices in active markets for identical assets or liabilities.

(2) Level 2 fair value estimates are based on observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

(3) As of December 29, 2018 and September 29, 2018, total cash, cash equivalents and marketable securities included \$19.9 billion and \$20.3 billion, respectively, that was restricted from general use, related to the State Aid Decision (refer to Note 5, "Income Taxes") and other agreements.

The Company may sell certain of its marketable debt securities prior to their stated maturities for reasons including, but not limited to, managing liquidity, credit risk, duration and asset allocation. The maturities of the Company's long-term marketable debt securities generally range from one to five years.

The following tables show information about the Company's marketable securities that had been in a continuous unrealized loss position for less than 12 months and for 12 months or greater as of December 29, 2018 and September 29, 2018 (in millions):

	December 29, 2018		
	Continuous Unrealized Losses		
	Less than	12 Months	Total
	12	or Greater	
	Months		
Fair value of marketable debt securities	\$53,336	\$127,006	\$180,342
Unrealized losses	\$(1,153)	\$(2,718)	\$(3,871)
	September 29, 2018		
	Continuous Unrealized Losses		
	Less than	12	Total
	12 Months	Months	

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or
Greater

Fair value of marketable securities	\$ 126,238	\$ 60,599	\$ 186,837
Unrealized losses	\$(2,400)	\$(1,889)	\$(4,289)

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The Company typically invests in highly rated securities, with the primary objective of minimizing the potential risk of principal loss. The Company's investment policy generally requires securities to be investment grade and limits the amount of credit exposure to any one issuer. Fair values were determined for each individual security in the investment portfolio. When evaluating a marketable debt security for other-than-temporary impairment, the Company reviews factors such as the length of time and extent to which fair value has been below its cost basis, the financial condition of the issuer and any changes thereto, changes in market interest rates and the Company's intent to sell, or whether it is more likely than not it will be required to sell the security before recovery of the security's cost basis. As of December 29, 2018, the Company does not consider any of its marketable debt securities to be other-than-temporarily impaired.

Non-Marketable Securities

The Company holds non-marketable equity securities of certain privately held companies without readily determinable fair values, and has elected to apply the measurement alternative. As such, the Company's non-marketable equity securities are measured at cost, less any impairment, and are adjusted for changes in fair value resulting from observable transactions for identical or similar investments of the same issuer. Gains and losses on non-marketable equity securities are recognized in other income/(expense), net. As of December 29, 2018, the Company's non-marketable equity securities had a carrying value of \$2.2 billion.

The Company holds a non-marketable debt security that is classified and accounted for as held-to-maturity. As of December 29, 2018, the Company's non-marketable debt security had an amortized cost basis and carrying value of \$1.5 billion.

Derivative Financial Instruments

The Company may use derivatives to partially offset its business exposure to foreign currency and interest rate risk on expected future cash flows, net investments in certain foreign subsidiaries, and certain existing assets and liabilities. However, the Company may choose not to hedge certain exposures for a variety of reasons including, but not limited to, accounting considerations or the prohibitive economic cost of hedging particular exposures. There can be no assurance the hedges will offset more than a portion of the financial impact resulting from movements in foreign currency exchange or interest rates.

To protect gross margins from fluctuations in foreign currency exchange rates, certain of the Company's subsidiaries whose functional currency is the U.S. dollar may hedge a portion of forecasted foreign currency revenue, and subsidiaries whose functional currency is not the U.S. dollar may hedge a portion of forecasted inventory purchases not denominated in the subsidiaries' functional currencies. The Company may enter into forward contracts, option contracts or other instruments to manage this risk and may designate these instruments as cash flow hedges. The Company generally hedges portions of its forecasted foreign currency exposure associated with revenue and inventory purchases, typically for up to 12 months.

To protect the net investment in a foreign operation from fluctuations in foreign currency exchange rates, the Company may enter into foreign currency forward and option contracts to offset a portion of the changes in the carrying amounts of these investments due to fluctuations in foreign currency exchange rates. In addition, the Company may use non-derivative financial instruments, such as its foreign currency-denominated debt, as hedges of its net investments in certain foreign subsidiaries. In both of these cases, the Company designates these instruments as net investment hedges.

To protect the Company's foreign currency-denominated term debt or marketable securities from fluctuations in foreign currency exchange rates, the Company may enter into forward contracts, cross-currency swaps or other instruments. These instruments may offset a portion of the foreign currency remeasurement gains or losses, or changes in fair value. The Company may designate these instruments as either cash flow or fair value hedges. As of December 29, 2018, the Company's hedged term debt- and marketable securities-related foreign currency transactions are expected to be recognized within 24 years.

The Company may also enter into non-designated foreign currency contracts to offset a portion of the foreign currency exchange gains and losses generated by the remeasurement of certain assets and liabilities denominated in non-functional currencies.

To protect the Company's foreign currency-denominated term debt or marketable securities from fluctuations in interest rates, the Company may enter into interest rate swaps, options or other instruments. These instruments may offset a

portion of the changes in interest income or expense, or changes in fair value. The Company designates these instruments as either cash flow or fair value hedges. As of December 29, 2018, the Company's hedged interest rate transactions are expected to be recognized within 9 years.

Cash Flow Hedges

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

Derivative instruments designated as cash flow hedges must be de-designated as hedges when it is probable the forecasted hedged transaction will not occur in the initially identified time period or within a subsequent two-month time period. Deferred gains and losses in AOCI associated with such derivative instruments are reclassified into other income/(expense), net in the period of de-designation. Any subsequent changes in fair value of such derivative instruments are reflected in other income/(expense), net unless they are re-designated as hedges of other transactions.

Net Investment Hedges

The effective portions of net investment hedges are recorded in OCI as a part of the cumulative translation adjustment. The ineffective portions and amounts excluded from the effectiveness testing of net investment hedges are recognized in other income/(expense), net. For forward exchange contracts designated as net investment hedges, the Company excludes changes in fair value relating to changes in the forward carry component from its definition of effectiveness. Accordingly, any gains or losses related to this forward carry component are recognized in earnings in the current period.

Fair Value Hedges

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

Non-Designated Derivatives

Derivatives that are not designated as hedging instruments are adjusted to fair value through earnings in the financial statement line item to which the derivative relates. As a result, during the three months ended December 29, 2018, the Company recognized a gain of \$255 million in net sales, a gain of \$175 million in cost of sales and a gain of \$723 million in other income/(expense), net.

The Company records all derivatives in the Condensed Consolidated Balance Sheets at fair value. The Company’s accounting treatment for these derivative instruments is based on its hedge designation. The following tables show the Company’s derivative instruments at gross fair value as of December 29, 2018 and September 29, 2018 (in millions):

	December 29, 2018		
	Fair Value	Fair Value	Total
	of	of	Fair
	Derivatives	Derivatives	Value
	Not	Designated	
	Designated	as Hedge	
	as Hedge	Instruments	
	Instruments		
Derivative assets ⁽¹⁾ :			
Foreign exchange contracts	\$ 1,110	\$ 419	\$ 1,529
Interest rate contracts	\$ 22	\$ —	\$ 22
Derivative liabilities ⁽²⁾ :			
Foreign exchange contracts	\$ 701	\$ 345	\$ 1,046
Interest rate contracts	\$ 821	\$ —	\$ 821

September 29, 2018
Fair Value of Derivatives Designated as Hedge Instruments
Fair Value of Derivatives Not Designated as Hedge Instruments
Total Fair Value

Derivative assets ⁽¹⁾:

Foreign exchange contracts \$1,015 \$ 259 \$1,274

Derivative liabilities ⁽²⁾:

Foreign exchange contracts \$543 \$ 137 \$680

Interest rate contracts \$1,456 \$ — \$1,456

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

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

The Company classifies cash flows related to derivative financial instruments as operating activities in its Condensed Consolidated Statements of Cash Flows.

The following table shows the pre-tax gains and losses of the Company's derivative and non-derivative instruments designated as cash flow, net investment and fair value hedges in OCI and the Condensed Consolidated Statements of Operations for the three months ended December 29, 2018 and December 30, 2017 (in millions):

	Three Months Ended	
	December 29, 2018	December 30, 2017
Gains/(Losses) recognized in OCI – effective portion:		
Cash flow hedges:		
Foreign exchange contracts	\$(478)	\$ 153
Interest rate contracts	—	1
Total	\$(478)	\$ 154
Net investment hedges:		
Foreign currency debt	\$(16)	\$ 2
Gains/(Losses) reclassified from AOCI into net income – effective portion:		
Cash flow hedges:		
Foreign exchange contracts	\$(118)	\$ (124)
Interest rate contracts	(1)	1
Total	\$(119)	\$ (123)
Gains/(Losses) on derivative instruments:		
Fair value hedges:		
Foreign exchange contracts	\$402	\$ —
Interest rate contracts	657	(274)
Total	\$1,059	\$ (274)

Gains/(Losses) related to hedged items:

Fair value hedges:

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Marketable securities	\$ (402)	\$ —
Fixed-rate debt	(657)	274
Total	\$ (1,059)	\$ 274

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The following table shows the notional amounts of the Company's outstanding derivative instruments and credit risk amounts associated with outstanding or unsettled derivative instruments as of December 29, 2018 and September 29, 2018 (in millions):

	December 29, 2018		September 29, 2018	
	Notional Amount	Credit Risk Amount	Notional Amount	Credit Risk Amount
Instruments designated as accounting hedges:				
Foreign exchange contracts	\$56,000	\$ 1,110	\$65,368	\$ 1,015
Interest rate contracts	\$33,250	\$ 22	\$33,250	\$ —

Instruments not designated as accounting hedges:

Foreign exchange contracts	\$82,013	\$ 419	\$63,062	\$ 259
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The notional amounts for outstanding derivative instruments provide one measure of the transaction volume outstanding and do not represent the amount of the Company's exposure to credit or market loss. The credit risk amounts represent the Company's gross exposure to potential accounting loss on derivative instruments that are outstanding or unsettled if all counterparties failed to perform according to the terms of the contract, based on then-current currency or interest rates at each respective date. The Company's exposure to credit loss and market risk will vary over time as currency and interest rates change. Although the table above reflects the notional and credit risk amounts of the Company's derivative instruments, it does not reflect the gains or losses associated with the exposures and transactions that the instruments are intended to hedge. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

The Company generally enters into master netting arrangements, which are designed to reduce credit risk by permitting net settlement of transactions with the same counterparty. To further limit credit risk, the Company generally enters into collateral security arrangements that provide for collateral to be received or posted when the net fair value of certain financial instruments fluctuates from contractually established thresholds. The Company presents its derivative assets and derivative liabilities at their gross fair values in its Condensed Consolidated Balance Sheets. The net cash collateral posted by the Company related to derivative instruments under its collateral security arrangements was \$56 million and \$1.0 billion as of December 29, 2018 and September 29, 2018, respectively, which were recorded as other current assets in the Condensed Consolidated Balance Sheets.

Under master netting arrangements with the respective counterparties to the Company's derivative contracts, the Company is allowed to net settle transactions with a single net amount payable by one party to the other. As of December 29, 2018 and September 29, 2018, the potential effects of these rights of set-off associated with the Company's derivative contracts, including the effects of collateral, would be a reduction to both derivative assets and derivative liabilities of \$1.9 billion and \$2.1 billion, respectively, resulting in a net derivative liability of \$260 million and a net derivative asset of \$138 million, respectively.

Accounts Receivable

Trade Receivables

The Company has considerable trade receivables outstanding with its third-party cellular network carriers, wholesalers, retailers, resellers, small and mid-sized businesses and education, enterprise and government customers. The Company generally does not require collateral from its customers; however, the Company will require collateral or third-party credit support in certain instances to limit credit risk. In addition, when possible, the Company attempts to limit credit risk on trade receivables with credit insurance for certain customers or by requiring third-party financing, loans or leases to support credit exposure. These credit-financing arrangements are directly between the third-party financing company and the end customer. As such, the Company generally does not assume any recourse or credit risk sharing related to any of these arrangements.

As of December 29, 2018, the Company had no customers that individually represented 10% or more of total trade receivables. As of September 29, 2018, the Company had one customer that represented 10% or more of total trade

receivables, which accounted for 10%. The Company's cellular network carriers accounted for 45% and 59% of total trade receivables as of December 29, 2018 and September 29, 2018, respectively.

Vendor Non-Trade Receivables

The Company has non-trade receivables from certain of its manufacturing vendors resulting from the sale of components to these vendors who manufacture sub-assemblies or assemble final products for the Company. The Company purchases these components directly from suppliers. As of December 29, 2018, the Company had two vendors that individually represented 10% or more of total vendor non-trade receivables, which accounted for 56% and 15%. As of September 29, 2018, the Company had two vendors that individually represented 10% or more of total vendor non-trade receivables, which accounted for 62% and 12%.

Note 4 – Condensed Consolidated Financial Statement Details

The following tables show the Company’s condensed consolidated financial statement details as of December 29, 2018 and September 29, 2018 (in millions):

Property, Plant and Equipment, Net

	December 29, 2018	September 29, 2018
Land and buildings	\$ 16,352	\$ 16,216
Machinery, equipment and internal-use software	66,823	65,982
Leasehold improvements	8,351	8,205
Gross property, plant and equipment	91,526	90,403
Accumulated depreciation and amortization	(51,929)	(49,099)
Total property, plant and equipment, net	\$ 39,597	\$ 41,304

Other Non-Current Liabilities

	December 29, 2018	September 29, 2018
Long-term taxes payable	\$ 30,948	\$ 33,589
Other non-current liabilities	23,607	15,325
Total other non-current liabilities	\$ 54,555	\$ 48,914

Other Income/(Expense), Net

The following table shows the detail of other income/(expense), net for the three months ended December 29, 2018 and December 30, 2017 (in millions):

	Three Months Ended	
	December 29, 2018	December 30, 2017
Interest and dividend income	\$ 1,307	\$ 1,452
Interest expense	(890)	(734)
Other income, net	143	38
Total other income/(expense), net	\$ 560	\$ 756

Note 5 – Income Taxes

U.S. Tax Cuts and Jobs Act

On December 22, 2017, the U.S. enacted the Tax Cuts and Jobs Act (the “Act”), which significantly changed U.S. tax law. The Act lowered the Company’s U.S. statutory federal income tax rate from 35% to 21% effective January 1, 2018, while also imposing a deemed repatriation tax on previously deferred foreign income. The Act also created a new minimum tax on certain future foreign earnings. The Company completed its accounting for the income tax effects of the Act during the first quarter of 2019, in accordance with the U.S. Securities and Exchange Commission Staff Accounting Bulletin No. 118.

Uncertain Tax Positions

As of December 29, 2018, the total amount of gross unrecognized tax benefits was \$14.7 billion, of which \$8.2 billion, if recognized, would impact the Company’s effective tax rate. The Company had accrued \$1.2 billion of gross interest and penalties as of December 29, 2018. Both the unrecognized tax benefits and the associated interest and penalties that are not expected to result in payment or receipt of cash within one year are classified as other non-current liabilities in the Condensed Consolidated Balance Sheet.

The Company is subject to taxation and files income tax returns in the U.S. federal jurisdiction and in many state and foreign jurisdictions. The U.S. Internal Revenue Service concluded its review of the years 2013 through 2015 in 2018, and all years prior to 2016 are closed. Tax years subsequent to 2006 in certain major U.S. states and subsequent to 2010 in certain major foreign jurisdictions remain open, and could be subject to examination by the taxing authorities. The Company 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 inconsistent with its expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs. Although timing of resolution and/or closure of audits is not certain, the Company believes it is reasonably possible that its gross unrecognized tax benefits could decrease (either by payment, release or a combination of both) in the next 12 months by as much as \$300 million.

European Commission State Aid Decision

On August 30, 2016, the European Commission announced its decision that Ireland granted state aid to the Company by providing tax opinions in 1991 and 2007 concerning the tax allocation of profits of the Irish branches of two subsidiaries of the Company (the "State Aid Decision"). The State Aid Decision ordered Ireland to calculate and recover additional taxes from the Company for the period June 2003 through December 2014. The recovery amount was calculated to be €13.1 billion, plus interest of €1.2 billion. Irish legislative changes, effective as of January 2015, eliminated the application of the tax opinions from that date forward. The Company believes the State Aid Decision to be without merit and appealed to the General Court of the Court of Justice of the European Union. Ireland has also appealed the State Aid Decision. The Company believes that any incremental Irish corporate income taxes potentially due related to the State Aid Decision would be creditable against U.S. taxes, subject to any foreign tax credit limitations in the Act. As of December 29, 2018, the entire recovery amount plus interest was funded into escrow, where it will remain restricted from general use pending conclusion of all appeals. Refer to Note 3, "Financial Instruments" for more information.

Note 6 – Debt

Commercial Paper

The Company issues unsecured short-term promissory notes ("Commercial Paper") pursuant to a commercial paper program. The Company uses net proceeds from the commercial paper program for general corporate purposes, including dividends and share repurchases. As of both December 29, 2018 and September 29, 2018, the Company had \$12.0 billion of Commercial Paper outstanding with maturities generally less than nine months. The weighted-average interest rate of the Company's Commercial Paper was 2.39% as of December 29, 2018 and 2.18% as of September 29, 2018. The following table provides a summary of cash flows associated with the issuance and maturities of Commercial Paper for the three months ended December 29, 2018 and December 30, 2017 (in millions):

	Three Months Ended	
	December 29,	December 30,
	2018	2017

Maturities 90 days or less:

Proceeds from/(Repayments of) commercial paper, net	\$2,011	\$ 1,621
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Maturities greater than 90 days:

Proceeds from commercial paper	2,166	3,441	
Repayments of commercial paper	(4,171)	(5,060))
Proceeds from/(Repayments of) commercial paper, net	(2,005)	(1,619))

Total change in commercial paper, net	\$6	\$ 2
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Term Debt

As of December 29, 2018, the Company had outstanding floating- and fixed-rate notes with varying maturities for an aggregate principal amount of \$103.8 billion (collectively the "Notes"). The Notes are senior unsecured obligations, and interest is payable in arrears, quarterly for the U.S. dollar-denominated and Australian dollar-denominated floating-rate notes, semi-annually for the U.S. dollar-denominated, Australian dollar-denominated, British pound-denominated, Japanese yen-denominated and Canadian dollar-denominated fixed-rate notes and annually for the euro-denominated

and Swiss franc-denominated fixed-rate notes.

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The following table provides a summary of the Company's term debt as of December 29, 2018 and September 29, 2018:

	Maturities (calendar year)	December 29, 2018 Amount (in millions)	Effective Interest Rate	September 29, 2018 Amount (in millions)	Effective Interest Rate
2013 debt issuance of \$17.0 billion:					
Fixed-rate 2.400% – 3.850% notes	2023–2043	\$8,500	2.44%–3.91 %	\$8,500	2.44%–3.91 %
2014 debt issuance of \$12.0 billion:					
Floating-rate notes	2019	1,000	2.89 %	1,000	2.64 %
Fixed-rate 2.100% – 4.450% notes	2019–2044	8,500	2.89%–4.48 %	8,500	2.64%–4.48 %
2015 debt issuances of \$27.3 billion:					
Floating-rate notes	2019–2020	1,497	1.87%–2.92 %	1,507	1.87%–2.64 %
Fixed-rate 0.350% – 4.375% notes	2019–2045	24,181	0.28%–4.51 %	24,410	0.28%–4.51 %
2016 debt issuances of \$24.9 billion:					
Floating-rate notes	2019–2021	1,350	2.72%–3.81 %	1,350	2.48%–3.44 %
Fixed-rate 1.100% – 4.650% notes	2019–2046	23,038	1.13%–4.78 %	23,059	1.13%–4.78 %
2017 debt issuances of \$28.7 billion:					
Floating-rate notes	2019–2022	3,250	2.68%–3.10 %	3,250	2.41%–2.84 %
Fixed-rate 0.875% – 4.300% notes	2019–2047	25,454	1.54%–4.30 %	25,617	1.54%–4.30 %
2018 debt issuance of \$7.0 billion:					
Fixed-rate 1.800% – 3.750% notes	2019–2047	7,000	1.83%–3.80 %	7,000	1.83%–3.80 %
Total term debt		103,770		104,193	
Unamortized premium/(discount) and issuance costs, net		(210)		(218)	
Hedge accounting fair value adjustments		(799)		(1,456)	
Less: Current portion of term debt		(9,772)		(8,784)	
Total non-current portion of term debt		\$92,989		\$93,735	

To manage interest rate risk on certain of its U.S. dollar-denominated fixed- or floating-rate notes, the Company has entered into interest rate swaps to effectively convert the fixed interest rates to floating interest rates or the floating interest rates to fixed interest rates on a portion of these notes. Additionally, to manage foreign currency risk on certain of its foreign currency-denominated notes, the Company has entered into foreign currency swaps to effectively convert these notes to U.S. dollar-denominated notes.

A portion of the Company's Japanese yen-denominated notes is designated as a hedge of the foreign currency exposure of the Company's net investment in a foreign operation. As of December 29, 2018 and September 29, 2018, the carrying value of the debt designated as a net investment hedge was \$1.0 billion and \$811 million, respectively. For further discussion regarding the Company's use of derivative instruments, refer to the Derivative Financial Instruments section of Note 3, "Financial Instruments."

The effective interest rates for the Notes include the interest on the Notes, amortization of the discount or premium and, if applicable, adjustments related to hedging. The Company recognized \$809 million and \$695 million of interest expense on its term debt for the three months ended December 29, 2018 and December 30, 2017, respectively.

As of December 29, 2018 and September 29, 2018, the fair value of the Company's Notes, based on Level 2 inputs, was \$102.6 billion and \$103.2 billion, respectively.

Note 7 – Shareholders' Equity

Share Repurchase Program

On May 1, 2018, the Company announced the Board of Directors had authorized a program to repurchase up to \$100 billion of the Company's common stock, of which \$37.3 billion had been utilized as of December 29, 2018. During the three months ended December 29, 2018, the Company repurchased 38.0 million shares of its common stock for \$8.2 billion. The Company's share repurchase program does not obligate it to acquire any specific number of shares. Under this program, shares may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended (the "Exchange Act").

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Note 8 – Comprehensive Income

The Company's OCI consists of foreign currency translation adjustments from those subsidiaries not using the U.S. dollar as their functional currency, net deferred gains and losses on certain derivative instruments accounted for as cash flow hedges and unrealized gains and losses on marketable debt securities classified as available-for-sale.

The following table shows the pre-tax amounts reclassified from AOCI into the Condensed Consolidated Statements of Operations, and the associated financial statement line item, for the three months ended December 29, 2018 and December 30, 2017 (in millions):

Comprehensive Income Components	Financial Statement Line Item	Three Months Ended	
		December 29, 2018	December 30, 2017
Unrealized (gains)/losses on derivative instruments:			
Foreign exchange contracts	Total net sales	\$63	\$ 184
	Total cost of sales	(375)	(27)
	Other income/(expense), net	396	(33)
Interest rate contracts	Other income/(expense), net	1	(1)
		85	123
Unrealized (gains)/losses on marketable securities	Other income/(expense), net	47	(116)
Total amounts reclassified from AOCI		\$132	\$ 7

The following table shows the changes in AOCI by component for the three months ended December 29, 2018 (in millions):

	Cumulative Foreign Currency Translation	Unrealized Gains/Losses on Derivative Instruments	Unrealized Gains/Losses on Marketable Securities	Total
Balances as of September 29, 2018	\$ (1,055)	\$ 810	\$ (3,209)	\$(3,454)
Other comprehensive income/(loss) before reclassifications	(82)	(472)	140	(414)
Amounts reclassified from AOCI	—	85	47	132
Tax effect	4	95	(40)	59
Other comprehensive income/(loss)	(78)	(292)	147	(223)
Cumulative effect of change in accounting principle ⁽¹⁾	—	—	89	89
Balances as of December 29, 2018	\$ (1,133)	\$ 518	\$ (2,973)	\$(3,588)

⁽¹⁾ Refer to Note 1, "Summary of Significant Accounting Policies" for more information on the Company's adoption of ASU 2016-01 at the beginning of the first quarter of 2019.

Note 9 – Benefit Plans

Stock Plans

The Company had 237.9 million shares reserved for future issuance under its stock plans as of December 29, 2018. Restricted stock units ("RSUs") granted under the Company's stock plans generally vest over four years, based on continued employment, and are settled upon vesting in shares of the Company's common stock on a one-for-one basis. Each share issued with respect to RSUs granted under the Company's stock plans reduces the number of shares available for grant under the plans by two shares. RSUs canceled and shares withheld to satisfy tax withholding obligations increase the number of shares available for grant under the plans utilizing a factor of two times the number of RSUs canceled or shares withheld.

Rule 10b5-1 Trading Plans

During the three months ended December 29, 2018, Section 16 officers Angela Ahrendts, Timothy D. Cook, Chris Kondo, Luca Maestri and Jeffrey Williams had equity trading plans in place in accordance with Rule 10b5-1(c)(1) under the Exchange Act. An equity trading plan is a written document that pre-establishes the amounts, prices and dates (or formula for determining the amounts, prices and dates) of future purchases or sales of the Company's stock, including shares acquired pursuant to the Company's employee and director equity plans.

Restricted Stock Units

A summary of the Company's RSU activity and related information for the three months ended December 29, 2018 is as follows:

	Number of RSUs (in thousands)	Weighted-Average Grant Date Fair Value Per RSU	Aggregate Fair Value (in millions)
Balance as of September 29, 2018	92,155	\$ 134.60	
RSUs granted	29,228	\$ 223.41	
RSUs vested	(18,935)	\$ 124.36	
RSUs canceled	(1,147)	\$ 154.53	
Balance as of December 29, 2018	101,301	\$ 161.91	\$ 15,826

The fair value as of the respective vesting dates of RSUs was \$4.1 billion and \$3.1 billion for the three months ended December 29, 2018 and December 30, 2017, respectively.

Share-Based Compensation

The following table shows share-based compensation expense and the related income tax benefit included in the Condensed Consolidated Statements of Operations for the three months ended December 29, 2018 and December 30, 2017 (in millions):

	Three Months Ended	
	December 29, 2018	December 30, 2017
Share-based compensation expense	\$1,559	\$ 1,296
Income tax benefit related to share-based compensation expense	\$(750)	\$(631)

As of December 29, 2018, the total unrecognized compensation cost related to outstanding RSUs and stock options was \$14.0 billion, which the Company expects to recognize over a weighted-average period of 2.9 years.

Note 10 – Commitments and Contingencies

Accrued Warranty and Indemnification

The following table shows changes in the Company's accrued warranties and related costs for the three months ended December 29, 2018 and December 30, 2017 (in millions):

	Three Months Ended	
	December 29, 2018	December 30, 2017
Beginning accrued warranty and related costs	\$3,692	\$ 3,834
Cost of warranty claims	(996)	(982)
Accruals for product warranty	1,123	1,471
Ending accrued warranty and related costs	\$3,819	\$ 4,323

Agreements entered into by the Company may include indemnification provisions, which may subject the Company to costs and damages in the event of a claim against an indemnified third party. Except as disclosed under the heading "Contingencies" below, 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 indemnification of third parties.

The Company offers an iPhone Upgrade Program, which is available to customers who purchase a qualifying iPhone in the U.S., the U.K. and mainland China. The iPhone Upgrade Program provides customers the right to trade in that iPhone for a specified amount when purchasing a new iPhone, provided certain conditions are met. The Company accounts for the trade-in right as a guarantee liability and recognizes arrangement revenue net of the fair value of such right, with subsequent changes to the guarantee liability recognized within net sales.

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 of the Company, 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. While the Company maintains directors and officers liability insurance coverage, such insurance coverage may be insufficient to cover all losses or all types of claims that may arise.

Concentrations in the Available Sources of Supply of Materials and Product

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

The Company uses some custom components that are not commonly used by its competitors, and new products introduced by the Company often utilize custom components available from only one source. When a component or product uses new technologies, initial capacity constraints may exist until the suppliers' yields have matured or manufacturing capacity has increased. If the Company's supply of components for a new or existing product were delayed or constrained, or if an outsourcing partner delayed shipments of completed products to the Company, the Company's financial condition and operating results could be materially adversely affected. The Company's business and financial performance could also be materially adversely affected depending on the time required to obtain sufficient quantities from the original source, or to identify and obtain sufficient quantities from an alternative source. Continued availability of these components at acceptable prices, or at all, may be affected if suppliers decide to concentrate on the production of common components instead of components customized to meet the Company's requirements.

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

Substantially all of the Company's hardware products are manufactured by outsourcing partners that are located primarily in Asia, with some Mac computers manufactured in the U.S. and Ireland. 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 single-sourced suppliers of components and manufacturers for many of the Company's products. Although the Company works closely with its outsourcing partners on manufacturing schedules, the Company's financial condition and operating results could be materially adversely affected if its outsourcing partners were unable to meet their production commitments. The Company's manufacturing purchase obligations typically cover its requirements for periods up to 150 days.

Other Off-Balance Sheet Commitments

Operating Leases

The Company leases various equipment and facilities, including retail space, under noncancelable operating lease arrangements. The Company does not currently utilize any other off-balance sheet financing arrangements. As of December 29, 2018, the Company's total future minimum lease payments under noncancelable operating leases were \$9.9 billion. The Company's retail store and other facility leases typically have original terms not exceeding 10 years and generally contain multi-year renewal options.

Unconditional Purchase Obligations

The Company has entered into certain off-balance sheet commitments that require the future purchase of goods or services ("unconditional purchase obligations"). The Company's unconditional purchase obligations primarily consist of payments for supplier arrangements, internet and telecommunication services, intellectual property licenses and content creation. As of December 29, 2018, the Company's total future payments under noncancelable unconditional

purchase obligations having a remaining term in excess of one year were \$7.4 billion.

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Contingencies

The Company is subject to various legal proceedings and claims that have arisen in the ordinary course of business and that have not been fully adjudicated, as further discussed in Part II, Item 1 of this Form 10-Q under the heading “Legal Proceedings” and in Part II, Item 1A of this Form 10-Q under the heading “Risk Factors.” The outcome of litigation is inherently uncertain. If one or more legal matters were resolved against the Company in a reporting period for amounts in excess of management’s expectations, the Company’s financial condition and operating results for that reporting period could be materially adversely affected. In the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies for asserted legal and other claims, except for the following matters:

VirnetX

VirnetX, Inc. filed two lawsuits in the U.S. District Court for the Eastern District of Texas (the “Eastern Texas District Court”) against the Company alleging that certain Company products infringe four patents (the “VirnetX Patents”) relating to network communications technology (“VirnetX I” and “VirnetX II”). On September 30, 2016, a jury returned a verdict in VirnetX I against the Company and awarded damages of \$302 million, which later increased to \$440 million in post-trial proceedings. The Company appealed the VirnetX I verdict to the U.S. Court of Appeals for the Federal Circuit (the “Federal Circuit”). On April 11, 2018, a jury returned a verdict in VirnetX II against the Company and awarded damages of \$503 million. VirnetX II is currently on appeal. The Company has challenged the validity of the VirnetX Patents at the U.S. Patent and Trademark Office (the “PTO”). In response, the PTO has declared the VirnetX Patents invalid. VirnetX appealed the invalidity decision of the PTO to the Federal Circuit. The Federal Circuit consolidated the Company’s appeal of the Eastern Texas District Court VirnetX I verdict and VirnetX’s appeals from the PTO invalidity proceedings. On January 15, 2019, the Federal Circuit affirmed the VirnetX I verdict, which the Company intends to further appeal. The remaining appeals from the PTO proceedings invalidating the VirnetX Patents remain pending.

Qualcomm

On January 20, 2017, the Company filed a lawsuit against Qualcomm Incorporated and affiliated parties (“Qualcomm”) in the U.S. District Court for the Southern District of California seeking, among other things, to enjoin Qualcomm from requiring the Company to pay royalties at the rate demanded by Qualcomm. As the Company does not believe the demanded royalty it has historically paid contract manufacturers for each applicable device is fair, reasonable and non-discriminatory, and believes it to be invalid and/or overstated in other respects as well, no Qualcomm-related royalty payments have been remitted by the Company to its contract manufacturers since the beginning of the second quarter of 2017. The Company believes it will prevail on the merits of the case and has accrued its best estimate for the ultimate resolution of this matter.

Following the Company’s lawsuit, Qualcomm has filed patent infringement suits against the Company and its affiliates in the U.S. and various international jurisdictions, some of which seek to enjoin the sale of certain of the Company’s products in particular countries. In one matter pending in China, on November 30, 2018, a court issued an order enjoining the sale in China of certain iPhone models running iOS 10 or iOS 11. The Company has taken steps to comply with the order and has deployed a software update to address the functionality at issue. The Company has sought reconsideration and a declaration of compliance with the order and has appealed the decision. In another matter pending in Germany, on December 20, 2018, a court issued an order enjoining the sale in Germany by the Company and certain of its subsidiaries of iPhone 7, 7 Plus, 8, 8 Plus and X. The Company has taken steps to comply with the order and has appealed the decision.

iOS Performance Management Cases

Various civil litigation matters have been filed in state and federal courts in the U.S. and in various international jurisdictions alleging violation of consumer protection laws, fraud, computer intrusion and other causes of action related to the Company’s performance management feature used in its iPhone operating systems, introduced to certain iPhones in iOS updates 10.2.1 and 11.2. The claims seek monetary damages and other non-monetary relief. On April 5, 2018, several U.S. federal actions were consolidated through a Multidistrict Litigation process into a single action in the U.S. District Court for the Northern District of California. In addition to civil litigation, the Company is also responding to governmental investigations and requests for information relating to the performance management feature. The Company believes that its iPhones were not defective, that the performance management feature

introduced with iOS updates 10.2.1 and 11.2 was intended to, and did, improve customers' user experience, and that the Company did not make any misleading statements or fail to disclose any material information. The Company has accrued its best estimate for the ultimate resolution of these matters.

Note 11 – Segment Information and Geographic Data

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

The Company manages its business primarily on a geographic basis. The Company’s reportable segments consist of the Americas, Europe, Greater China, Japan and Rest of Asia Pacific. Americas includes both North and South America. Europe includes European countries, as well as India, the Middle East and Africa. Greater China includes China, Hong Kong and Taiwan. Rest of Asia Pacific includes Australia and those Asian countries not included in the Company’s other reportable segments. Although the reportable segments provide similar hardware and software products and similar services, each one is managed separately to better align with the location of the Company’s customers and distribution partners and the unique market dynamics of each geographic region. The accounting policies of the various segments are the same as those described in Note 1, “Summary of Significant Accounting Policies” of the Notes to Consolidated Financial Statements in Part II, Item 8 of the 2018 Form 10-K.

The Company evaluates the performance of its reportable segments based on net sales and operating income. Net sales for geographic segments are generally based on the location of customers and sales through the Company’s retail stores located in those geographic locations. Operating income for each segment includes net sales to third parties, related cost of sales and operating expenses directly attributable to the segment. Advertising expenses are generally included in the geographic segment in which the expenditures are incurred. Operating income for each segment excludes other income and expense and certain expenses managed outside the reportable segments. Costs excluded from segment operating income include various corporate expenses such as research and development, corporate marketing expenses, certain share-based compensation expenses, income taxes, various nonrecurring charges and other separately managed general and administrative costs. The Company does not include intercompany transfers between segments for management reporting purposes.

The following table shows information by reportable segment for the three months ended December 29, 2018 and December 30, 2017 (in millions):

	Three Months Ended	
	December 29,	December 30,
	2018	2017
Americas:		
Net sales	\$36,940	\$ 35,193
Operating income	\$11,200	\$ 11,316
Europe:		
Net sales	\$20,363	\$ 21,054
Operating income	\$6,658	\$ 6,893
Greater China:		
Net sales	\$13,169	\$ 17,956
Operating income	\$5,314	\$ 6,908
Japan:		
Net sales	\$6,910	\$ 7,237
Operating income	\$3,014	\$ 3,082
Rest of Asia Pacific:		
Net sales	\$6,928	\$ 6,853
Operating income	\$2,560	\$ 2,575

A reconciliation of the Company's segment operating income to the Condensed Consolidated Statements of Operations for the three months ended December 29, 2018 and December 30, 2017 is as follows (in millions):

	Three Months Ended	
	December 29, 2018	December 30, 2017
Segment operating income	\$28,746	\$ 30,774
Research and development expense	(3,902)	(3,407)
Other corporate expenses, net	(1,498)	(1,093)
Total operating income	\$23,346	\$ 26,274

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

This section and other parts of this Quarterly Report on Form 10-Q ("Form 10-Q") contain forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, that involve risks and uncertainties.

Forward-looking statements provide current expectations of future events based on certain assumptions and include any statement that does not directly relate to any historical or current fact. Forward-looking statements can also be identified by words such as "future," "anticipates," "believes," "estimates," "expects," "intends," "plans," "predicts," "will," "could," "can," "may," and similar terms. Forward-looking statements are not guarantees of future performance and the Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in Part II, Item 1A of this Form 10-Q under the heading "Risk Factors," which are incorporated herein by reference. The following discussion should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended September 29, 2018 (the "2018 Form 10-K") filed with the U.S. Securities and Exchange Commission (the "SEC") and the condensed consolidated financial statements and notes thereto included in Part I, Item 1 of this Form 10-Q. All information presented herein is based on the Company's fiscal calendar. Unless otherwise stated, references to particular years, quarters, months or periods refer to the Company's fiscal years ended in September and the associated quarters, months and periods of those fiscal years. Each of the terms the "Company" and "Apple" as used herein refers collectively to Apple Inc. and its wholly-owned subsidiaries, unless otherwise stated. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Available Information

The Company's Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), are filed with the SEC. The Company is subject to the informational requirements of the Exchange Act and files or furnishes reports, proxy statements and other information with the SEC. Such reports and other information filed by the Company with the SEC are available free of charge at investor.apple.com/investor-relations/sec-filings/default.aspx when such reports are available on the SEC's website. The SEC maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at www.sec.gov. The Company periodically provides other information for investors on its corporate website, www.apple.com, and its investor relations website, investor.apple.com. This includes press releases and other information about financial performance, information on corporate governance and details related to the Company's annual meeting of shareholders. The information contained on the websites referenced in this Form 10-Q is not incorporated by reference into this filing. Further, the Company's references to website URLs are intended to be inactive textual references only.

Overview and Highlights

The Company designs, manufactures and markets mobile communication and media devices and personal computers, and sells a variety of related software, services, accessories and third-party digital content and applications. The Company's products and services include iPhone, Mac, iPad, Apple Watch, AirPods, Apple TV, HomePod, a portfolio of consumer and professional software applications, iOS, macOS, watchOS and tvOS operating systems, iCloud, Apple Pay and a variety of accessory, service and support offerings. The Company sells and delivers digital content and applications through the iTunes Store, App Store, Mac App Store, TV App Store, Book Store and Apple Music (collectively "Digital Content and Services"). The Company sells its products worldwide through its retail stores, online stores and direct sales force, as well as through third-party cellular network carriers, wholesalers, retailers and resellers. In addition, the Company sells a variety of third-party Apple-compatible products, including application software and various accessories, through its retail and online stores. The Company sells to consumers, small and mid-sized businesses and education, enterprise and government customers.

Business Strategy

The Company is committed to bringing the best user experience to its customers through its innovative hardware, software and services. The Company's business strategy leverages its unique ability to design and develop its own operating systems, hardware, application software and services to provide its customers products and solutions with innovative design, superior ease-of-use and seamless integration. As part of its strategy, the Company continues to expand its platform for the discovery and delivery of digital content and applications through its Digital Content and

Services, which allows customers to discover and download or stream digital content, iOS, Mac, Apple Watch and Apple TV applications, and books through either a Mac or Windows personal computer or through iPhone, iPad and iPod touch devices, Apple TV, Apple Watch and HomePod. The Company also supports a community for the development of third-party software and hardware products and digital content that complement the Company's offerings. The Company believes a high-quality buying experience with knowledgeable salespersons who can convey the value of the Company's products and services greatly enhances its ability to attract and retain customers. Therefore, the Company's strategy also includes building and expanding its own retail and online stores and its third-party distribution network to effectively reach more customers and provide them with a high-quality sales and post-sales support experience. The Company believes ongoing investment in research and development ("R&D"), marketing and advertising is critical to the development and sale of innovative products, services and technologies.

Business Seasonality and Product Introductions

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

First Quarter Fiscal 2019 Highlights

Total net sales decreased 5% or \$4.0 billion during the first quarter of 2019 compared to the same quarter in 2018, driven by lower iPhone net sales, partially offset primarily by higher Wearables, Home and Accessories and Services net sales. The weakness in foreign currencies relative to the U.S. dollar had an unfavorable impact on net sales during the first quarter of 2019.

The Company began shipping iPhone XR in October 2018. During the first quarter of 2019, the Company introduced two new versions of iPad Pro® as well as a new Apple Pencil® and Smart Keyboard Folio™, all of which began shipping in November 2018. The Company also introduced a new version of MacBook Air® and a new Mac mini®, both of which began shipping in November 2018.

The Company repurchased \$8.2 billion of its common stock and paid dividends and dividend equivalents of \$3.6 billion during the first quarter of 2019.

Products and Services Performance

Beginning in the first quarter of 2019, the Company classified the amortization of the deferred value of Maps, Siri and free iCloud services, which are bundled in the sales price of iPhone, Mac, iPad and certain other products, in Services net sales. Historically, the Company classified the amortization of these amounts in Products net sales consistent with its management reporting framework. As a result, Products and Services net sales information for the first quarter of 2018 was reclassified to conform to the 2019 presentation.

The following table shows net sales by category for the three months ended December 29, 2018 and December 30, 2017 (dollars in millions):

	Three Months Ended		Change
	December 29, 2018	December 30, 2017	
Net sales by category:			
iPhone ⁽¹⁾	\$51,982	\$ 61,104	(15)%
Mac ⁽¹⁾	7,416	6,824	9 %
iPad ⁽¹⁾	6,729	5,755	17 %
Wearables, Home and Accessories ⁽¹⁾⁽²⁾	7,308	5,481	33 %
Services ⁽³⁾	10,875	9,129	19 %
Total net sales	\$84,310	\$ 88,293	(5)%

(1) Products net sales include amortization of the deferred value of unspecified software upgrade rights, which are bundled in the sales price of the respective product.

(2) Wearables, Home and Accessories net sales include sales of AirPods, Apple TV, Apple Watch, Beats products, HomePod, iPod touch and Apple-branded and third-party accessories.

(3) Services net sales include sales from Digital Content and Services, AppleCare, Apple Pay, licensing and other services. Services net sales also include amortization of the deferred value of Maps, Siri and free iCloud services, which are bundled in the sales price of certain products.

iPhone

iPhone net sales decreased during the first quarter of 2019 compared to the same quarter in 2018 due to lower iPhone unit sales in all the reportable geographic segments.

Mac

Mac net sales increased during the first quarter of 2019 compared to the same quarter in 2018 due primarily to higher net sales of MacBook Air.

iPad

iPad net sales increased during the first quarter of 2019 compared to the same quarter in 2018 due primarily to higher net sales of iPad Pro.

Wearables, Home and Accessories

Wearables, Home and Accessories net sales increased during the first quarter of 2019 compared to the same quarter in 2018 due primarily to higher net sales of Apple Watch and AirPods.

Services

Services net sales increased during the first quarter of 2019 compared to the same quarter in 2018 due primarily to licensing, the App Store and AppleCare.

Segment Operating Performance

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

The following table shows net sales by reportable segment for the three months ended December 29, 2018 and December 30, 2017 (dollars in millions):

	Three Months Ended		Change
	December 29, 2018	December 30, 2017	
Net sales by reportable segment:			
Americas	\$36,940	\$ 35,193	5 %
Europe	20,363	21,054	(3)%
Greater China	13,169	17,956	(27)%
Japan	6,910	7,237	(5)%
Rest of Asia Pacific	6,928	6,853	1 %
Total net sales	\$84,310	\$ 88,293	(5)%

Americas

Americas net sales increased during the first quarter of 2019 compared to the same quarter in 2018 due primarily to higher Wearables, Home and Accessories and Services net sales, partially offset by lower iPhone net sales. The weakness in foreign currencies relative to the U.S. dollar had an unfavorable impact on Americas net sales during the first quarter of 2019.

Europe

Europe net sales decreased during the first quarter of 2019 compared to the same quarter in 2018 due primarily to lower iPhone net sales, partially offset by higher Wearables, Home and Accessories and Services net sales. The weakness in foreign currencies relative to the U.S. dollar had an unfavorable impact on Europe net sales during the first quarter of 2019.

Greater China

Greater China net sales decreased during the first quarter of 2019 compared to the same quarter in 2018 due primarily to lower iPhone net sales.

Japan

Japan net sales decreased during the first quarter of 2019 compared to the same quarter in 2018 due primarily to lower iPhone net sales, partially offset by higher Services and iPad net sales.

Rest of Asia Pacific

Rest of Asia Pacific net sales during the first quarter of 2019 were generally flat compared to the same quarter in 2018, as higher Wearables, Home and Accessories and Services net sales were offset by lower iPhone net sales. The weakness in foreign currencies relative to the U.S. dollar had an unfavorable impact on Rest of Asia Pacific net sales during the first quarter of 2019.

Gross Margin

Products and services gross margin and gross margin percentage for the three months ended December 29, 2018 and December 30, 2017 were as follows (dollars in millions):

	Three Months Ended	
	December 29, 2018	December 30, 2017
Gross margin:		
Products	\$25,197	\$ 28,589
Services	6,834	5,323
Total gross margin	\$32,031	\$ 33,912

Gross margin percentage:

Products	34.3	%	36.1	%
Services	62.8	%	58.3	%
Total gross margin percentage	38.0	%	38.4	%

Products Gross Margin

Products gross margin decreased during the first quarter of 2019 compared to the same quarter in 2018 due primarily to lower iPhone unit sales and the weakness in foreign currencies relative to the U.S. dollar, partially offset by higher net sales of Mac, iPad and Wearables. Year-over-year products gross margin percentage decreased during the first quarter of 2019 due primarily to a different product mix and the impact of lower iPhone unit sales on the Company's products fixed cost structure.

Services Gross Margin

Services gross margin increased during the first quarter of 2019 compared to the same quarter in 2018 due primarily to a different services mix. Year-over-year services gross margin percentage increased during the first quarter of 2019 due primarily to a favorable mix of services with higher margins and the impact of higher services net sales on the Company's services fixed cost structure.

The Company anticipates total gross margin percentage during the second quarter of 2019 to be between 37.0% and 38.0%. The foregoing statement regarding the Company's expected total gross margin percentage in the second quarter of 2019 is forward-looking and could differ from actual results. The Company's future gross margins can be impacted by multiple factors including, but not limited to, those set forth in Part II, Item 1A of this Form 10-Q under the heading "Risk Factors" and those described in this paragraph. In general, the Company believes gross margins will be subject to volatility and remain under downward pressure due to a variety of factors, including: continued industry-wide global product pricing pressures and product pricing actions that the Company may take in response to such pressures; increased competition; the Company's ability to effectively stimulate demand for certain of its products; compressed product life cycles; potential increases in the cost of components and outside manufacturing services; the Company's ability to manage product quality and warranty costs effectively; shifts in the mix of products and services, or in the geographic, currency or channel mix; fluctuations in exchange rates; and costs associated with the Company's frequent introductions and transitions of products and services.

Operating Expenses

Operating expenses for the three months ended December 29, 2018 and December 30, 2017 were as follows (dollars in millions):

	Three Months Ended		
	December 29, 2018	December 30, 2017	Change
Research and development	\$3,902	\$ 3,407	
Percentage of total net sales	5	% 4	%
Selling, general and administrative	\$4,783	\$ 4,231	
Percentage of total net sales	6	% 5	%
Total operating expenses	\$8,685	\$ 7,638	
Percentage of total net sales	10	% 9	%

Research and Development

The growth in R&D expense during the first quarter of 2019 compared to the same quarter in 2018 was driven primarily by increases in headcount-related expenses and infrastructure-related costs. The Company continues to believe that focused investments in R&D are critical to its future growth and competitive position in the marketplace, and to the development of new and updated products and services that are central to the Company's core business strategy.

Selling, General and Administrative

The growth in selling, general and administrative expense during the first quarter of 2019 compared to the same quarter in 2018 was driven primarily by increases in professional fees and headcount-related expenses.

Other Income/(Expense), Net

Other income/(expense), net for the three months ended December 29, 2018 and December 30, 2017 was as follows (dollars in millions):

	Three Months Ended		
	December 29, 2018	December 30, 2017	Change
Interest and dividend income	\$1,307	\$ 1,452	
Interest expense	(890)	(734)	
Other income, net	143	38	
Total other income/(expense), net	\$560	\$ 756	(26)%

The decrease in other income/(expense), net during the first quarter of 2019 compared to the same quarter in 2018 was due primarily to higher interest expense on debt, lower interest income and lower investment-related gains, partially offset by the impact of foreign exchange-related items. The weighted-average interest rate earned by the Company on its cash, cash equivalents and marketable securities was 2.19% and 2.11% in the first quarter of 2019 and 2018, respectively.

Provision for Income Taxes

Provision for income taxes, effective tax rate and statutory federal income tax rate for the three months ended December 29, 2018 and December 30, 2017 were as follows (dollars in millions):

	Three Months Ended			
	December 29, 2018		December 30, 2017	
Provision for income taxes	\$3,941		\$ 6,965	
Effective tax rate	16.5	%	25.8	%
Statutory federal income tax rate	21	%	24.5	%

The Company's effective tax rate for the first quarter of 2019 was lower than the statutory federal income tax rate of 21% due primarily to the lower tax rate on foreign earnings and tax benefits from share-based compensation.

The Company's effective tax rate for the first quarter of 2019 was lower compared to the same quarter in 2018 due to higher taxes in 2018 as a result of the Tax Cuts and Jobs Act (the "Act") and a lower statutory federal income tax rate in 2019, partially offset by higher taxes on foreign earnings in 2019.

Recent Accounting Pronouncements

Hedging

In August 2017, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities ("ASU 2017-12"). ASU 2017-12 expands component and fair value hedging, specifies the presentation of the effects of hedging instruments, and eliminates the separate measurement and presentation of hedge ineffectiveness. The Company will adopt ASU 2017-12 in its first quarter of 2020 utilizing the modified retrospective transition method and is currently evaluating the impact of adoption on its consolidated financial statements.

Financial Instruments

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("ASU 2016-13"), which modifies the measurement of expected credit losses on certain financial instruments. The Company will adopt ASU 2016-13 in its first quarter of 2021 utilizing the modified retrospective transition method. Based on the composition of the Company's investment portfolio, current market conditions, and historical credit loss activity, the adoption of ASU 2016-13 is not expected to have a material impact on its consolidated financial statements.

Leases

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) ("ASU 2016-02"), which modifies lease accounting for lessees to increase transparency and comparability by recording lease assets and liabilities for operating leases and disclosing key information about leasing arrangements. The Company will adopt ASU 2016-02 utilizing the modified retrospective transition method through a cumulative-effect adjustment at the beginning of its first quarter of 2020. While the Company is currently evaluating the impact of adopting ASU 2016-02, based on the lease portfolio as of December 29, 2018, the Company anticipates recording lease assets and liabilities of approximately \$9.1 billion on its Condensed Consolidated Balance Sheets, with no material impact to its Condensed Consolidated Statements of Operations. However, the ultimate impact of adopting ASU 2016-02 will depend on the Company's lease portfolio as of the adoption date.

Liquidity and Capital Resources

The following tables present selected financial information and statistics as of December 29, 2018 and September 29, 2018 and for the first three months of 2019 and 2018 (in millions):

	December 29, September 29, 2018 2018	
Cash, cash equivalents and marketable securities ⁽¹⁾	\$ 245,035	\$ 237,100
Property, plant and equipment, net	\$ 39,597	\$ 41,304
Commercial paper	\$ 11,969	\$ 11,964
Total term debt	\$ 102,761	\$ 102,519
Working capital	\$ 32,545	\$ 15,410
	Three Months Ended December 29, December 30, 2018 2017	
Cash generated by operating activities	\$26,690	\$ 28,293
Cash generated by/(used in) investing activities	\$5,844	\$ (13,590)
Cash used in financing activities	\$(13,676)	\$ (7,501)

(1) As of December 29, 2018 and September 29, 2018, total cash, cash equivalents and marketable securities included \$19.9 billion and \$20.3 billion, respectively, that was restricted from general use, related to the State Aid Decision (refer to Note 5, "Income Taxes" in the Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of this Form 10-Q) and other agreements.

The Company believes its existing balances of cash, cash equivalents and marketable securities, along with commercial paper and other short-term liquidity arrangements, will be sufficient to satisfy its working capital needs, capital asset purchases, dividends, share repurchases, debt repayments and other liquidity requirements associated with its existing operations over the next 12 months.

In connection with the State Aid Decision, as of December 29, 2018, the entire recovery amount of €13.1 billion plus interest of €1.2 billion was funded into escrow, where it will remain restricted from general use pending conclusion of all appeals.

The Company's marketable securities investment portfolio is primarily invested in highly rated securities, with the primary objective of minimizing the potential risk of principal loss. The Company's investment policy generally requires securities to be investment grade and limits the amount of credit exposure to any one issuer.

During the three months ended December 29, 2018, cash generated by operating activities of \$26.7 billion was a result of \$20.0 billion of net income, non-cash adjustments to net income of \$5.0 billion and an increase in the net change in operating assets and liabilities of \$1.8 billion. Cash generated by investing activities of \$5.8 billion during the three months ended December 29, 2018 consisted primarily of proceeds from maturities and sales of marketable securities, net of purchases, of \$9.8 billion, partially offset by cash used to acquire property, plant and equipment of \$3.4 billion. Cash used in financing activities of \$13.7 billion during the three months ended December 29, 2018 consisted primarily of cash used to repurchase common stock of \$8.8 billion and cash used to pay dividends and dividend equivalents of \$3.6 billion.

During the three months ended December 30, 2017, cash generated by operating activities of \$28.3 billion was a result of \$20.1 billion of net income and an increase in the net change in operating assets and liabilities of \$37.9 billion, partially offset by non-cash adjustments to net income of \$29.7 billion. Cash used in investing activities of \$13.6 billion during the three months ended December 30, 2017 consisted primarily of cash used for purchases of marketable securities, net of sales and maturities, of \$10.4 billion and cash used to acquire property, plant and equipment of \$2.8 billion. Cash used in financing activities of \$7.5 billion during the three months ended December 30, 2017 consisted primarily of cash used to repurchase common stock of \$10.1 billion and cash used to pay dividends and dividend equivalents of \$3.3 billion, partially offset by proceeds from the issuance of term debt, net of \$7.0 billion.

Capital Assets

The Company's capital expenditures were \$1.5 billion during the first three months of 2019. The Company anticipates utilizing approximately \$12.0 billion for capital expenditures during 2019, which includes product tooling and

manufacturing process equipment; data centers; corporate facilities and infrastructure, including information systems hardware, software and enhancements; and retail store facilities.

Debt

The Company issues unsecured short-term promissory notes (“Commercial Paper”) pursuant to a commercial paper program. The Company uses the net proceeds from the commercial paper program for general corporate purposes, including dividends and share repurchases. As of December 29, 2018, the Company had \$12.0 billion of Commercial Paper outstanding, with a weighted-average interest rate of 2.39% and maturities generally less than nine months. As of December 29, 2018, the Company had outstanding floating- and fixed-rate notes with varying maturities for an aggregate principal amount of \$103.8 billion (collectively the “Notes”). The Company has entered, and in the future may enter, into interest rate swaps to manage interest rate risk on the Notes. In addition, the Company has entered, and in the future may enter, into foreign currency swaps to manage foreign currency risk on the Notes. Further information regarding the Company’s debt issuances and related hedging activity can be found in Part I, Item 1 of this Form 10-Q in the Notes to Condensed Consolidated Financial Statements in Note 3, “Financial Instruments” and Note 6, “Debt.”

Capital Return Program

On May 1, 2018, the Company announced the Board of Directors had authorized a program to repurchase up to \$100 billion of the Company’s common stock, of which \$37.3 billion had been utilized as of December 29, 2018. During the three months ended December 29, 2018, the Company repurchased 38.0 million shares of its common stock for \$8.2 billion. The Company’s share repurchase program does not obligate it to acquire any specific number of shares. Under this program, shares may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 under the Exchange Act.

On May 1, 2018, the Company also announced the Board of Directors raised the Company’s quarterly cash dividend from \$0.63 to \$0.73 per share, beginning with the dividend paid during the third quarter of 2018. The Company intends to increase its dividend on an annual basis, subject to declaration by the Board of Directors.

Contractual Obligations

Operating Leases

As of December 29, 2018, the Company’s total future minimum lease payments under noncancelable operating leases were \$9.9 billion. The Company’s retail store and other facility leases typically have original terms not exceeding 10 years and generally contain multi-year renewal options.

Manufacturing Purchase Obligations

The Company utilizes several outsourcing partners to manufacture sub-assemblies for the Company’s products and to perform final assembly and testing of finished products. These outsourcing partners acquire components and build product based on demand information supplied by the Company, which typically covers periods up to 150 days. The Company also obtains individual components for its products from a wide variety of individual suppliers. As of December 29, 2018, the Company expects to pay \$30.2 billion under manufacturing-related supplier arrangements, which are primarily noncancelable.

Other Purchase Obligations

The Company’s other purchase obligations consist of noncancelable obligations to acquire capital assets, including product tooling and manufacturing process equipment, and noncancelable obligations related to advertising, licensing, R&D, internet and telecommunications services, content creation and other activities. As of December 29, 2018, the Company had other purchase obligations of \$6.3 billion.

Other Non-Current Liabilities

As of December 29, 2018, a significant portion of the other non-current liabilities in the Company’s Condensed Consolidated Balance Sheet consisted of the \$30.9 billion deemed repatriation tax payable imposed by the Act. The Company plans to pay the deemed repatriation tax payable in installments in accordance with the Act. The Company’s remaining other non-current liabilities primarily consist of items for which the Company is unable to make a reasonably reliable estimate of the timing of payments.

Indemnification

Agreements entered into by the Company may include indemnification provisions, which may subject the Company to costs and damages in the event of a claim against an indemnified third party. Except as disclosed in Part I, Item 1 of this Form 10-Q in the Notes to Condensed Consolidated Financial Statements in Note 10, “Commitments and Contingencies” under the heading “Contingencies,” 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 indemnification of third parties.

The Company offers an iPhone Upgrade Program, which is available to customers who purchase a qualifying iPhone in the U.S., the U.K. and mainland China. The iPhone Upgrade Program provides customers the right to trade in that iPhone for a specified amount when purchasing a new iPhone, provided certain conditions are met. The Company accounts for the trade-in right as a guarantee liability and recognizes arrangement revenue net of the fair value of such right, with subsequent changes to the guarantee liability recognized within net sales.

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 of the Company, 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. While the Company maintains directors and officers liability insurance coverage, such insurance coverage may be insufficient to cover all losses or all types of claims that may arise.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles and the Company’s discussion and analysis of its financial condition and operating results require the Company’s management to make judgments, assumptions and estimates that affect the amounts reported. Management bases its estimates on historical experience and on various other assumptions it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates, and such differences may be material.

Note 1, “Summary of Significant Accounting Policies” in Part I, Item 1 of this Form 10-Q and in the Notes to Consolidated Financial Statements in Part II, Item 8 of the 2018 Form 10-K, and “Critical Accounting Policies and Estimates” in Part II, Item 7 of the 2018 Form 10-K describe the significant accounting policies and methods used in the preparation of the Company’s condensed consolidated financial statements. With the exception of Revenue Recognition and Impairment of Marketable Debt Securities, there have been no material changes to the Company’s critical accounting policies and estimates since the 2018 Form 10-K.

Revenue Recognition

The Company has identified up to three performance obligations regularly included in arrangements involving the sale of iPhone, Mac, iPad and certain other products. The first performance obligation, which represents the substantial portion of the allocated sales price, is the hardware and bundled software delivered at the time of sale. The second performance obligation is the right to receive certain product-related bundled services, which include iCloud, Siri and Maps. The third performance obligation is the right to receive, on a when-and-if-available basis, future unspecified software upgrades relating to the software bundled with each device. The Company allocates revenue and any related discounts to these performance obligations based on their relative stand-alone selling prices (“SSP”). Because the Company lacks observable prices for the undelivered performance obligations, the allocation of revenue is based on the Company’s estimated SSPs. Revenue allocated to the product-related bundled services and unspecified software upgrade rights is deferred and recognized on a straight-line basis over the estimated period they are expected to be provided.

The Company’s process for determining estimated SSPs involves management’s judgment and considers multiple factors that may vary over time depending upon the unique facts and circumstances related to each deliverable. Should future facts and circumstances change, the Company’s SSPs and the future rate of related amortization for unspecified software upgrades and services related to future sales of these devices could change. Factors subject to change include

the nature of the unspecified software upgrade rights and product-related bundled services offered, their estimated value and the estimated period they are expected to be provided.

Impairment of Marketable Debt Securities

The Company's investments in marketable debt securities are classified as available-for-sale and reported at fair value. 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 determination, 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 will more likely than not be required to sell, the security before recovery of its amortized cost basis. The Company's assessment of whether an available-for-sale debt security is other-than-temporarily impaired could change in the future due to new developments or changes in assumptions related to any particular security, which would have an adverse impact on the Company's financial condition and operating results.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes to the Company's market risk during the first three months of 2019. For a discussion of the Company's exposure to market risk, refer to the Company's market risk disclosures set forth in Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk" of the 2018 Form 10-K.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on an evaluation under the supervision and with the participation of the Company's management, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act were effective as of December 29, 2018 to provide reasonable assurance that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms and (ii) accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the first quarter of 2019, which were identified in connection with management's evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

The Company is subject to legal proceedings and claims that have not been fully resolved and that have arisen in the ordinary course of business. Except as described in Part I, Item 1 of this Form 10-Q in the Notes to Condensed Consolidated Financial Statements in Note 10, “Commitments and Contingencies” under the heading “Contingencies,” in the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies for asserted legal and other claims.

The outcome of litigation is inherently uncertain. If one or more legal matters were resolved against the Company in a reporting period for amounts in excess of management’s expectations, the Company’s financial condition and operating results for that reporting period could be materially adversely affected. Refer to the risk factor “The Company could be impacted by unfavorable results of legal proceedings, such as being found to have infringed on intellectual property rights” in Part II, Item 1A of this Form 10-Q under the heading “Risk Factors.” The Company settled certain matters during the first quarter of 2019 that did not individually or in the aggregate have a material impact on the Company’s financial condition or operating results.

Item 1A. Risk Factors

The following description of risk factors includes any material changes to, and supersedes the description of, risk factors associated with the Company’s business previously disclosed in Part I, Item 1A of the 2018 Form 10-K under the heading “Risk Factors.” The business, financial condition and operating results of the Company can be affected by a number of factors, whether currently known or unknown, including but not limited to those described below, any one or more of which could, directly or indirectly, cause the Company’s actual financial condition and operating results to vary materially from past, or from anticipated future, financial