

APPLE INC
Form 10-Q
January 28, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 28, 2013

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____.

Commission file number: 000-10030

APPLE INC.

(Exact name of Registrant as specified in its charter)

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California
(State or other jurisdiction)

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

of incorporation or organization)

1 Infinite Loop

Cupertino, California
(Address of principal executive offices)

95014
(Zip Code)

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

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

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

Yes No

891,989,000 shares of common stock issued and outstanding as of January 10, 2014

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Apple Inc.

Form 10-Q

For the Fiscal Quarter Ended December 28, 2013

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

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

| | Three Months Ended | |
|--|------------------------------|------------------------------|
| | December 28, 2013 | December 29, 2012 |
| Net sales | \$ 57,594 | \$ 54,512 |
| Cost of sales | 35,748 | 33,452 |
| Gross margin | 21,846 | 21,060 |
| Operating expenses: | | |
| Research and development | 1,330 | 1,010 |
| Selling, general and administrative | 3,053 | 2,840 |
| Total operating expenses | 4,383 | 3,850 |
| Operating income | 17,463 | 17,210 |
| Other income/(expense), net | 246 | 462 |
| Income before provision for income taxes | 17,709 | 17,672 |
| Provision for income taxes | 4,637 | 4,594 |
| Net income | \$ 13,072 | \$ 13,078 |
| Earnings per share: | | |
| Basic | \$ 14.59 | \$ 13.93 |
| Diluted | \$ 14.50 | \$ 13.81 |
| Shares used in computing earnings per share: | | |
| Basic | 896,072 | 938,916 |
| Diluted | 901,452 | 947,217 |
| Cash dividends declared per common share | \$ 3.05 | \$ 2.65 |

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents**APPLE INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)**

(In millions)

| | Three Months Ended | |
|---|------------------------------|------------------------------|
| | December 28, 2013 | December 29, 2012 |
| Net income | \$ 13,072 | \$ 13,078 |
| Other comprehensive income/(loss): | | |
| Change in foreign currency translation, net of tax | (67) | (26) |
| Change in unrecognized gains/losses on derivative instruments: | | |
| Change in fair value of derivatives, net of tax | 213 | 146 |
| Adjustment for net (gains)/losses realized and included in net income, net of tax | 72 | 112 |
| Total change in unrecognized gains/losses on derivative instruments, net of tax | 285 | 258 |
| Change in unrealized gains/losses on marketable securities: | | |
| Change in fair value of marketable securities, net of tax | (42) | (66) |
| Adjustment for net (gains)/losses realized and included in net income, net of tax | (11) | (53) |
| Total change in unrealized gains/losses on marketable securities, net of tax | (53) | (119) |
| Total other comprehensive income/(loss) | 165 | 113 |
| Total comprehensive income | \$ 13,237 | \$ 13,191 |

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents**APPLE INC.****CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)**

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

| | December 28, 2013 | September 28, 2013 |
|--|----------------------|-----------------------|
| ASSETS: | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 14,077 | \$ 14,259 |
| Short-term marketable securities | 26,634 | 26,287 |
| Accounts receivable, less allowances of \$94 and \$99, respectively | 14,200 | 13,102 |
| Inventories | 2,122 | 1,764 |
| Deferred tax assets | 3,742 | 3,453 |
| Vendor non-trade receivables | 10,998 | 7,539 |
| Other current assets | 8,574 | 6,882 |
| Total current assets | 80,347 | 73,286 |
| Long-term marketable securities | 118,131 | 106,215 |
| Property, plant and equipment, net | 15,488 | 16,597 |
| Goodwill | 2,022 | 1,577 |
| Acquired intangible assets, net | 4,105 | 4,179 |
| Other assets | 5,091 | 5,146 |
| Total assets | \$ 225,184 | \$ 207,000 |
| LIABILITIES AND SHAREHOLDERS EQUITY: | | |
| Current liabilities: | | |
| Accounts payable | \$ 29,588 | \$ 22,367 |
| Accrued expenses | 15,824 | 13,856 |
| Deferred revenue | 8,357 | 7,435 |
| Total current liabilities | 53,769 | 43,658 |
| Deferred revenue non-current | 3,071 | 2,625 |
| Long-term debt | 16,961 | 16,960 |
| Other non-current liabilities | 21,699 | 20,208 |
| Total liabilities | 95,500 | 83,451 |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Common stock, no par value; 1,800,000 shares authorized; 892,447 and 899,213 shares issued and outstanding, respectively | 20,559 | 19,764 |
| Retained earnings | 109,431 | 104,256 |
| Accumulated other comprehensive income/(loss) | (306) | (471) |
| Total shareholders' equity | 129,684 | 123,549 |

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| | | | | |
|--|----|---------|----|---------|
| Total liabilities and shareholders' equity | \$ | 225,184 | \$ | 207,000 |
|--|----|---------|----|---------|

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents**APPLE INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

(In millions)

| | Three Months Ended | |
|--|------------------------------|------------------------------|
| | December 28, 2013 | December 29, 2012 |
| Cash and cash equivalents, beginning of the period | \$ 14,259 | \$ 10,746 |
| Operating activities: | | |
| Net income | 13,072 | 13,078 |
| Adjustments to reconcile net income to cash generated by operating activities: | | |
| Depreciation and amortization | 2,144 | 1,588 |
| Share-based compensation expense | 681 | 545 |
| Deferred income tax expense | 1,253 | 1,179 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | (1,098) | (668) |
| Inventories | (358) | (664) |
| Vendor non-trade receivables | (3,459) | (2,174) |
| Other current and non-current assets | (319) | 413 |
| Accounts payable | 8,191 | 6,145 |
| Deferred revenue | 1,368 | 1,611 |
| Other current and non-current liabilities | 1,195 | 2,373 |
| Cash generated by operating activities | 22,670 | 23,426 |
| Investing activities: | | |
| Purchases of marketable securities | (48,397) | (37,192) |
| Proceeds from maturities of marketable securities | 5,556 | 3,460 |
| Proceeds from sales of marketable securities | 30,302 | 23,002 |
| Payments made in connection with business acquisitions, net | (525) | (284) |
| Payments for acquisition of property, plant and equipment | (1,985) | (2,317) |
| Payments for acquisition of intangible assets | (59) | (138) |
| Other | 5 | (52) |
| Cash used in investing activities | (15,103) | (13,521) |
| Financing activities: | | |
| Proceeds from issuance of common stock | 134 | 76 |
| Excess tax benefits from equity awards | 280 | 404 |
| Taxes paid related to net share settlement of equity awards | (365) | (534) |
| Dividends and dividend equivalents paid | (2,769) | (2,493) |
| Repurchase of common stock | (5,029) | (1,950) |
| Cash used in financing activities | (7,749) | (4,497) |
| Increase/(decrease) in cash and cash equivalents | (182) | 5,408 |
| Cash and cash equivalents, end of the period | \$ 14,077 | \$ 16,154 |

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Supplemental cash flow disclosure:

| | | | | |
|---------------------------------|----|-------|----|-------|
| Cash paid for income taxes, net | \$ | 3,387 | \$ | 1,890 |
| Cash paid for interest | \$ | 161 | \$ | 0 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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Apple Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 1 Summary of Significant Accounting Policies

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

Basis of Presentation and Preparation

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

These condensed consolidated financial statements and accompanying notes should be read in conjunction with the Company's annual consolidated financial statements and the notes thereto for the fiscal year ended September 28, 2013, included in its Annual Report on Form 10-K (the "2013 Form 10-K"). The Company's fiscal year is the 52 or 53-week period that ends on the last Saturday of September. An additional week is included in the first fiscal quarter approximately every six years to realign fiscal quarters with calendar quarters. The Company's fiscal years 2014 and 2013 each include 52 weeks. Unless otherwise stated, references to particular years, quarters or months refer to the Company's fiscal years ended in September and the associated quarters or months of those fiscal years.

During the first quarter of 2014, the Company adopted updated accounting standards that (i) required disclosure of additional information about the amounts reclassified out of Accumulated Other Comprehensive Income ("AOCI") by component and (ii) required gross and net disclosures about offsetting assets and liabilities. The adoption of these updated standards only impacted the disclosures in the Notes to the Condensed Consolidated Financial Statements; accordingly, the adoption had no impact on the Company's financial position or results of operations. The Company has provided these additional disclosures in this Form 10-Q in Note 8, "Comprehensive Income" and Note 2, "Financial Instruments", respectively.

Revenue Recognition

In 2013, the Company's combined best estimates of selling price ("ESPs") for the unspecified software upgrade rights and the rights to receive the non-software services included with its qualifying hardware devices ranged from \$5 to \$25. Beginning in the first quarter of 2014, the Company adjusted the combined ESPs for Mac from \$20 to \$40 to reflect additions to unspecified software upgrade rights related to expansion of bundled essential software.

Table of Contents**Earnings Per Share**

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

The following table shows the computation of basic and diluted earnings per share for the three months ended December 28, 2013 and December 29, 2012 (in thousands, except net income in millions and per share amounts):

| | Three Months Ended | |
|-------------------------------------|----------------------|----------------------|
| | December 28, 2013 | December 29, 2012 |
| Numerator: | | |
| Net income | \$ 13,072 | \$ 13,078 |
| Denominator: | | |
| Weighted-average shares outstanding | 896,072 | 938,916 |
| Effect of dilutive securities | 5,380 | 8,301 |
| Weighted-average diluted shares | 901,452 | 947,217 |
| Basic earnings per share | \$ 14.59 | \$ 13.93 |
| Diluted earnings per share | \$ 14.50 | \$ 13.81 |

Potentially dilutive securities representing 0.4 million and 3.7 million shares of common stock for the three months ended December 28, 2013 and December 29, 2012, respectively, were excluded from the computation of diluted earnings per common share because their effect would have been antidilutive.

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

The following tables show the Company's cash and available-for-sale securities' adjusted cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category recorded as cash and cash equivalents or short- or long-term marketable securities as of December 28, 2013 and September 28, 2013 (in millions):

| | December 28, 2013 | | | | | | |
|--------------------|-------------------|---------------------|----------------------|---------------|---------------------------------|--|---------------------------------------|
| | Adjusted Cost | Unrealized Gains | Unrealized Losses | Fair Value | Cash and Cash Equivalents | Short-Term Marketable Securities | Long-Term Marketable Securities |
| Cash | \$ 8,404 | \$ 0 | \$ 0 | \$ 8,404 | \$ 8,404 | \$ 0 | \$ 0 |
| Level 1 (a): | | | | | | | |
| Money market funds | 2,236 | 0 | 0 | 2,236 | 2,236 | 0 | 0 |
| Mutual funds | 4,045 | 0 | (248) | 3,797 | 0 | 3,797 | 0 |

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| | | | | | | | |
|---|------------|--------|----------|------------|-----------|-----------|------------|
| Subtotal | 6,281 | 0 | (248) | 6,033 | 2,236 | 3,797 | 0 |
| Level 2 (b): | | | | | | | |
| U.S. Treasury securities | 39,177 | 11 | (62) | 39,126 | 629 | 8,498 | 29,999 |
| U.S. agency securities | 16,087 | 7 | (37) | 16,057 | 1,016 | 3,854 | 11,187 |
| Non-U.S. government securities | 5,470 | 25 | (141) | 5,354 | 0 | 276 | 5,078 |
| Certificates of deposit and time deposits | 1,438 | 0 | 0 | 1,438 | 668 | 494 | 276 |
| Commercial paper | 2,212 | 0 | 0 | 2,212 | 1,122 | 991 | 99 |
| Corporate securities | 57,709 | 297 | (221) | 57,785 | 2 | 7,658 | 50,125 |
| Municipal securities | 6,246 | 49 | (13) | 6,282 | 0 | 1,021 | 5,261 |
| Mortgage- and asset-backed securities | 16,221 | 23 | (93) | 16,151 | 0 | 45 | 16,106 |
| Subtotal | 144,560 | 412 | (567) | 144,405 | 3,437 | 22,837 | 118,131 |
| Total | \$ 159,245 | \$ 412 | \$ (815) | \$ 158,842 | \$ 14,077 | \$ 26,634 | \$ 118,131 |

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| | September 28, 2013 | | | | | | | |
|---|--------------------|---------------------|----------------------|---------------|---------------------------------|--|---------------------------------------|--|
| | Adjusted Cost | Unrealized Gains | Unrealized Losses | Fair Value | Cash and Cash Equivalents | Short-Term Marketable Securities | Long-Term Marketable Securities | |
| Cash | \$ 8,705 | \$ 0 | \$ 0 | \$ 8,705 | \$ 8,705 | \$ 0 | \$ 0 | |
| Level 1 (a): | | | | | | | | |
| Money market funds | 1,793 | 0 | 0 | 1,793 | 1,793 | 0 | 0 | |
| Mutual funds | 3,999 | 0 | (197) | 3,802 | 0 | 3,802 | 0 | |
| Subtotal | 5,792 | 0 | (197) | 5,595 | 1,793 | 3,802 | 0 | |
| Level 2 (b): | | | | | | | | |
| U.S. Treasury securities | 27,642 | 24 | (47) | 27,619 | 431 | 7,554 | 19,634 | |
| U.S. agency securities | 16,878 | 12 | (52) | 16,838 | 177 | 3,412 | 13,249 | |
| Non-U.S. government securities | 5,545 | 35 | (137) | 5,443 | 50 | 313 | 5,080 | |
| Certificates of deposit and time deposits | 2,344 | 0 | 0 | 2,344 | 1,264 | 844 | 236 | |
| Commercial paper | 2,998 | 0 | 0 | 2,998 | 1,835 | 1,163 | 0 | |
| Corporate securities | 54,586 | 275 | (252) | 54,609 | 0 | 8,077 | 46,532 | |
| Municipal securities | 6,257 | 45 | (22) | 6,280 | 4 | 1,114 | 5,162 | |
| Mortgage- and asset-backed securities | 16,396 | 23 | (89) | 16,330 | 0 | 8 | 16,322 | |
| Subtotal | 132,646 | 414 | (599) | 132,461 | 3,761 | 22,485 | 106,215 | |
| Total | \$ 147,143 | \$ 414 | \$ (796) | \$ 146,761 | \$ 14,259 | \$ 26,287 | \$ 106,215 | |

- (a) The fair value of Level 1 securities is estimated based on quoted prices in active markets for identical assets or liabilities.
- (b) The fair value of Level 2 securities is estimated based on observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

The Company may sell certain of its marketable securities prior to their stated maturities for strategic reasons including, but not limited to, anticipation of credit deterioration and duration management. The net realized gains or losses recognized by the Company related to such sales were not significant during the three months ended December 28, 2013 and December 29, 2012. The maturities of the Company's long-term marketable securities generally range from one to five years.

As of December 28, 2013 and September 28, 2013, gross unrealized losses related to individual securities that had been in a continuous loss position for 12 months or longer were not significant.

As of December 28, 2013, the Company considers the declines in market value of its marketable securities investment portfolio to be temporary in nature and does not consider any of its investments other-than-temporarily impaired. The Company typically invests in highly-rated securities, and its investment policy generally limits the amount of credit exposure to any one issuer. The policy requires investments generally to be investment grade, with the primary objective of minimizing the potential risk of principal loss. Fair values were determined for each individual security in the investment portfolio. When evaluating an investment for other-than-temporary impairment the Company reviews factors such as the length of time and extent to which fair value has been below its cost basis, the financial condition of the issuer and any changes thereto, changes in market interest rates, and the Company's intent to sell, or whether it is more likely than not it will be required to sell the investment before recovery of the investment's cost basis. During the three months ended December 28, 2013 and December 29, 2012, the Company did not recognize any significant impairment charges.

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Derivative Financial Instruments

The Company uses derivatives to partially offset its business exposure to foreign currency and interest rate risk. The Company may enter into forward contracts, option contracts, swaps, or other derivative instruments to offset some of the risk on expected future cash flows, on net investments in certain foreign subsidiaries, and on certain existing assets and liabilities.

To help protect gross margins from fluctuations in foreign currency exchange rates, certain of the Company's subsidiaries whose functional currency is the U.S. dollar hedge a portion of forecasted foreign currency revenue. The Company's subsidiaries whose functional currency is not the U.S. dollar and who sell in local currencies may hedge a portion of forecasted inventory purchases not denominated in the subsidiaries functional currencies. The Company typically hedges portions of its forecasted foreign currency exposure associated with revenue and inventory purchases, typically for up to 12 months.

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

To help protect against adverse fluctuations in interest rates, the Company may enter into interest rate swaps, options, or other instruments to offset a portion of the changes in income or expense due to fluctuations in interest rates.

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

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

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 as a component of other income/(expense), net in the same period as the related income or expense is recognized. The Company's hedged foreign currency transactions and hedged interest rate transactions as of December 28, 2013 are expected to occur within 12 months and five years, respectively.

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Derivative instruments designated as cash flow hedges must be de-designated as hedges when it is probable the forecasted hedged transaction will not occur in the initially identified time period or within a subsequent two-month time period. Deferred gains and losses in AOCI associated with such derivative instruments are reclassified immediately into other income and expense. Any subsequent changes in fair value of such derivative instruments are reflected in other income and expense unless they are re-designated as hedges of other transactions. The Company did not recognize any significant net gains or losses related to the loss of hedge designation on discontinued cash flow hedges during the three months ended December 28, 2013 and December 29, 2012.

The Company's unrealized net gains and losses on net investment hedges, included in the cumulative translation adjustment account of AOCI, were not significant as of December 28, 2013 and September 28, 2013. The ineffective portions and amounts excluded from the effectiveness test of net investment hedges are recorded in other income and expense.

The gain/loss recognized in other income and expense for foreign currency forward and option contracts not designated as hedging instruments was not significant during the three months ended December 28, 2013 and December 29, 2012.

The following table shows the notional principal amounts of the Company's outstanding derivative instruments and credit risk amounts associated with outstanding or unsettled derivative instruments as of December 28, 2013 and September 28, 2013 (in millions):

| | December 28, 2013 | | September 28, 2013 | |
|--|-----------------------|------------------------|-----------------------|------------------------|
| | Notional Principal | Credit Risk Amounts | Notional Principal | Credit Risk Amounts |
| Instruments designated as accounting hedges: | | | | |
| Foreign exchange contracts | \$ 23,553 | \$ 331 | \$ 35,013 | \$ 159 |
| Interest rate contracts | \$ 3,000 | \$ 55 | \$ 3,000 | \$ 44 |
| Instruments not designated as accounting hedges: | | | | |
| Foreign exchange contracts | \$ 16,859 | \$ 48 | \$ 16,131 | \$ 25 |

The notional principal amounts for outstanding derivative instruments provide one measure of the transaction volume outstanding and do not represent the amount of the Company's exposure to credit or market loss. The credit risk amounts represent the Company's gross exposure to potential accounting loss on derivative instruments that are outstanding or unsettled if all counterparties failed to perform according to the terms of the contract, based on then-current currency or interest rates at each respective date. The Company's gross exposure on these transactions may be further mitigated by collateral received from certain counterparties. The Company's exposure to credit loss and market risk will vary over time as currency and interest rates change. Although the table above reflects the notional principal 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.

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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. As of December 28, 2013, the Company received \$165 million of cash collateral related to the derivative instruments under its collateral security arrangements, which were recorded as accrued expenses in the Condensed Consolidated Balance Sheet. As of September 28, 2013, the Company posted cash collateral related to the derivative instruments under its collateral security arrangements of \$164 million, which it recorded as other current assets in the Condensed Consolidated Balance Sheet. The Company did not have any derivative instruments with credit-risk related contingent features that would require it to post additional collateral as of December 28, 2013 or September 28, 2013.

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. However, the Company has elected to present the derivative assets and derivative liabilities on a gross basis in its Condensed Consolidated Balance Sheets. As of December 28, 2013 and September 28, 2013, 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 \$356 million and \$333 million, respectively, resulting in net derivative liabilities of \$66 million and \$57 million, respectively.

The following tables show the Company's derivative instruments at gross fair value as reflected in the Condensed Consolidated Balance Sheets as of December 28, 2013 and September 28, 2013 (in millions):

| | December 28, 2013 | | |
|-----------------------------|---|---|------------------------|
| | Fair Value of Derivatives Designated as Hedge Instruments | Fair Value of Derivatives Not Designated as Hedge Instruments | Total Fair Value |
| Derivative assets (a): | | | |
| Foreign exchange contracts | \$ 263 | \$ 48 | \$ 311 |
| Interest rate contracts | \$ 55 | \$ 0 | \$ 55 |
| Derivative liabilities (b): | | | |
| Foreign exchange contracts | \$ 231 | \$ 36 | \$ 267 |

| | September 28, 2013 | | |
|-----------------------------|---|---|------------------------|
| | Fair Value of Derivatives Designated as Hedge Instruments | Fair Value of Derivatives Not Designated as Hedge Instruments | Total Fair Value |
| Derivative assets (a): | | | |
| Foreign exchange contracts | \$ 145 | \$ 25 | \$ 170 |
| Interest rate contracts | \$ 44 | \$ 0 | \$ 44 |
| Derivative liabilities (b): | | | |
| Foreign exchange contracts | \$ 389 | \$ 46 | \$ 435 |

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

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

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The following table shows the pre-tax effect of the Company's derivative instruments designated as cash flow and net investment hedges in the Condensed Consolidated Statements of Operations for the three months ended December 28, 2013 and December 29, 2012 (in millions):

| | Three Months Ended | | | | | | |
|----------------------------|--|----------------------|--|----------------------|---|----------------------|----------------------|
| | Gains/(Losses) Recognized in OCI - Effective Portion | | Gains/(Losses) Reclassified from AOCI into Net Income - Effective Portion | | Gains/(Losses) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing Financial Statement | | |
| | December 28, 2013 | December 29, 2012 | December 28, 2013 | December 29, 2012 | Line Item | December 28, 2013 | December 29, 2012 |
| | | | | | | | |
| Cash flow hedges: | | | | | | | |
| Foreign exchange contracts | \$ 264 | \$ 205 | \$ (74) | \$ (159) | Other income/(expense), net | \$ (3) | \$ 9 |
| Interest rate contracts | 21 | 0 | (4) | 0 | Other income/(expense), net | 0 | 0 |
| Net investment hedges: | | | | | | | |
| Foreign exchange contracts | 24 | 36 | 0 | 0 | Other income/(expense), net | 1 | 0 |
| Total | \$ 309 | \$ 241 | \$ (78) | \$ (159) | | \$ (2) | \$ 9 |

Accounts Receivable

The Company has considerable trade receivables outstanding with its third-party cellular network carriers, wholesalers, retailers, value-added resellers, small and mid-sized businesses, and education, enterprise and government customers that are not covered by collateral, third-party financing arrangements or credit insurance. There were no customers that accounted for 10% or more of the Company's trade receivables as of December 28, 2013. As of September 28, 2013, the Company had two customers that represented 10% or more of total trade receivables, one of which accounted for 13% and the other 10%. The Company's cellular network carriers accounted for 48% and 68% of trade receivables as of December 28, 2013 and September 28, 2013, respectively.

Additionally, the Company has non-trade receivables from certain of its manufacturing vendors resulting from the sale of components to these manufacturing vendors who manufacture sub-assemblies or assemble final products for the Company. Vendor non-trade receivables from two of the Company's vendors accounted for 62% and 15% of total non-trade receivables as of December 28, 2013 and three of the Company's vendors accounted for 47%, 21% and 15% of total non-trade receivables as of September 28, 2013.

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

The following tables show the Company's condensed consolidated financial statement details as of December 28, 2013 and September 28, 2013 (in millions):

Inventories

| | December 28, 2013 | September 28, 2013 |
|--------------------------|-------------------|--------------------|
| Components | \$ 523 | \$ 683 |
| Finished goods | 1,599 | 1,081 |
| Total inventories | \$ 2,122 | \$ 1,764 |

Property, Plant and Equipment

| | December 28, 2013 | September 28, 2013 |
|--|-------------------|--------------------|
| Land and buildings | \$ 3,625 | \$ 3,309 |
| Machinery, equipment and internal-use software | 21,537 | 21,242 |
| Leasehold improvements | 4,126 | 3,968 |
| Gross property, plant and equipment | 29,288 | 28,519 |
| Accumulated depreciation and amortization | (13,800) | (11,922) |
| Net property, plant and equipment | \$ 15,488 | \$ 16,597 |

Accrued Expenses

| | December 28, 2013 | September 28, 2013 |
|--|-------------------|--------------------|
| Accrued warranty and related costs | \$ 3,980 | \$ 2,967 |
| Accrued taxes | 2,083 | 1,200 |
| Deferred margin on component sales | 1,475 | 1,262 |
| Accrued marketing and selling expenses | 1,143 | 1,291 |
| Accrued compensation and employee benefits | 1,002 | 959 |
| Other current liabilities | 6,141 | 6,177 |
| Total accrued expenses | \$ 15,824 | \$ 13,856 |

Non-Current Liabilities

| | December 28, 2013 | September 28, 2013 |
|--------------------------|-------------------|--------------------|
| Deferred tax liabilities | \$ 18,306 | \$ 16,489 |

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| | | | | |
|--|-----------|---------------|-----------|---------------|
| Other non-current liabilities | | 3,393 | | 3,719 |
| Total other non-current liabilities | \$ | 21,699 | \$ | 20,208 |

Other Income and Expense

The following table shows the detail of other income and expense for the three months ended December 28, 2013 and December 29, 2012 (in millions):

| | Three Months Ended | |
|--|---------------------------|--------------------------|
| | December 28, 2013 | December 29, 2012 |
| Interest and dividend income | \$ 427 | \$ 421 |
| Interest expense | (84) | 0 |
| Other expense, net | (97) | 41 |
| Total other income/(expense), net | \$ 246 | \$ 462 |

Table of Contents**Note 4 Goodwill and Other Intangible Assets**

The Company's acquired intangible assets with definite useful lives primarily consist of patents and licenses and are amortized over periods typically from three to seven years. The following table summarizes the components of gross and net intangible asset balances as of December 28, 2013 and September 28, 2013 (in millions):

| | December 28, 2013 | | | September 28, 2013 | | |
|---|-----------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Definite lived and amortizable acquired intangible assets | \$ 6,271 | \$ (2,266) | \$ 4,005 | \$ 6,081 | \$ (2,002) | \$ 4,079 |
| Indefinite lived and non-amortizable acquired intangible assets | 100 | 0 | 100 | 100 | 0 | 100 |
| Total acquired intangible assets | \$ 6,371 | \$ (2,266) | \$ 4,105 | \$ 6,181 | \$ (2,002) | \$ 4,179 |

During the first quarter of 2014, the Company completed various business acquisitions. The aggregate cash consideration paid, net of cash acquired, was \$525 million, of which \$440 million was allocated to goodwill, \$156 million to acquired intangible assets and \$71 million to net liabilities assumed.

Note 5 Income Taxes

As of December 28, 2013, the Company recorded gross unrecognized tax benefits of \$3.0 billion, of which \$1.5 billion, if recognized, would affect the Company's effective tax rate. As of September 28, 2013, the total amount of gross unrecognized tax benefits was \$2.7 billion, of which \$1.4 billion, if recognized, would affect the Company's effective tax rate. The Company's total gross unrecognized tax benefits are classified as other non-current liabilities in the Condensed Consolidated Balance Sheets. The Company had \$643 million and \$590 million of gross interest and penalties accrued as of December 28, 2013 and September 28, 2013, respectively, which are classified as other non-current liabilities in the Condensed Consolidated Balance Sheets.

Management believes that an adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs. Although timing of the resolution and/or closure of audits is not certain, the Company believes it is reasonably possible that tax audit resolutions could reduce its unrecognized tax benefits by between \$140 million and \$160 million in the next 12 months.

Table of Contents**Note 6 Long-Term Debt**

In May 2013, the Company issued floating- and fixed-rate notes with varying maturities for an aggregate principal amount of \$17.0 billion (collectively the Notes). The Notes are senior unsecured obligations, and interest is payable in arrears, quarterly for the floating-rate notes and semi-annually for the fixed-rate notes.

The principal amounts and associated effective interest rates of the Notes as of December 28, 2013, are as follows:

| | Amount (in millions) | Effective Interest Rate |
|---------------------------------|-------------------------|-------------------------------|
| Floating-rate notes, due 2016 | \$ 1,000 | 0.51% |
| Floating-rate notes, due 2018 | 2,000 | 1.10% |
| Fixed-rate 0.45% notes due 2016 | 1,500 | 0.51% |
| Fixed-rate 1.00% notes due 2018 | 4,000 | 1.08% |
| Fixed-rate 2.40% notes due 2023 | 5,500 | 2.44% |
| Fixed-rate 3.85% notes due 2043 | 3,000 | 3.91% |
| Total | \$ 17,000 | |

The floating-rate notes due 2016 and 2018 bear interest at the three-month London InterBank Offered Rate (LIBOR) plus 0.05% and 0.25%, respectively. To manage the risk of fluctuations in interest rates associated with the floating-rate notes, the Company entered into interest rate swaps with an aggregate notional amount of \$3.0 billion designated as cash flow hedges of its floating-rate notes. These hedges effectively convert the floating interest rate on the floating-rate notes to a fixed interest rate. The gains and losses related to changes in the fair value of the interest rate swaps are recorded in OCI with a portion reclassified to interest expense each period to offset changes in interest rates on the floating-rate notes. The effective rates for the Notes include the interest on the Notes, amortization of the discount and, if applicable, adjustments related to hedging. The Company recognized \$84 million of interest expense for the three months ended December 28, 2013. As of December 28, 2013, the aggregate unamortized discount for the Company's Notes was \$39 million.

Future principal payments for the Company's Notes as of December 28, 2013, are as follows (in millions):

| | |
|--------------|------------------|
| 2014 | \$ 0 |
| 2015 | 0 |
| 2016 | 2,500 |
| 2017 | 0 |
| 2018 | 6,000 |
| Thereafter | 8,500 |
| Total | \$ 17,000 |

As of December 28, 2013, the fair value of the Company's Notes, based on Level 2 inputs, was \$15.8 billion.

Table of Contents**Note 7 Shareholders Equity****Preferred Stock**

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

Dividend and Share Repurchase Program

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

| | Dividends Per Share | Amount (in millions) |
|----------------|--------------------------------|---------------------------------|
| 2014: | | |
| First quarter | \$ 3.05 | \$ 2,739 |
| 2013: | | |
| Fourth quarter | \$ 3.05 | \$ 2,763 |
| Third quarter | 3.05 | 2,789 |
| Second quarter | 2.65 | 2,490 |
| First quarter | 2.65 | 2,486 |
| | \$ 11.40 | \$ 10,528 |

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

In 2012, the Company's Board of Directors authorized a program to repurchase up to \$10 billion of the Company's common stock beginning in 2013. In April 2013, the Company's Board of Directors increased the share repurchase program authorization from \$10 billion to \$60 billion, of which \$28.0 billion had been utilized as of December 28, 2013. The Company's share repurchase program does not obligate it to acquire any specific number of shares. Under the program, shares may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended (the Exchange Act).

In August 2012, the Company entered into an accelerated share repurchase arrangement (ASR) with a financial institution to purchase up to \$1.95 billion of the Company's common stock in 2013. In the first quarter of 2013, 2.6 million shares were initially delivered to the Company. In April 2013, the purchase period for the ASR ended and an additional 1.5 million shares were delivered to the Company. In total, 4.1 million shares were delivered under the ASR at an average repurchase price of \$478.20 per share. The shares were retired in the quarters they were delivered, and the up-front payment of \$1.95 billion was accounted for as a reduction to shareholders' equity in the Company's Condensed Consolidated Balance Sheet in the first quarter of 2013.

In April 2013, the Company entered into a new ASR program with two financial institutions to purchase up to \$12 billion of the Company's common stock. In exchange for up-front payments totaling \$12 billion, the financial institutions committed to deliver shares during the ASR's purchase periods, which will end during 2014. The total number of shares ultimately delivered, and therefore the average price paid per share, will be determined at the end of the applicable purchase period based on the volume weighted-average price of the Company's stock during that period. During the third quarter of 2013, 23.5 million shares were initially delivered to the Company and retired. This does not represent the final number of shares to be delivered under the ASR. The up-front payments of \$12 billion were accounted for as a reduction to shareholders' equity in the Company's Condensed Consolidated Balance Sheet.

The Company reflected the ASRs as a repurchase of common stock for purposes of calculating earnings per share and as forward contracts indexed to its own common stock. The forward contracts met all of the applicable criteria for equity classification, and, therefore, were not accounted for as derivative instruments.

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During the three months ended December 28, 2013, the Company repurchased 9.5 million shares of its common stock in the open market at an average price of \$523.51 per share for a total of \$5.0 billion. These shares were retired upon repurchase.

Table of Contents**Note 8 Comprehensive Income**

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

The following table shows the gross amounts reclassified from AOCI into the Condensed Consolidated Statements of Operations and the associated financial statement line item, for the three months ended December 28, 2013:

| Comprehensive Income Components | Financial Statement Line Item | Amount (in millions) |
|--|-------------------------------|-------------------------|
| Unrecognized gains/losses on derivative instruments: | | |
| Foreign exchange contracts | Revenue | \$ 184 |
| | Cost of Sales | (110) |
| | Other income/expense, net | 10 |
| Interest rate contracts | Other income/expense, net | 4 |
| | | 88 |
| Unrealized gains/losses on marketable securities | Other income/expense, net | (17) |
| Total amounts reclassified from AOCI | | \$ 71 |

The following table shows the changes in AOCI by component for the three months ended December 28, 2013 (in millions):

| | Cumulative Foreign Currency Translation | Unrecognized Gains/Losses on Derivative Instruments | Unrealized Gains/Losses on Marketable Securities | Total |
|--|--|--|---|----------|
| September 28, 2013 | \$ (105) | \$ (175) | \$ (191) | \$ (471) |
| Other comprehensive income/(loss) before reclassifications | (90) | 261 | (68) | 103 |
| Amounts reclassified from AOCI | 0 | 88 | (17) | 71 |
| Tax effect | 23 | (64) | 32 | (9) |
| Other comprehensive income/(loss) | (67) | 285 | (53) | 165 |
| December 28, 2013 | \$ (172) | \$ 110 | \$ (244) | \$ (306) |

Note 9 Benefit Plans**Restricted Stock Units**

A summary of the Company's RSU activity and related information for the three months ended December 28, 2013, is as follows:

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| | Number of RSUs (in thousands) | Weighted- Average Grant Date Fair Value | Aggregate Intrinsic Value (in millions) |
|-------------------------------|-------------------------------------|--|--|
| Balance at September 28, 2013 | 13,326 | \$ 435.70 | |
| RSUs granted | 6,183 | \$ 491.93 | |
| RSUs vested | (2,256) | \$ 379.23 | |
| RSUs cancelled | (216) | \$ 461.35 | |
| Balance at December 28, 2013 | 17,037 | \$ 463.23 | \$ 9,543 |

RSUs that vested during the three months ended December 28, 2013 and December 29, 2012 had a fair value of \$1.1 billion and \$1.5 billion, respectively, as of the vesting date.

Table of Contents**Stock Options**

A summary of the Company's stock option activity and related information for the three months ended December 28, 2013, is as follows:

| | Number of Options (in thousands) | Weighted- Average Exercise Price | Outstanding Options Weighted- Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value (in millions) |
|--|--|---|---|--|
| Balance at September 28, 2013 | 4,094 | \$ 139.65 | | |
| Options granted | 1 | \$ 66.26 | | |
| Options exercised | (1,308) | \$ 102.86 | | |
| Balance at December 28, 2013 | 2,787 | \$ 156.89 | 1.2 | \$ 1,124 |
| Exercisable at December 28, 2013 | 2,768 | \$ 157.56 | 1.1 | \$ 1,114 |
| Expected to vest after December 28, 2013 | 19 | \$ 58.03 | 7.6 | \$ 10 |

Aggregate intrinsic value represents the value of the Company's closing stock price on the last trading day of the period in excess of the weighted-average exercise price multiplied by the number of options outstanding or exercisable. The total intrinsic value of options at the time of exercise was \$559 million and \$347 million for the three-months ended December 28, 2013 and December 29, 2012, respectively.

The Company had approximately 16.6 million shares reserved for future issuance under the Company's stock plans as of December 28, 2013. RSUs granted reduce the number of shares available for grant under the Company's stock plans utilizing a factor of two times the number of RSUs granted. Similarly, RSUs cancelled increase the number of shares available for grant under the Company's stock plans utilizing a factor of two times the number of RSUs cancelled. Stock options count against the number of shares available for grant on a one-for-one basis.

Share-based Compensation

Share-based compensation cost for RSUs is measured based on the closing fair market value of the Company's common stock on the date of grant. Share-based compensation cost for stock options and employee stock purchase plan rights (stock purchase rights) is measured at the grant date and offering date, respectively, based on the fair-value as calculated by the Black-Scholes-Merton (BSM) option-pricing model. The BSM option-pricing model incorporates various assumptions including expected volatility, estimated expected life and interest rates. The Company recognizes share-based compensation cost over the award's requisite service period on a straight-line basis for time-based RSUs and on a graded basis for RSUs that are contingent on the achievement of performance metrics.

The weighted-average fair value per stock option granted during the three months ended December 28, 2013 was \$333.26. The Company did not grant any stock options during the three months ended December 29, 2012. The weighted-average fair value of stock purchase rights per share was \$103.99 and \$136.84 during the three months ended December 28, 2013 and December 29, 2012, respectively.

In conjunction with certain business combinations, the Company assumed 29,000 stock options with a weighted-average fair value per share of \$407.80 during the three months ended December 29, 2012. The Company did not assume any stock options during the three months ended December 28, 2013.

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The following table shows a summary of the share-based compensation expense included in the Condensed Consolidated Statements of Operations for the three months ended December 28, 2013 and December 29, 2012 (in millions):

| | Three Months Ended | |
|--|----------------------|----------------------|
| | December 28, 2013 | December 29, 2012 |
| Cost of sales | \$ 109 | \$ 85 |
| Research and development | 289 | 224 |
| Selling, general and administrative | 283 | 236 |
| Total share-based compensation expense | \$ 681 | \$ 545 |

The income tax benefit related to share-based compensation expense was \$265 million and \$214 million for the three months ended December 28, 2013 and December 29, 2012, respectively. As of December 28, 2013, the total unrecognized compensation cost related to outstanding stock options and RSUs expected to vest was \$6.6 billion, which the Company expects to recognize over a weighted-average period of 3.2 years.

Stock Plans*Rule 10b5-1 Trading Plans*

During the three months ended December 28, 2013, executive officers Timothy D. Cook, Peter Oppenheimer, D. Bruce Sewell, Philip W. Schiller, Daniel Riccio and Jeffrey E. 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.

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 28, 2013 and December 29, 2012 (in millions):

| | Three Months Ended | |
|--|----------------------|----------------------|
| | December 28, 2013 | December 29, 2012 |
| Beginning accrued warranty and related costs | \$ 2,967 | \$ 1,638 |
| Cost of warranty claims | (1,064) | (686) |
| Accruals for product warranty | 2,077 | 1,358 |
| Ending accrued warranty and related costs | \$ 3,980 | \$ 2,310 |

The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against it or an indemnified third-party and, in the opinion of management, does not have a potential liability related to unresolved infringement claims subject to indemnification that would materially adversely affect its financial condition or operating results. Therefore, the Company did not record a liability for infringement costs related to indemnification as of either December 28, 2013 or September 28, 2013.

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

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Concentrations in the Available Sources of Supply of Materials and Product

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

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

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

Substantially all of the Company's hardware products are manufactured by outsourcing partners that are located primarily in Asia. A significant concentration of this manufacturing is currently performed by a small number of outsourcing partners, often in single locations. Certain of these outsourcing partners are the sole-sourced suppliers of components and manufacturers for many of the Company's products. Although the Company works closely with its outsourcing partners on manufacturing schedules, the Company's operating results could be adversely affected if its outsourcing partners were unable to meet their production commitments. The Company's purchase commitments typically cover its requirements for periods up to 150 days.

Other Off-Balance Sheet Commitments

The Company leases various equipment and facilities, including retail space, under noncancelable operating lease arrangements. The Company does not currently utilize any other off-balance sheet financing arrangements. The major facility leases are typically for terms not exceeding 10 years and generally provide renewal options for terms not exceeding five additional years. Leases for retail space are for terms ranging from five to 20 years, the majority of which are for 10 years, and often contain multi-year renewal options. As of December 28, 2013, the Company's total future minimum lease payments under noncancelable operating leases were \$4.7 billion, of which \$3.5 billion related to leases for retail space.

The Company utilizes several outsourcing partners to manufacture sub-assemblies for the Company's products and to perform final assembly and testing of finished products. These outsourcing partners acquire components and build product based on demand information supplied by the Company, which typically covers periods up to 150 days. The Company also obtains individual components for its products from a wide variety of individual suppliers. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. Where appropriate, the purchases are applied to inventory component prepayments that are outstanding with the respective supplier. As of December 28, 2013, the Company had outstanding off-balance sheet third-party manufacturing commitments and component purchase commitments of \$16.1 billion.

In addition to the commitments mentioned above, the Company had additional off-balance sheet obligations of \$1.5 billion as of December 28, 2013, which were comprised mainly of commitments to acquire capital assets, including product tooling and manufacturing process equipment, and commitments related to advertising, research and development, Internet and telecommunications services and other obligations.

Table of Contents**Contingencies**

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

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

On August 24, 2012, a jury returned a verdict awarding the Company \$1.05 billion in its lawsuit against Samsung Electronics Co., Ltd and affiliated parties in the United States District Court, Northern District of California, San Jose Division. The District Court upheld \$640 million of the jury's award and ordered a new trial as to the remainder. The retrial jury awarded an additional \$290 million, bringing the total verdict to \$930 million. Because the award is subject to entry of final judgment and appeal, the Company has not recognized the award in its results of operations.

VirnetX, Inc. v. Apple Inc. et al.

On August 11, 2010, VirnetX, Inc. filed an action against the Company alleging that certain of its products infringed on four patents relating to network communications technology. On November 6, 2012, a jury returned a verdict against the Company, and awarded damages of \$368 million. The Company is challenging the verdict, believes it has valid defenses and has not recorded a loss accrual at this time.

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 operating segments consist of the Americas, Europe, Greater China, Japan, Rest of Asia Pacific and Retail operations. The Americas segment includes both North and South America. The Europe segment includes European countries, as well as India, the Middle East and Africa. The Greater China segment includes China, Hong Kong and Taiwan. The Rest of Asia Pacific segment includes Australia and Asian countries, other than those countries included in the Company's other operating segments. The results of the Company's geographic segments do not include results of the Retail segment. Each operating segment provides similar hardware and software products and similar services. The accounting policies of the various segments are the same as those described in Note 1, "Summary of Significant Accounting Policies" of the Notes to Consolidated Financial Statements in Part II, Item 8 of the Company's 2013 Form 10-K.

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

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The following table shows information by operating segment for the three months ended December 28, 2013 and December 29, 2012 (in millions):

| | Three Months Ended | |
|------------------------------|----------------------|----------------------|
| | December 28, 2013 | December 29, 2012 |
| Americas: | | |
| Net sales | \$ 20,098 | \$ 20,341 |
| Operating income | \$ 7,266 | \$ 7,349 |
| Europe: | | |
| Net sales | \$ 13,073 | \$ 12,464 |
| Operating income | \$ 4,576 | \$ 4,409 |
| Greater China: | | |
| Net sales | \$ 8,844 | \$ 6,830 |
| Operating income | \$ 3,140 | \$ 2,544 |
| Japan: | | |
| Net sales | \$ 4,948 | \$ 4,443 |
| Operating income | \$ 2,379 | \$ 2,260 |
| Rest of Asia Pacific: | | |
| Net sales | \$ 3,633 | \$ 3,993 |
| Operating income | \$ 1,329 | \$ 1,335 |
| Retail: | | |
| Net sales | \$ 6,998 | \$ 6,441 |
| Operating income | \$ 1,744 | \$ 1,557 |

A reconciliation of the Company's segment operating income to the condensed consolidated financial statements for the three months ended December 28, 2013 and December 29, 2012 is as follows (in millions):

| | Three Months Ended | |
|----------------------------------|----------------------|----------------------|
| | December 28, 2013 | December 29, 2012 |
| Segment operating income | \$ 20,434 | \$ 19,454 |
| Share-based compensation expense | (681) | (545) |
| Other corporate expenses, net | (2,290) | (1,699) |
| Total operating income | \$ 17,463 | \$ 17,210 |

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

This section and other parts of this Form 10-Q contain forward-looking statements, 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 also can be identified by words such as future, anticipates, believes, estimates, expects, intends, plans, predicts, will, would, could, can, may, and similar terms. Forward-looking statements are not guarantees of future performance and the Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in Part II, Item 1A of this Form 10-Q under the heading Risk Factors, which are incorporated herein by reference. The following discussion should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended September 28, 2013 (the 2013 Form 10-K) filed with the U.S. Securities and Exchange Commission (the SEC) and the condensed consolidated financial statements and notes thereto included elsewhere in this Form 10-Q. All information presented herein is based on the Company's fiscal calendar. Unless otherwise stated, references in this report to particular years, quarters, months or periods refer to the Company's fiscal years ended in September and the associated quarters, months, or periods of those fiscal years. Each of the terms the Company and Apple as used herein refers collectively to Apple Inc. and its wholly-owned subsidiaries, unless otherwise stated. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Available Information

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

Overview and Highlights*Company Background*

The Company designs, manufactures, and markets mobile communication and media devices, personal computers, and portable digital music players, and sells a variety of related software, services, peripherals, networking solutions, and third-party digital content and applications. The Company's products and services include iPhone®, iPad®, Mac®, iPod®, Apple TV®, a portfolio of consumer and professional software applications, the iOS and OS X® operating systems, iCloud®, and a variety of accessory, service and support offerings. The Company also sells and delivers digital content and applications through the iTunes Store®, App Store®, iBooks Store®, and Mac App Store®. The Company sells its products worldwide through its retail stores, online stores, and direct sales force, as well as through third-party cellular network carriers, wholesalers, retailers, and value-added resellers. In addition, the Company sells a variety of third-party iPhone, iPad, Mac and iPod compatible products, including application software, and various accessories, through its online and retail stores. The Company sells to consumers; small and mid-sized businesses; and education, enterprise and government customers.

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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 new products and solutions with superior ease-of-use, seamless integration, and innovative design. The Company believes continual investment in research and development, marketing and advertising is critical to the development and sale of innovative products and technologies. As part of its strategy, the Company continues to expand its platform for the discovery and delivery of third-party digital content and applications through the iTunes Store. As part of the iTunes Store, the Company's App Store and iBooks Store allow customers to discover and download applications and books through either a Mac or Windows-based computer or through iOS devices, namely iPhone, iPad and iPod touch®. The Company's Mac App Store allows customers to easily discover, download and install Mac applications. The Company also supports a community for the development of third-party software and hardware products and digital content that complement the Company's offerings. The Company 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 enhancing 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.

Business Seasonality and Product Introductions

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

First Quarter Fiscal 2014 Highlights

Net sales rose 6% or \$3.1 billion during the first quarter of 2014 compared to the same quarter in 2013. Net sales and unit sales increased for iPhone, iPad and Mac following the launches of new iPhone and iPad models and upgraded Macs, and net sales of iTunes, Software and Services increased due to increased revenue from sales of iOS Apps, AppleCare and licensing. Growth in net sales was particularly strong in Greater China and Japan, with both operating segments reporting double-digit year-over-year growth in net sales. Total channel inventory for iPhone and iPad increased during the first quarter of 2014 in support of new product launches and seasonal demand. Growth in net sales during the first quarter of 2014 was negatively impacted by the continuing decline of iPod net sales and by weakness in some foreign currencies, particularly the Japanese Yen.

During the first quarter of 2014, the Company introduced iPad Air™, its fifth generation iPad, iPad mini™ with Retina® display and a new Mac Pro®; released upgraded versions of MacBook Pro®; and expanded the rollout of iPhone 5s, iPhone 5c and upgraded versions of iMac® which were initially released in September 2013. In October 2013, the Company released OS X Mavericks and new iOS and Mac versions of its iLife and iWork Apps. While the Company still relies on outsourcing partners in Asia for final assembly of most of its hardware products, during the first quarter of 2014, an outsourcing partner began final assembly of the Company's new Mac Pro in the United States.

During the first quarter of 2014, the Company utilized \$5 billion to repurchase its common stock and paid dividends of \$2.7 billion or \$3.05 per common share.

Table of Contents*Sales Data*

The following table shows net sales by operating segment and net sales and unit sales by product during the three months ended December 28, 2013 and December 29, 2012 (dollars in millions and units in thousands):

| | December 28, 2013 | Three Months Ended December 29, 2012 | Change |
|--|----------------------|--|--------|
| Net Sales by Operating Segment: | | | |
| Americas | \$ 20,098 | \$ 20,341 | (1)% |
| Europe | 13,073 | 12,464 | 5% |
| Greater China (a) | 8,844 | 6,830 | 29% |
| Japan | 4,948 | 4,443 | 11% |
| Rest of Asia Pacific | 3,633 | 3,993 | (9)% |
| Retail | 6,998 | 6,441 | 9% |
| Total net sales | \$ 57,594 | \$ 54,512 | 6% |
| Net Sales by Product: | | | |
| iPhone (b) | \$ 32,498 | \$ 30,660 | 6% |
| iPad (b) | 11,468 | 10,674 | 7% |
| Mac (b) | 6,395 | 5,519 | 16% |
| iPod (b) | 973 | 2,143 | (55)% |
| iTunes, Software and Services (c) | 4,397 | 3,687 | 19% |
| Accessories (d) | 1,863 | 1,829 | 2% |
| Total net sales | \$ 57,594 | \$ 54,512 | 6% |
| Unit Sales by Product: | | | |
| iPhone | 51,025 | 47,789 | 7% |
| iPad | 26,035 | 22,860 | 14% |
| Mac | 4,837 | 4,061 | 19% |
| iPod | 6,049 | 12,679 | (52)% |

(a) Greater China includes China, Hong Kong and Taiwan.

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

(c) Includes revenue from sales on the iTunes Store, the App Store, the Mac App Store, and the iBooks Store, and revenue from sales of AppleCare, licensing and other services.

(d) Includes sales of hardware peripherals and Apple-branded and third-party accessories for iPhone, iPad, Mac and iPod.

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

The following table presents iPhone net sales and unit sales information for the first quarter of 2014 and 2013 (dollars in millions and units in thousands):

| | Three Months Ended | | Change |
|-------------------------------|----------------------|----------------------|--------|
| | December 28, 2013 | December 29, 2012 | |
| Net sales | \$ 32,498 | \$ 30,660 | 6% |
| Percentage of total net sales | 56% | 56% | |
| Unit sales | 51,025 | 47,789 | 7% |

The year-over-year growth in iPhone net sales and unit sales resulted from the launch of new iPhones at the end of fiscal 2013. iPhone 5s was subject to supply constraints for much of the first quarter of 2014, and as supply and demand came into balance near the end of the quarter overall iPhone channel inventory increased from levels at the beginning of the quarter. Overall average selling prices (ASPs) for iPhone were relatively flat during the first quarter of 2014 compared to the first quarter of 2013.

iPad

The following table presents iPad net sales and unit sales information for the first quarter of 2014 and 2013 (dollars in millions and units in thousands):

| | Three Months Ended | | Change |
|-------------------------------|----------------------|----------------------|--------|
| | December 28, 2013 | December 29, 2012 | |
| Net sales | \$ 11,468 | \$ 10,674 | 7% |
| Percentage of total net sales | 20% | 20% | |
| Unit sales | 26,035 | 22,860 | 14% |

The year-over-year growth in iPad net sales and unit sales resulted primarily from the launch of iPad Air and iPad mini with Retina display, which both became available in November 2013. iPad Air and iPad mini with Retina display were subject to supply constraints for much of the first quarter of 2014. Overall iPad channel inventory increased from the beginning to the end of the quarter, and iPads were near supply and demand balance by the end of the quarter. iPad ASPs declined approximately 6% during the first quarter of 2014 compared to the first quarter of 2013 primarily as a result of a price reduction on the iPad mini and a shift in mix towards iPad mini and iPad mini with Retina display.

Table of Contents*Mac*

The following table presents Mac net sales and unit sales information for the first quarter of 2014 and 2013 (dollars in millions and units in thousands):

| | Three Months Ended | | Change |
|-------------------------------|------------------------------|------------------------------|---------------|
| | December 28, 2013 | December 29, 2012 | |
| Net sales | \$ 6,395 | \$ 5,519 | 16% |
| Percentage of total net sales | 11% | 10% | |
| Unit sales | 4,837 | 4,061 | 19% |

The year-over-year growth in Mac net sales and unit sales was driven by the launch of the upgraded iMac and strong performance of the MacBook Air. Additionally, Mac net sales and unit sales were negatively impacted throughout the first quarter of 2013 by supply constraints on new iMac models that were announced in October 2012 but did not ship until the final month of that quarter.

iTunes, Software and Services

The following table presents net sales information of iTunes, Software and Services for the first quarter of 2014 and 2013 (dollars in millions):

| | Three Months Ended | | Change |
|-------------------------------|------------------------------|------------------------------|---------------|
| | December 28, 2013 | December 29, 2012 | |
| Net sales | \$ 4,397 | \$ 3,687 | 19% |
| Percentage of total net sales | 8% | 7% | |

The increase in net sales of iTunes, Software and Services in the first quarter of 2014 compared to the first quarter of 2013 was due to growth in net sales from the iTunes Store, AppleCare and licensing. The iTunes Store generated a total of \$2.4 billion in net sales during the first quarter of 2014 versus \$2.1 billion during the first quarter of 2013. Growth in the iTunes Store, which includes the App Store, the Mac App Store and the iBooks Store, was driven by increases in revenue from App sales reflecting continued growth in the installed base of iOS devices and the expansion in the number of third-party iOS Apps available. Net sales of digital content, including music, movies, TV shows and books, from the iTunes Store was relatively flat in the first quarter of 2014 compared to the first quarter of 2013.

Table of Contents**Segment Operating Performance**

The Company manages its business primarily on a geographic basis. Accordingly, the Company determined its reportable operating segments, which are generally based on the nature and location of its customers, to be the Americas, Europe, Greater China, Japan, Rest of Asia Pacific and Retail. The Americas segment includes both North and South America. The Europe segment includes European countries, as well as India, the Middle East and Africa. The Greater China segment includes China, Hong Kong and Taiwan. The Rest of Asia Pacific segment includes Australia and Asian countries, other than those countries included in the Company's other operating segments. The results of the Company's geographic segments do not include results of the Retail segment. Each operating segment provides similar hardware and software products and similar services. Further information regarding the Company's operating segments may be found in Note 11, Segment Information and Geographic Data in Notes to Condensed Consolidated Financial Statements of this Form 10-Q.

Americas

The following table presents Americas net sales information for the first quarter of 2014 and 2013 (dollars in millions):

| | Three Months Ended | | Change |
|-------------------------------|------------------------------|------------------------------|---------------|
| | December 28, 2013 | December 29, 2012 | |
| Net sales | \$ 20,098 | \$ 20,341 | (1)% |
| Percentage of total net sales | 35% | 37% | |

The small decline in Americas net sales during the first quarter of 2014 compared to the first quarter of 2013 resulted from a decline in net sales of iPod and weakness in foreign currencies relative to the U.S. dollar. This decline was partially offset by increases in net sales of Mac and iTunes, Software and Services. iPhone net sales and unit sales declined slightly during the first quarter of 2014, which the Company believes is largely attributable to some carriers beginning to restrict early upgrades and supply constraints on iPhone 5s. While iPad unit sales in the Americas increased, iPad net sales declined slightly as a result of the decline in iPad ASPs, and iPad channel inventory increased from the prior quarter to support the launch of new iPad models and seasonal demand.

Europe

The following table presents Europe net sales information for the first quarter of 2014 and 2013 (dollars in millions):

| | Three Months Ended | | Change |
|-------------------------------|------------------------------|------------------------------|---------------|
| | December 28, 2013 | December 29, 2012 | |
| Net sales | \$ 13,073 | \$ 12,464 | 5% |
| Percentage of total net sales | 23% | 23% | |

The increase in Europe net sales during the first quarter of 2014 compared to the first quarter of 2013 reflects increases in net sales and unit sales in all of the Company's primary product categories except iPod, reflecting the impact of the Company's recent product launches. Net sales growth was driven primarily by increased demand in emerging markets within the Europe segment and by the favorable impact of strength in certain European currencies versus the U.S. dollar. Both iPhone and iPad channel inventory increased sequentially during the quarter to support recent product launches and seasonal demand.

Table of Contents*Greater China*

The following table presents Greater China net sales information for the first quarter of 2014 and 2013 (dollars in millions):

| | Three Months Ended | | Change |
|-------------------------------|----------------------|----------------------|--------|
| | December 28, 2013 | December 29, 2012 | |
| Net sales | \$ 8,844 | \$ 6,830 | 29% |
| Percentage of total net sales | 15% | 13% | |

During the first quarter of 2014, Greater China experienced year-over-year increases in net sales and unit sales of iPhone, iPad and Mac, significantly higher than those experienced by the Company overall. Higher iPhone net sales and unit sales resulted from the launch of new iPhones in Greater China at the end of fiscal 2013, whereas iPhone 5 was not launched in China during the first quarter of 2013 until mid-December 2012. Net sales were also favorably impacted by the launch of iPad Air and iPad mini with Retina display in China during the first quarter of 2014 without comparable product launches in China during the first quarter of 2013. iPad channel inventory increased from the prior quarter to support the launch of new iPad models and seasonal demand.

Japan

The following table presents Japan net sales information for the first quarter of 2014 and 2013 (dollars in millions):

| | Three Months Ended | | Change |
|-------------------------------|----------------------|----------------------|--------|
| | December 28, 2013 | December 29, 2012 | |
| Net sales | \$ 4,948 | \$ 4,443 | 11% |
| Percentage of total net sales | 9% | 8% | |

The increase in Japan net sales during the first quarter of 2014 compared to the first quarter of 2013 reflects higher net sales and unit sales of iPhone and iPad, reflecting the impact of the Company's recent product launches. First quarter 2014 iPhone unit sales were particularly strong in Japan following the launch of new iPhones. Both iPhone and iPad channel inventory increased sequentially during the quarter to support new product launches, seasonal demand and the addition of a significant new carrier. The increase in sales of iPhone and iPad were partially offset by a significant adverse impact on net sales due to weakness in the Japanese Yen relative to the U.S. dollar.

Rest of Asia Pacific

The following table presents Rest of Asia Pacific net sales information for the first quarter of 2014 and 2013 (dollars in millions):

| | Three Months Ended | | Change |
|-------------------------------|----------------------|----------------------|--------|
| | December 28, 2013 | December 29, 2012 | |
| Net sales | \$ 3,633 | \$ 3,993 | (9)% |
| Percentage of total net sales | 6% | 7% | |

During the first quarter of 2014, the Rest of Asia Pacific segment experienced year-over-year declines in net sales in all major product areas except Mac. Net sales were negatively affected by several factors including the adverse impact on net sales from weakness in several currencies relative to the U.S. dollar, including the Australian dollar, and a decline in net sales of iPod. Additionally, supply and demand balance in certain countries was achieved for iPhone 5s later in the first quarter of 2014 than it was for iPhone 5 in the first quarter of 2013. Both iPhone and iPad channel inventory increased sequentially during the quarter to support recent product launches and seasonal demand.

Table of Contents*Retail*

The following table presents Retail net sales information for the first quarter of 2014 and 2013 (dollars in millions):

| | Three Months Ended | | Change |
|-------------------------------|----------------------|----------------------|--------|
| | December 28, 2013 | December 29, 2012 | |
| Net sales | \$ 6,998 | \$ 6,441 | 9% |
| Percentage of total net sales | 12% | 12% | |
| U.S. stores | 254 | 251 | |
| International stores | 166 | 150 | |
| Total store count | 420 | 401 | |

The increase in Retail net sales during the first quarter of 2014 compared to the first quarter of 2013 resulted from increases in net sales in all of the Company's primary product categories except iPod, and reflects increases in unit sales of iPhone, iPad and Mac. With an average of 418 and 396 stores open during the first quarter of 2014 and 2013, respectively, average revenue per store increased to \$16.7 million in the first quarter of 2014 from \$16.3 million in the first quarter of 2013.

The Retail segment reported operating income of \$1.7 billion during the first quarter of 2014 as compared to \$1.6 billion during the first quarter of 2013. The year-over-year increase in Retail operating income during the first quarter of 2014 was primarily attributable to the overall increase in net sales and better leverage on operating expenses. As of December 28, 2013, the Retail segment had approximately 43,700 full-time equivalent employees.

Gross Margin

Gross margin for the first quarter of 2014 and 2013 was as follows (dollars in millions):

| | Three Months Ended | |
|-------------------------|----------------------|----------------------|
| | December 28, 2013 | December 29, 2012 |
| Net sales | \$ 57,594 | \$ 54,512 |
| Cost of sales | 35,748 | 33,452 |
| Gross margin | \$ 21,846 | \$ 21,060 |
| Gross margin percentage | 37.9% | 38.6% |

The decrease in the gross margin percentage during the first quarter of 2014 compared to the first quarter of 2013 was driven by multiple factors including higher cost structures on new products, price reductions on certain products, higher expenses associated with warranty costs and the adverse impact of changes in some foreign currency exchange rates. The impact of these factors was partially offset by lower costs for some components.

The Company anticipates gross margin during the second quarter of 2014 to be between 37% and 38%. The foregoing statement regarding the Company's expected gross margin percentage in the second quarter of 2014 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 and margins on individual products will remain under downward pressure due to a variety of factors, including continued industry wide global product pricing pressures, increased competition, compressed product life cycles, product transitions, potential increases in the cost of components, and potential

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strengthening of the U.S. dollar, as well as potential increases in the costs of outside manufacturing services and a potential shift in the Company's sales mix towards products with lower gross margins. In response to competitive pressures, the Company expects it will continue to take product pricing actions, which would adversely affect gross margins. Gross margins could also be affected by the Company's ability to manage product quality and warranty costs effectively and to stimulate demand for certain of its products. Due to the Company's significant international operations, financial results can be significantly affected in the short-term by fluctuations in exchange rates.

Table of Contents**Operating Expenses**

Operating expenses for the first quarter of 2014 and 2013 were as follows (dollars in millions):

| | Three Months Ended | | Change |
|---|----------------------|----------------------|--------|
| | December 28, 2013 | December 29, 2012 | |
| Research and development expense | \$ 1,330 | \$ 1,010 | 32% |
| Percentage of net sales | 2.3% | 1.9% | |
| Selling, general and administrative expense | \$ 3,053 | \$ 2,840 | 8% |
| Percentage of net sales | 5.3% | 5.2% | |
| Total operating expenses | \$ 4,383 | \$ 3,850 | 14% |
| Percentage of net sales | 7.6% | 7.1% | |

Research and Development (R&D) Expense

The growth in R&D expense during the first quarter of 2014 compared to the first quarter of 2013 was driven primarily by an increase in headcount and related expenses to support expanded R&D activities. The Company continues to believe that focused investments in R&D are critical to its future growth and competitive position in the marketplace and are directly related to timely development of new and enhanced products that are central to the Company's core business strategy. As such, the Company expects to make further investments in R&D to remain competitive.

Selling, General and Administrative (SG&A) Expense

The growth in SG&A expense during the first quarter of 2014 compared to the first quarter of 2013 was primarily due to the Company's continued expansion of its Retail segment, increased headcount and related expenses, and higher spending on professional services.

Other Income and Expense

Other income and expense for the first quarter of 2014 and 2013 was as follows (dollars in millions):

| | Three Months Ended | | Change |
|-----------------------------------|----------------------|----------------------|--------|
| | December 28, 2013 | December 29, 2012 | |
| Interest and dividend income | \$ 427 | \$ 421 | |
| Interest expense | (84) | 0 | |
| Other expense, net | (97) | 41 | |
| Total other income/(expense), net | \$ 246 | \$ 462 | (47)% |

The decrease in other income and expense during the first quarter of 2014 compared to the first quarter of 2013 was due primarily to interest expense on debt, higher expenses associated with foreign exchange rate movements, and lower realized gains from investment sales. The weighted-average interest rate earned by the Company on its cash, cash equivalents and marketable securities was 1.03% and 1.07% in the first quarter of 2014 and 2013, respectively.

Table of Contents**Provision for Income Taxes**

Provision for income taxes and effective tax rates for the first quarter of 2014 and 2013 were as follows (dollars in millions):

| | Three Months Ended | |
|----------------------------|----------------------|----------------------|
| | December 28, 2013 | December 29, 2012 |
| Provision for income taxes | \$ 4,637 | \$ 4,594 |
| Effective tax rate | 26.2% | 26.0% |

The Company's effective tax rates for both periods differ from the statutory federal income tax rate of 35% due primarily to certain undistributed foreign earnings, a substantial portion of which was generated by subsidiaries organized in Ireland, for which no U.S. taxes are provided because such earnings are intended to be indefinitely reinvested outside the U.S.

The Internal Revenue Service (the IRS) has completed its field audit of the Company's federal income tax returns for the years 2004 through 2006 and proposed certain adjustments. The Company has contested certain of these adjustments through the IRS Appeals Office. The IRS is currently examining the years 2007 through 2012. All IRS audit issues for years prior to 2004 have been resolved. In addition, the Company is subject to audits by state, local, and foreign tax authorities. Management believes that adequate provisions have been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs.

Liquidity and Capital Resources

The following tables present selected financial information and statistics as of December 28, 2013 and September 28, 2013 and during the first quarter of 2014 and 2013 (in millions):

| | December 28, 2013 | September 28, 2013 |
|--|----------------------|-----------------------|
| Cash, cash equivalents and marketable securities | \$ 158,842 | \$ 146,761 |
| Property, plant and equipment, net | \$ 15,488 | \$ 16,597 |
| Long-term debt | \$ 16,961 | \$ 16,960 |
| Working capital | \$ 26,578 | \$ 29,628 |

| | Three Months Ended | |
|--|----------------------|----------------------|
| | December 28, 2013 | December 29, 2012 |
| Cash generated by operating activities | \$ 22,670 | \$ 23,426 |
| Cash used in investing activities | \$ (15,103) | \$ (13,521) |
| Cash used in financing activities | \$ (7,749) | \$ (4,497) |

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The Company believes its existing balances of cash, cash equivalents and marketable securities will be sufficient to satisfy its working capital needs, capital asset purchases, outstanding commitments, and other liquidity requirements associated with its existing operations over the next 12 months. The Company currently anticipates the cash used for future dividends and the share repurchase program will come from its current domestic cash, cash generated from on-going U.S. operating activities and from borrowings.

As of December 28, 2013 and September 28, 2013, \$124.4 billion and \$111.3 billion, respectively, of the Company's cash, cash equivalents and marketable securities were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S. The Company's marketable securities investment portfolio is invested primarily in highly-rated securities and its investment policy generally limits the amount of credit exposure to any one issuer. The policy requires investments generally to be investment grade with the objective of minimizing the potential risk of principal loss.

During the first quarter of 2014, cash generated from operating activities of \$22.7 billion was a result of \$13.1 billion of net income, non-cash adjustments to net income of \$4.1 billion and an increase in net change in operating assets and liabilities of \$5.5 billion. Cash used in investing activities of \$15.1 billion during the three months ended December 28, 2013 consisted primarily of net purchases, sales and maturities of marketable securities of \$12.5 billion and cash used to acquire property, plant and equipment of \$2.0 billion. Cash used in financing activities during the three months ended December 28, 2013 consisted primarily of cash used to repurchase common stock of \$5.0 billion and cash used to pay dividends and dividend equivalents of \$2.8 billion.

During the first quarter of 2013, cash generated from operating activities of \$23.4 billion was a result of \$13.1 billion of net income, non-cash adjustments to net income of \$3.3 billion and an increase in net change in operating assets and liabilities of \$7.0 billion. Cash used in investing activities of \$13.5 billion during the three months ended December 29, 2012 consisted primarily of net purchases, sales and maturities of marketable securities of \$10.7 billion and cash used to acquire property, plant and equipment of \$2.3 billion. Cash used in financing activities during the three months ended December 29, 2012 consisted primarily of cash used to pay dividends and dividend equivalents of \$2.5 billion and cash used to repurchase common stock of \$1.95 billion.

Capital Assets

The Company's capital expenditures were \$779 million during the first quarter of 2014 consisting of \$108 million for retail store facilities and \$671 million for other capital expenditures, including product tooling and manufacturing process equipment, and other corporate facilities and infrastructure. The Company's actual cash payments for capital expenditures during the first quarter of 2014 were \$2.0 billion.

The Company anticipates utilizing approximately \$11.0 billion for capital expenditures during 2014, including approximately \$550 million for retail store facilities and approximately \$10.5 billion for other capital expenditures, including product tooling and manufacturing process equipment, and corporate facilities and infrastructure, including information systems hardware, software and enhancements.

During 2014, the Company expects to open about 30 new retail stores, with approximately two-thirds located outside of the U.S. During 2014, the Company also expects to remodel approximately 20 of its existing stores.

Table of Contents*Long-Term Debt*

In the third quarter of 2013, the Company issued \$17.0 billion of long-term debt, which included \$3.0 billion of floating-rate notes. To manage the risk of adverse fluctuations in interest rates associated with the floating-rate notes, the Company entered into interest rate swaps with an aggregate notional amount of \$3.0 billion, which, in effect, fixed the interest rate of the floating-rate notes. Of the aggregate principal amount of \$17.0 billion, \$2.5 billion is due in 2016 and \$14.5 billion is due in 2018 through 2043.

Dividend and Share Repurchase Program

In the third quarter of 2013, the Company raised its cash dividend by 15% to \$3.05 per common share. The Company expects to continue to pay quarterly dividends of \$3.05 per common share each quarter, subject to declaration by the Board of Directors.

In 2012, the Company's Board of Directors authorized a program to repurchase up to \$10 billion of the Company's common stock. In April 2013, the Company's Board of Directors increased the share repurchase program authorization from \$10 billion to \$60 billion, of which \$28.0 billion had been utilized as of December 28, 2013. The share repurchase program is expected to be completed by December 2015. The Company's share repurchase program does not obligate it to acquire any specific number of shares. Under the program, shares may be repurchased in privately negotiated or open market transactions, including under plans complying with Rule 10b5-1 under the Exchange Act.

Beginning in August 2012 through December 2015, the Company anticipates it will utilize approximately \$100 billion to pay dividends and dividend equivalents, repurchase shares, and remit withheld taxes related to net share settlement of restricted stock units, of which \$45.3 billion had been utilized through December 28, 2013. The following table presents the Company's dividends, share repurchases and net share settlement activity from the start of the program through the first quarter of 2014 (in millions):

| | Dividends and Dividend Equivalents Paid | Accelerated Share Repurchases | Open Market Share Repurchases | Taxes Related to Settlement of Equity Awards | Total |
|---------|--|--|--|---|--------------|
| 2012 | \$ 2,488 | \$ 0 | \$ 0 | \$ 56 | \$ 2,544 |
| 2013 | 10,564 | 13,950 | 9,000 | 1,082 | 34,596 |
| Q1 2014 | 2,769 | 0 | 5,000 | 365 | 8,134 |
| Total | \$ 15,821 | \$ 13,950 | \$ 14,000 | \$ 1,503 | \$ 45,274 |

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Off-Balance Sheet Arrangements and Contractual Obligations

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

Lease Commitments

The Company's major facility leases are typically for terms not exceeding 10 years and generally provide renewal options for terms not exceeding five additional years. Leases for retail space are for terms ranging from five to 20 years, the majority of which are for 10 years, and often contain multi-year renewal options. As of December 28, 2013, the Company's total future minimum lease payments under noncancelable operating leases were \$4.7 billion, of which \$3.5 billion related to leases for retail space.

Purchase Commitments with Outsourcing Partners and Component Suppliers

The Company utilizes several outsourcing partners to manufacture sub-assemblies for the Company's products and to perform final assembly and testing of finished products. These outsourcing partners acquire components and build product based on demand information supplied by the Company, which typically covers periods up to 150 days. The Company also obtains individual components for its products from a wide variety of individual suppliers. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. Where appropriate, the purchases are applied to inventory component prepayments that are outstanding with the respective supplier. As of December 28, 2013, the Company had outstanding off-balance sheet third-party manufacturing commitments and component purchase commitments of \$16.1 billion.

Other Obligations

In addition to the commitments mentioned above, the Company had additional off-balance sheet obligations of \$1.5 billion as of December 28, 2013, that were comprised mainly of commitments to acquire capital assets, including product tooling and manufacturing process equipment, and commitments related to advertising, research and development, Internet and telecommunications services and other obligations.

The Company's other non-current liabilities in the Condensed Consolidated Balance Sheets consist primarily of deferred tax liabilities, gross unrecognized tax benefits and the related gross interest and penalties. As of December 28, 2013, the Company had non-current deferred tax liabilities of \$18.3 billion. Additionally, as of December 28, 2013, the Company had gross unrecognized tax benefits of \$3.0 billion and an additional \$643 million for gross interest and penalties classified as non-current liabilities. At this time, the Company is unable to make a reasonably reliable estimate of the timing of payments due to uncertainties in the timing of tax audit outcomes.

Indemnification

The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against it or an indemnified third-party. In the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss with respect to indemnification of end-users of its operating system or application software for infringement of third-party intellectual property rights. The Company did not record a liability for infringement costs related to indemnification as of December 28, 2013 or September 28, 2013.

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

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Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles (GAAP) and the Company s discussion and analysis of its financial condition and operating results require the Company s management to make judgments, assumptions, and estimates that affect the amounts reported in its condensed consolidated financial statements and accompanying notes. Note 1, Summary of Significant Accounting Policies of this Form 10-Q and in the Notes to Consolidated Financial Statements in Part II, Item 8 of the Company s 2013 Form 10-K describes the significant accounting policies and methods used in the preparation of the Company s condensed consolidated financial statements. Management bases its estimates on historical experience and on various other assumptions it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates and such differences may be material.

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

Revenue Recognition

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

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

For sales of qualifying versions of iOS devices, Mac and Apple TV, the Company has indicated it may from time to time provide future unspecified software upgrades and features free of charge to customers. The Company also provides various non-software services to owners of qualifying versions of iOS devices and Mac. Because the Company has neither VSOE nor TPE for the unspecified software upgrade rights or the non-software services, revenue is allocated to these rights and services based on the Company s ESPs. Revenue allocated to the unspecified software upgrade rights and non-software services based on the Company s ESPs is deferred and recognized on a straight-line basis over the estimated period the software upgrades and non-software services are expected to be provided for each of these devices, which ranges from two to four years.

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The Company's process for determining ESPs 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 ESPs and the future rate of related amortization for software upgrades and non-software services related to future sales of these devices could change. Factors subject to change include the unspecified software upgrade rights offered, the estimated value of unspecified software upgrade rights, the estimated or actual costs incurred to provide non-software services, and the estimated period software upgrades and non-software services are expected to be provided.

The Company records reductions to revenue for estimated commitments related to price protection and other customer incentive programs. For transactions involving price protection, the Company recognizes revenue net of the estimated amount to be refunded, provided the refund amount can be reasonably and reliably estimated and the other conditions for revenue recognition have been met. The Company's policy requires that, if refunds cannot be reliably estimated, revenue is not recognized until reliable estimates can be made or the price protection lapses. For the Company's other customer incentive programs, the estimated cost is recognized at the later of the date at which the Company has sold the product or the date at which the program is offered. The Company also records reductions to revenue for expected future product returns based on the Company's historical experience. Future market conditions and product transitions may require the Company to increase customer incentive programs that could result in reductions to future revenue. Additionally, certain customer incentive programs require management to estimate the number of customers who will actually redeem the incentive. Management's estimates are based on historical experience and the specific terms and conditions of particular incentive programs. If a greater than estimated proportion of customers redeems such incentives, the Company would be required to record additional reductions to revenue, which would have an adverse impact on the Company's results of operations.

Valuation and Impairment of Marketable Securities

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

Inventory Valuation and Valuation of Manufacturing-Related Assets and Estimated Purchase Commitment Cancellation Fees

The Company must order components for its products and build inventory in advance of product shipments and has invested in manufacturing process equipment, including capital assets held at its suppliers' facilities. In addition, the Company has made prepayments to certain of its suppliers associated with long-term supply agreements to secure supply of inventory components. The Company records a write-down for inventories of components and products, including third-party products held for resale, which have become obsolete or are in excess of anticipated demand or net realizable value. The Company performs a detailed review of inventory that considers multiple factors including demand forecasts, product life cycle status, product development plans, current sales levels, and component cost trends. The Company also reviews its manufacturing-related capital assets and inventory prepayments for impairment whenever events or circumstances indicate the carrying amount of such assets may not be recoverable. If the Company determines that an asset is not recoverable, it records an impairment loss equal to the amount by which the carrying value of such an asset exceeds its fair value.

The industries in which the Company competes are subject to a rapid and unpredictable pace of product and component obsolescence and demand changes. In certain circumstances the Company may be required to record additional write-downs of inventory, inventory prepayments and/or manufacturing-related capital assets. These circumstances include future demand or market conditions for the Company's products being less favorable than forecasted, unforeseen technological changes or changes to the Company's product development plans that negatively impact the utility of any of these assets, or significant deterioration in the financial condition of one or more of the Company's suppliers that hold any of the Company's manufacturing process equipment or to whom the Company has made an inventory prepayment. Such write-downs would adversely affect the Company's results of operations in the period when the write-downs were recorded.

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The Company records accruals for estimated cancellation fees related to component orders that have been cancelled or are expected to be cancelled. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders in each case based on projected demand. Where appropriate, the purchases are applied to inventory component prepayments that are outstanding with the respective supplier. Purchase commitments typically cover the Company's forecasted component and manufacturing requirements for periods up to 150 days. If there is an abrupt and substantial decline in demand for one or more of the Company's products, if the Company's product development plans change, or if there is an unanticipated change in technological requirements for any of the Company's products, then the Company may be required to record additional accruals for cancellation fees that would adversely affect its results of operations in the period when the cancellation fees are identified and recorded.

Warranty Costs

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

Income Taxes

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

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

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

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Legal and Other Contingencies

As discussed in Part II, Item 1 of this Form 10-Q under the heading "Legal Proceedings" and in Note 10, "Commitments and Contingencies" in the Notes to Condensed Consolidated Financial Statements of this Form 10-Q, the Company is subject to various legal proceedings and claims that arise in the ordinary course of business. The Company records a liability when it is probable that a loss has been incurred and the amount is reasonably estimable. There is significant judgment required in both the probability determination and as to whether an exposure can be reasonably estimated. In the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies for legal and other contingencies. However, the outcome of legal proceedings and claims brought against the Company is subject to significant uncertainty. Therefore, although management considers the likelihood of such an outcome to be remote, if one or more of these legal matters were resolved against the Company in a reporting period for amounts in excess of management's expectations, the Company's consolidated financial statements for that reporting period could be materially adversely affected.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's market risk disclosures set forth in Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk" of its 2013 Form 10-K have not changed materially for the first three months of 2014.

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 28, 2013 to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms and (ii) accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the first quarter of 2014, 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.

Table of Contents**PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

The Company is subject to the various legal proceedings and claims discussed below as well as certain other legal proceedings and claims that have not been fully resolved and that have arisen in the ordinary course of business. In the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies. However, the outcome of legal proceedings and claims brought against the Company is subject to significant uncertainty. Therefore, although management considers the likelihood of such an outcome to be remote, if one or more of these legal matters were resolved against the Company in a reporting period for amounts in excess of management's expectations, the Company's consolidated financial statements for that reporting period could be materially adversely affected. See the risk factor *The Company could be impacted by unfavorable results of legal proceedings, such as being found to have infringed on intellectual property rights* in Part II, Item 1A of this Form 10-Q under the heading Risk Factors. The Company settled certain matters during the first quarter of 2014 that did not individually or in the aggregate have a material impact on the Company's financial condition or results of operations.

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

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

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

On April 11, 2012, the U.S. Department of Justice filed a civil antitrust action against the Company and five major book publishers in the U.S. District Court for the Southern District of New York, alleging an unreasonable restraint of interstate trade and commerce in violation of §1 of the Sherman Act and seeking, among other things, injunctive relief, the District Court's declaration that the Company's agency agreements with the publishers are null and void and/or the District Court's reformation of such agreements. On July 10, 2013, the District Court found, following a bench trial, that the Company conspired to restrain trade in violation of §1 of the Sherman Act and relevant state statutes to the extent those laws are congruent with §1 of the Sherman Act. The District Court entered a permanent injunction, which took effect on October 6, 2013 and will be in effect for five years unless the judgment is overturned on appeal. The Company has taken the necessary steps to comply with the terms of the District Court's order, including renegotiating agreements with the five major eBook publishers, updating its antitrust training program and hiring an antitrust compliance monitor. A damages trial is set for May 2014. The Company has appealed the District Court's decision.

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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 Company's 2013 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 results of operations and financial condition to vary materially from past, or from anticipated future, results of operations and financial condition. Any of these factors, in whole or in part, could materially and adversely affect the Company's business, financial condition, results of operations and common stock price.

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

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

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

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

In the event of further financial turmoil affecting the banking system and financial markets, additional consolidation of the financial services industry, or significant financial service institution failures, there could be a new or incremental tightening in the credit markets, low liquidity, and extreme volatility in fixed income, credit, currency, and equity markets. This could have a number of effects on the Company's business, including the insolvency or financial instability of outsourcing partners or suppliers or their inability to obtain credit to finance development and/or manufacture products resulting in product delays; inability of customers, including channel partners, to obtain credit to finance purchases of the Company's products; failure of derivative counterparties and other financial institutions; and restricting the Company's ability to issue new debt. Other income and expense also could vary materially from expectations depending on gains or losses realized on the sale or exchange of financial instruments; impairment charges resulting from revaluations of debt and equity securities and other investments; interest rates; cash balances; volatility in foreign exchange rates; and changes in fair value of derivative instruments. Increased volatility in the financial markets and overall economic uncertainty would increase the risk of the actual amounts realized in the future on the Company's financial instruments differing significantly from the fair values currently assigned to them.

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Global markets for the Company's products and services are highly competitive and subject to rapid technological change, and the Company may be unable to compete effectively in these markets.

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

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

The Company markets certain mobile communication and media devices based on the iOS mobile operating system and also markets related third-party digital content and applications. The Company faces substantial competition in these markets from companies that have significant technical, marketing, distribution and other resources, as well as established hardware, software and digital content supplier relationships; and the Company has a minority market share in the smartphone market. Additionally, the Company faces significant price competition as competitors reduce their selling prices and attempt to imitate the Company's product features and applications within their own products or, alternatively, collaborate with each other to offer solutions that are more competitive than those they currently offer. The Company also competes with illegitimate ways to obtain third-party digital content and applications. Some of the Company's competitors have greater experience, product breadth and distribution channels than the Company. Because some current and potential competitors have substantial resources and/or experience and a lower cost structure, they may be able to provide products and services at little or no profit or even at a loss. The Company also expects competition to intensify as competitors attempt to imitate the Company's approach to providing components seamlessly within their individual offerings or work collaboratively to offer integrated solutions. The Company's financial condition and operating results depend substantially on the Company's ability to continually improve iOS and iOS devices in order to maintain their functional and design advantages.

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

There can be no assurance the Company will be able to continue to provide products and services that compete effectively.

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To remain competitive and stimulate customer demand, the Company must successfully manage frequent product introductions and transitions.

Due to the highly volatile and competitive nature of the industries in which the Company competes, the Company must continually introduce new products, services and technologies, enhance existing products and services, and effectively stimulate customer demand for new and upgraded products. The success of new product introductions depends on a number of factors including, but not limited to, timely and successful product development, market acceptance, the Company's ability to manage the risks associated with new product production ramp-up issues, the availability of application software for new products, the effective management of purchase commitments and inventory levels in line with anticipated product demand, the availability of products in appropriate quantities and costs to meet anticipated demand, and the risk that new products may have quality or other defects or deficiencies in the early stages of introduction. Accordingly, the Company cannot determine in advance the ultimate effect of new product introductions and transitions.

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

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

Carriers providing cellular network service for iPhone typically subsidize users' purchases of the device. There is no assurance that such subsidies will be continued at all or in the same amounts upon renewal of the Company's agreements with these carriers or in agreements the Company enters into with new carriers.

Many resellers have narrow operating margins and have been adversely affected in the past by weak economic conditions. Some resellers have perceived the expansion of the Company's direct sales as conflicting with their business interests as distributors and resellers of the Company's products. Such a perception could discourage resellers from investing resources in the distribution and sale of the Company's products or lead them to limit or cease distribution of those products. The Company has invested and will continue to invest in programs to enhance reseller sales, including staffing selected resellers' stores with Company employees and contractors, and improving product placement displays. These programs could require a substantial investment while providing no assurance of return or incremental revenue. The financial condition of these resellers could weaken, these resellers could stop distributing the Company's products, or uncertainty regarding demand for the Company's products could cause resellers to reduce their ordering and marketing of the Company's products.

The Company faces substantial inventory and other asset risk in addition to purchase commitment cancellation risk.

The Company records a write-down for product and component inventories that have become obsolete or exceed anticipated demand or net realizable value and accrues necessary cancellation fee reserves for orders of excess products and components. The Company also reviews its long-lived assets, including capital assets held at its suppliers' facilities and inventory prepayments, for impairment whenever events or circumstances indicate the carrying amount of an asset may not be recoverable. If the Company determines that impairment has occurred, it records a write-down equal to the amount by which the carrying value of the assets exceeds its fair value. Although the Company believes its provisions related to inventory, capital assets, inventory prepayments and other assets and purchase commitments are currently adequate, no assurance can be given that the Company will not incur additional related charges given the rapid and unpredictable pace of product obsolescence in the industries in which the Company competes.

The Company must order components for its products and build inventory in advance of product announcements and shipments. Consistent with industry practice, components are normally acquired through a combination of purchase orders, supplier contracts, and open orders, in each case based on projected demand. Where appropriate, the purchases are applied to inventory component prepayments that are outstanding with the respective supplier. Purchase commitments typically cover forecasted component and manufacturing requirements for periods up to 150 days. Because the Company's markets are volatile, competitive and subject to rapid technology and price changes, there is a risk the Company will forecast incorrectly and order or produce excess or insufficient amounts of components or products, or not fully utilize firm purchase commitments.

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

Because the Company currently obtains components from single or limited sources, the Company is subject to significant supply and pricing risks. Many components, including those that are available from multiple sources, are at times subject to industry-wide shortages and significant commodity pricing fluctuations. While the Company has entered into various agreements for the supply of components, there can be no assurance that the Company will be able to extend or renew these agreements on similar terms, or at all. The follow-on effects from global economic conditions on the Company's suppliers, described in *Global and regional economic conditions could materially adversely affect the Company* above, also could affect the Company's ability to obtain components. Therefore, the Company remains subject to significant risks of supply shortages and price increases.

The Company and other participants in the markets for mobile communication and media devices and personal computers also compete for various components with other industries that have experienced increased demand for their products. The Company uses some custom components that are not common to the rest of these industries. The Company's new products often utilize custom components available from only one source. When a component or product uses new technologies, initial capacity constraints may exist until the suppliers' yields have matured or manufacturing capacity has increased. Continued availability of these components at acceptable prices, or at all, may be affected if those suppliers decided to concentrate on the production of common components instead of components customized to meet the Company's requirements. The supply of components for a new or existing product could be delayed or constrained, or a key manufacturing vendor could delay shipments of completed products to the Company.

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

Substantially all of the Company's manufacturing is performed in whole or in part by a few outsourcing partners located primarily in Asia. The Company has also outsourced much of its transportation and logistics management. While these arrangements may lower operating costs, they also reduce the Company's direct control over production and distribution. It is uncertain what effect such diminished control will have on the quality or quantity of products or services, or the Company's flexibility to respond to changing conditions. Although arrangements with these partners may contain provisions for warranty expense reimbursement, the Company may remain responsible to the consumer for warranty service in the event of product defects and could experience an unanticipated product defect or warranty liability. While the Company relies on its partners to adhere to its supplier code of conduct, material violations of the supplier code of conduct could occur.

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

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

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

The Company sells complex hardware and software products and services that can contain design and manufacturing defects. Sophisticated operating system software and applications, such as those sold by the Company, often contain bugs that can unexpectedly interfere with the software's intended operation. The Company's online services may from time to time experience outages, service slowdowns, or errors. Defects may also occur in components and products the Company purchases from third parties. There can be no assurance the Company will be able to detect and fix all defects in the hardware, software and services it sells. Failure to do so could result in lost revenue, significant warranty and other expenses, and harm to the Company's reputation.

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

The Company contracts with numerous third parties to offer their digital content through the iTunes Store. This includes the right to make available music, movies, TV shows and books currently available through the iTunes Store. The licensing arrangements with these third parties are short-term and do not guarantee the continuation or renewal of these arrangements on reasonable terms, if at all. Some third-party content providers and distributors currently or in the future may offer competing products and services, and could take action to make it more difficult or impossible for the Company to license their content in the future. Other content owners, providers or distributors may seek to limit the Company's access to, or increase the cost of, such content. The Company may be unable to continue to offer a wide variety of content at reasonable prices with acceptable usage rules, or continue to expand its geographic reach. Failure to obtain the right to make available third-party digital content, or to make available such content on commercially reasonable terms, could have a material adverse impact on the Company's financial condition and operating results.

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

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

The Company believes decisions by customers to purchase its hardware products depend in part on the availability of third-party software applications and services. There is no assurance that third-party developers will continue to develop and maintain software applications and services for the Company's products. If third-party software applications and services cease to be developed and maintained for the Company's products, customers may choose not to buy the Company's products.

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

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

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

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

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

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

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

Regardless of the scope or validity of such patents or other intellectual property rights, or the merits of any claims by potential or actual litigants, the Company may have to engage in protracted litigation. If the Company is found to infringe one or more patents or other intellectual property rights, regardless of whether it can develop non-infringing technology, it may be required to pay substantial damages or royalties to a third-party, or it may be subject to a temporary or permanent injunction prohibiting the Company from marketing or selling certain products.

In certain cases, the Company may consider the desirability of entering into licensing agreements, although no assurance can be given that such licenses can be obtained on acceptable terms or that litigation will not occur. These licenses may also significantly increase the Company's operating expenses.

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

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

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

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

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

By way of example, laws and regulations related to mobile communications and media devices in the many jurisdictions in which the Company operates are extensive and subject to change. Such changes could include, among others, restrictions on the production, manufacture, distribution, and use of devices, locking devices to a carrier's network, or mandating the use of devices on more than one carrier's network. These devices are also subject to certification and regulation by governmental and standardization bodies, as well as by cellular network carriers for use on their networks. These certification processes are extensive and time consuming, and could result in additional testing requirements, product modifications, or delays in product shipment dates, or could preclude the Company from selling certain products.

Compliance with these laws, regulations and similar requirements may be onerous and expensive, and they may be inconsistent from jurisdiction to jurisdiction, further increasing the cost of compliance and doing business. Any such costs, which may rise in the future as a result of changes in these laws and regulations or in their interpretation could individually or in the aggregate make the Company's products and services less attractive to the Company's customers, delay the introduction of new products in one or more regions, or cause the Company to change or limit its business practices. The Company has implemented policies and procedures designed to ensure compliance with applicable laws and regulations, but there can be no assurance that the Company's employees, contractors, or agents will not violate such laws and regulations or the Company's policies and procedures.

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

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

The Company also could be significantly affected by other risks associated with international activities including, but not limited to, economic and labor conditions, increased duties, taxes and other costs, and political instability. Margins on sales of the Company's products in foreign countries, and on sales of products that include components obtained from foreign suppliers, could be materially adversely affected by international trade regulations, including duties, tariffs and antidumping penalties. The Company is also exposed to credit and collectability risk on its trade receivables with customers in certain international markets. There can be no assurance the Company can effectively limit its credit risk and avoid losses.

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

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

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

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

The Company has invested, and in the future may invest, in new business strategies or acquisitions. Such endeavors may involve significant risks and uncertainties, including distraction of management from current operations, greater than expected liabilities and expenses, inadequate return of capital, and unidentified issues not discovered in the Company's due diligence. These new ventures are inherently risky and may not be successful.

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

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

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

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

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

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

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

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

The Company's privacy policy and related practices concerning the use and disclosure of data are posted on its website. Any failure by the Company, its suppliers or other parties with whom the Company does business to comply with its posted privacy policy or with other federal, state or international privacy-related or data protection laws and regulations could result in proceedings against the Company by governmental entities or others.

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

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

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

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

War, terrorism, geopolitical uncertainties, public health issues, and other business interruptions have caused and could cause damage or disruption to international commerce and the global economy, and thus could have a material adverse effect on the Company, its suppliers, logistics providers, manufacturing vendors and customers, including channel partners. The Company's business operations are subject to interruption by, among others, natural disasters, fire, power shortages, nuclear power plant accidents, terrorist attacks and other hostile acts, labor disputes, public health issues, and other events beyond its control. Such events could decrease demand for the Company's products, make it difficult or impossible for the Company to make and deliver products to its customers, including channel partners, or to receive components from its suppliers, and create delays and inefficiencies in the Company's supply chain. Should major public health issues, including pandemics, arise, the Company could be adversely affected by more stringent employee travel restrictions, additional limitations in freight services, governmental actions limiting the movement of products between regions, delays in production ramps of new products, and disruptions in the operations of the Company's manufacturing vendors and component suppliers. The majority of the Company's research and development activities, its corporate headquarters, information technology systems, and other critical business operations, including certain component suppliers and manufacturing vendors, are in locations that could be affected by natural disasters. In the event of a natural disaster, the Company could incur significant losses, require substantial recovery time and experience significant expenditures in order to resume operations.

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

The Company's profit margins vary across its products and distribution channels. The Company's software, accessories, and service and support contracts generally have higher gross margins than certain of the Company's other products. Gross margins on the Company's hardware products vary across product lines and can change over time as a result of product transitions, pricing and configuration changes, and component, warranty, and other cost fluctuations. The Company's direct sales generally have higher associated gross margins than its indirect sales through its channel partners. In addition, the Company's gross margin and operating margin percentages, as well as overall profitability, may be materially adversely impacted as a result of a shift in product, geographic or channel mix, component cost increases, the strengthening U.S. dollar, price competition, or the introduction of new products, including those that have higher cost structures with flat or reduced pricing.

The Company has typically experienced higher net sales in its first quarter compared to other quarters due in part to seasonal holiday demand. Additionally, new product introductions can significantly impact net sales, product costs and operating expenses. The Company could be subject to unexpected developments late in a quarter, such as lower-than-anticipated demand for the Company's products, issues with new product introductions, an internal systems failure, or failure of one of the Company's logistics, components supply, or manufacturing partners.

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The Company's stock price is subject to volatility.

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

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

The Company's primary exposure to movements in foreign currency exchange rates relates to non-U.S. dollar denominated sales and operating expenses worldwide. Weakening of foreign currencies relative to the U.S. dollar adversely affects the U.S. dollar value of the Company's foreign currency-denominated sales and earnings, and generally leads the Company to raise international pricing, potentially reducing demand for the Company's products. Margins on sales of the Company's products in foreign countries, and on sales of products that include components obtained from foreign suppliers, could be materially adversely affected by foreign currency exchange rate fluctuations. In some circumstances, for competitive or other reasons, the Company may decide not to raise local prices to fully offset the dollar's strengthening, or at all, which would adversely affect the U.S. dollar value of the Company's foreign currency denominated sales and earnings. Conversely, a strengthening of foreign currencies relative to the U.S. dollar, while generally beneficial to the Company's foreign currency-denominated sales and earnings, could cause the Company to reduce international pricing and incur losses on its foreign currency derivative instruments, thereby limiting the benefit. Additionally, strengthening of foreign currencies may also increase the Company's cost of product components denominated in those currencies, thus adversely affecting gross margins.

The Company uses derivative instruments, such as foreign currency forward and option contracts, to hedge certain exposures to fluctuations in foreign currency exchange rates. The use of such hedging activities may not offset any or more than a portion of the adverse financial effects of unfavorable movements in foreign exchange rates over the limited time the hedges are in place.

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

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

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

The Company distributes its products through third-party cellular network carriers, wholesalers, retailers and value-added resellers. A substantial majority of the Company's outstanding trade receivables are not covered by collateral or credit insurance. The Company's exposure to credit and collectability risk on its trade receivables is higher in certain international markets and its ability to mitigate such risks may be limited. The Company also has unsecured vendor non-trade receivables resulting from purchases of components by outsourcing partners and other vendors that manufacture sub-assemblies or assemble final products for the Company. In addition, the Company has made prepayments associated with long-term supply agreements to secure supply of inventory components. As of December 28, 2013, a significant portion of the Company's trade receivables was concentrated within cellular network carriers, and its non-trade receivables and prepayments related to long-term supply agreements were concentrated among a few individual vendors located primarily in Asia. While the Company has procedures to monitor and limit exposure to credit risk on its trade and vendor non-trade receivables as well as long-term prepayments, there can be no assurance such procedures will effectively limit its credit risk and avoid losses.

The Company could be subject to changes in its tax rates, the adoption of new U.S. or international tax legislation or exposure to additional tax liabilities.

The Company is subject to taxes in the U.S. and numerous foreign jurisdictions, including Ireland, where a number of the Company's subsidiaries are organized. Due to economic and political conditions, tax rates in various jurisdictions may be subject to significant change. The Company's future effective tax rates could be affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, or changes in tax laws or their interpretation, including in the U.S. and Ireland. The Company is also subject to the examination of its tax returns and other tax matters by the Internal Revenue Service and other tax authorities and governmental bodies. The Company regularly assesses the likelihood of an adverse outcome resulting from these examinations to determine the adequacy of its provision for taxes. There can be no assurance as to the outcome of these examinations. If the Company's effective tax rates were to increase, particularly in the U.S. or Ireland, or if the ultimate determination of the Company's taxes owed is for an amount in excess of amounts previously accrued, the Company's operating results, cash flows, and financial condition could be adversely affected.

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Share repurchase activity during the three months ended December 28, 2013 was as follows (in millions, except number of shares, which are reflected in thousands, and per share amounts):

| Q1 2014 Fiscal Periods | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs (a) |
|----------------------------------|----------------------------------|------------------------------|--|--|
| September 29 to November 2, 2013 | 2,101 | \$ 509.02 | 2,101 | |
| November 3 to November 30, 2013 | 6,485 | \$ 522.78 | 6,485 | |
| December 1 to December 28, 2013 | 964 | \$ 560.04 | 964 | |
| Total | 9,550 | | 9,550 | \$ 32,050 |

- (a) In 2012, the Company's Board of Directors authorized a program to repurchase up to \$10 billion of the Company's common stock beginning in 2013. In April 2013, the Company's Board of Directors increased the share repurchase program authorization from \$10 billion to \$60 billion. The Company's share repurchase program does not obligate it to acquire any specific number of shares. Under the program, shares may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 under the Exchange Act. The \$32.1 billion represents the remaining amount available to repurchase shares under the authorized repurchase program.

Item 3. Defaults Upon Senior Securities

None.

Item 5. Other Information

None.

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

| Exhibit | Exhibit Description | Incorporated by | | |
|-----------|---|-----------------|---------|--------------------------------------|
| | | Form | Exhibit | Reference Filing Date/ Period End |
| 3.1 | Restated Articles of Incorporation, filed with the Secretary of State of the State of California on July 10, 2009. | 10-Q | 3.1 | 6/27/09 |
| 3.2 | Amended Bylaws of the Registrant, as of April 20, 2011. | 10-Q | 3.2 | 3/26/11 |
| 4.1 | Form of Common Stock Certificate of the Registrant. | 10-Q | 4.1 | 12/30/06 |
| 4.2 | Indenture, dated as of April 29, 2013, between the Registrant and The Bank of New York Mellon Trust Company, N.A., as Trustee. | S-3 | 4.1 | 4/29/13 |
| 4.3 | Officer's Certificate of the Registrant, dated as of May 3, 2013, including forms of global notes representing the Floating Rate Notes due 2016, Floating Rate Notes due 2018, 0.45% Notes due 2016, 1.00% Notes due 2018, 2.40% Notes due 2023 and 3.85% Notes due 2043. | 8-K | 4.1 | 5/3/13 |
| 10.1* | Amended Employee Stock Purchase Plan, effective as of March 8, 2010. | 10-Q | 10.1 | 3/27/10 |
| 10.2* | Form of Indemnification Agreement between the Registrant and each director and executive officer of the Registrant. | 10-Q | 10.2 | 6/27/09 |
| 10.3*, ** | 1997 Director Stock Plan, as amended through August 23, 2012. | | | |
| 10.4* | 2003 Employee Stock Plan, as amended through February 25, 2010. | 8-K | 10.1 | 3/1/10 |
| 10.5* | Form of Restricted Stock Unit Award Agreement effective as of November 11, 2008. | 10-Q | 10.10 | 12/27/08 |
| 10.6* | Form of Restricted Stock Unit Award Agreement effective as of November 16, 2010. | 10-Q | 10.10 | 12/25/10 |
| 10.7* | Form of Restricted Stock Unit Award Agreement effective as of April 6, 2012. | 10-Q | 10.8 | 3/31/12 |
| 10.8* | Summary Description of Amendment, effective as of May 24, 2012, to certain Restricted Stock Unit Award Agreements outstanding as of April 5, 2012. | 10-Q | 10.8 | 6/30/12 |
| 31.1** | Rule 13a-14(a) / 15d-14(a) Certification of Chief Executive Officer. | | | |
| 31.2** | Rule 13a-14(a) / 15d-14(a) Certification of Chief Financial Officer. | | | |
| 32.1*** | Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer. | | | |
| 101.INS** | XBRL Instance Document. | | | |
| 101.SCH** | XBRL Taxonomy Extension Schema Document. | | | |
| 101.CAL** | XBRL Taxonomy Extension Calculation Linkbase Document. | | | |
| 101.DEF** | XBRL Taxonomy Extension Definition Linkbase Document. | | | |
| 101.LAB** | XBRL Taxonomy Extension Label Linkbase Document. | | | |
| 101.PRE** | XBRL Taxonomy Extension Presentation Linkbase Document. | | | |

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* Indicates management contract or compensatory plan or arrangement.

** Filed herewith.

*** Furnished herewith.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

January 28, 2014

APPLE INC.

By: /s/ Peter Oppenheimer
Peter Oppenheimer

Senior Vice President,

Chief Financial Officer

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