

APPLE INC
Form 10-Q
August 01, 2018

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 June 30, 2018

or

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

For the transition period from _____ to _____.

Commission File Number: 001-36743

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

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

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

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

Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Emerging growth company

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

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

Yes No

4,829,926,000 shares of common stock, par value \$0.00001 per share, issued and outstanding as of July 20, 2018

Apple Inc.

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For the Fiscal Quarter Ended June 30, 2018

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

Apple Inc.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

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

	Three Months Ended		Nine Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Net sales	\$53,265	\$ 45,408	\$202,695	\$ 176,655
Cost of sales	32,844	27,920	124,940	108,400
Gross margin	20,421	17,488	77,755	68,255
Operating expenses:				
Research and development	3,701	2,937	10,486	8,584
Selling, general and administrative	4,108	3,783	12,489	11,447
Total operating expenses	7,809	6,720	22,975	20,031
Operating income	12,612	10,768	54,780	48,224
Other income/(expense), net	672	540	1,702	1,948
Income before provision for income taxes	13,284	11,308	56,482	50,172
Provision for income taxes	1,765	2,591	11,076	12,535
Net income	\$11,519	\$ 8,717	\$45,406	\$ 37,637
Earnings per share:				
Basic	\$2.36	\$ 1.68	\$9.07	\$ 7.18
Diluted	\$2.34	\$ 1.67	\$8.99	\$ 7.14
Shares used in computing earnings per share:				
Basic	4,882,167	5,195,088	5,006,640	5,239,847
Diluted	4,926,609	5,233,499	5,050,963	5,274,394
Cash dividends declared per share	\$0.73	\$ 0.63	\$1.99	\$ 1.77

See accompanying Notes to Condensed Consolidated Financial Statements.

Apple Inc.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

(In millions)

	Three Months Ended		Nine Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Net income	\$11,519	\$8,717	\$45,406	\$37,637
Other comprehensive income/(loss):				
Change in foreign currency translation, net of tax effects of \$(3), \$(35), \$4 and \$(3), respectively	(590	) 120	(287	) (41
Change in unrealized gains/losses on derivative instruments:				
Change in fair value of derivatives, net of tax benefit/(expense) of \$70, \$(16), \$(60) and \$(269), respectively	109	(166	) 170	1,002
Adjustment for net (gains)/losses realized and included in net income, net of tax expense/(benefit) of \$(254), \$176, \$(198) and \$276, respectively	978	(409	) 873	(1,135
Total change in unrealized gains/losses on derivative instruments, net of tax	1,087	(575	) 1,043	(133
Change in unrealized gains/losses on marketable securities:				
Change in fair value of marketable securities, net of tax benefit/(expense) of \$154, \$(197), \$1,159 and \$536, respectively	(568	) 364	(3,417	) (980
Adjustment for net (gains)/losses realized and included in net income, net of tax expense/(benefit) of \$(7), \$16, \$27 and \$12, respectively	24	(32	) (22	) (25
Total change in unrealized gains/losses on marketable securities, net of tax	(544	) 332	(3,439	) (1,005
Total other comprehensive income/(loss)	(47	) (123	) (2,683	) (1,179
Total comprehensive income	\$11,472	\$8,594	\$42,723	\$36,458
See accompanying Notes to Condensed Consolidated Financial Statements.				

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Apple Inc.

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

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

	June 30, 2018	September 30, 2017
ASSETS:		
Current assets:		
Cash and cash equivalents	\$31,971	\$ 20,289
Short-term marketable securities	38,999	53,892
Accounts receivable, net	14,104	17,874
Inventories	5,936	4,855
Vendor non-trade receivables	12,263	17,799
Other current assets	12,488	13,936
Total current assets	115,761	128,645
Long-term marketable securities	172,773	194,714
Property, plant and equipment, net	38,117	33,783
Other non-current assets	22,546	18,177
Total assets	\$349,197	\$ 375,319
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	\$38,489	\$ 49,049
Accrued expenses	25,184	25,744
Deferred revenue	7,403	7,548
Commercial paper	11,974	11,977
Current portion of long-term debt	5,498	6,496
Total current liabilities	88,548	100,814
Deferred revenue, non-current	2,878	2,836
Long-term debt	97,128	97,207
Other non-current liabilities	45,694	40,415
Total liabilities	234,248	241,272
Commitments and contingencies		
Shareholders' equity:		
Common stock and additional paid-in capital, \$0.00001 par value: 12,600,000 shares authorized; 4,842,917 and 5,126,201 shares issued and outstanding, respectively	38,624	35,867
Retained earnings	79,436	98,330
Accumulated other comprehensive income/(loss)	(3,111)	(150)
Total shareholders' equity	114,949	134,047
Total liabilities and shareholders' equity	\$349,197	\$ 375,319
See accompanying Notes to Condensed Consolidated Financial Statements.		

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Apple Inc.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(In millions)

	Nine Months Ended	
	June 30, 2018	July 1, 2017
Cash and cash equivalents, beginning of the period	\$20,289	\$20,484
Operating activities:		
Net income	45,406	37,637
Adjustments to reconcile net income to cash generated by operating activities:		
Depreciation and amortization	8,149	7,673
Share-based compensation expense	3,995	3,666
Deferred income tax expense/(benefit)	(33,109)	4,764
Other	(410)	(142)
Changes in operating assets and liabilities:		
Accounts receivable, net	3,756	3,381
Inventories	(1,114)	(1,014)
Vendor non-trade receivables	5,536	3,312
Other current and non-current assets	(65)	(3,229)
Accounts payable	(11,139)	(5,212)
Deferred revenue	(103)	(418)
Other current and non-current liabilities	37,009	(1,942)
Cash generated by operating activities	57,911	48,476
Investing activities:		
Purchases of marketable securities	(56,133)	(123,781)
Proceeds from maturities of marketable securities	46,290	19,347
Proceeds from sales of marketable securities	41,614	76,747
Payments for acquisition of property, plant and equipment	(10,272)	(8,586)
Payments made in connection with business acquisitions, net	(431)	(248)
Purchases of non-marketable securities	(1,788)	(213)
Proceeds from non-marketable securities	310	126
Other	(523)	104
Cash generated by/(used in) investing activities	19,067	(36,504)
Financing activities:		
Proceeds from issuance of common stock	328	274
Payments for taxes related to net share settlement of equity awards	(2,267)	(1,646)
Payments for dividends and dividend equivalents	(10,182)	(9,499)
Repurchases of common stock	(53,634)	(25,105)
Proceeds from issuance of term debt, net	6,969	21,725
Repayments of term debt	(6,500)	(3,500)
Change in commercial paper, net	(10)	3,866
Cash used in financing activities	(65,296)	(13,885)
Increase/(Decrease) in cash and cash equivalents	11,682	(1,913)
Cash and cash equivalents, end of the period	\$31,971	\$18,571
Supplemental cash flow disclosure:		
Cash paid for income taxes, net	\$8,819	\$9,752
Cash paid for interest	\$2,120	\$1,456

See accompanying Notes to Condensed Consolidated Financial Statements.

Apple Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 1 – Summary of Significant Accounting Policies

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

Basis of Presentation and Preparation

The accompanying condensed consolidated financial statements include the accounts of the Company. Intercompany accounts and transactions have been eliminated. In the opinion of the Company’s management, the condensed consolidated financial statements reflect all adjustments, which are normal and recurring in nature, necessary for fair financial statement presentation. The preparation of these condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles (“GAAP”) requires management to make estimates and assumptions that affect the amounts reported in these condensed consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates. Certain prior period amounts in the condensed consolidated financial statements and accompanying notes have been reclassified to conform to the current period’s presentation. These condensed consolidated financial statements and accompanying notes should be read in conjunction with the Company’s annual consolidated financial statements and the notes thereto included in its Annual Report on Form 10-K for the fiscal year ended September 30, 2017 (the “2017 Form 10-K”).

The Company’s fiscal year is the 52- or 53-week period that ends on the last Saturday of September. The first quarter of 2018 spanned 13 weeks, whereas a 14th week was added to the first fiscal quarter of 2017, as is done every five or six years, to realign the Company’s fiscal quarters with calendar quarters. Unless otherwise stated, references to particular years, quarters, months and periods refer to the Company’s fiscal years ended in September and the associated quarters, months and periods of those fiscal years.

Share-Based Compensation

During the first quarter of 2018, the Company adopted the Financial Accounting Standards Board’s (the “FASB”) Accounting Standards Update (“ASU”) No. 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (“ASU 2016-09”), which modified certain aspects of the accounting for share-based payment transactions, including income taxes, classification of awards and classification in the statement of cash flows. Historically, excess tax benefits or deficiencies from the Company’s equity awards were recorded as additional paid-in capital in its Condensed Consolidated Balance Sheets and were classified as a financing activity in its Condensed Consolidated Statements of Cash Flows. Beginning in 2018, the Company records any excess tax benefits or deficiencies from its equity awards as part of the provision for income taxes in its Condensed Consolidated Statements of Operations in the reporting periods in which equity vesting occurs. The Company elected to apply the cash flow classification requirements related to excess tax benefits retrospectively to all periods presented, which resulted in an increase to cash generated by operating activities in the Condensed Consolidated Statements of Cash Flows of \$534 million for the nine months ended July 1, 2017.

Earnings Per Share

The following table shows the computation of basic and diluted earnings per share for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 (net income in millions and shares in thousands):

	Three Months		Nine Months	
	Ended		Ended	
	June 30,	July 1,	June 30,	July 1,
	2018	2017	2018	2017
Numerator:				
Net income	\$ 11,519	\$ 8,717	\$ 45,406	\$ 37,637
Denominator:				
Weighted-average basic shares outstanding	4,882,167	5,195,088	5,006,640	5,239,847
Effect of dilutive securities	44,442	38,411	44,323	34,547
Weighted-average diluted shares	4,926,609	5,233,499	5,050,963	5,274,394
Basic earnings per share	\$ 2.36	\$ 1.68	\$ 9.07	\$ 7.18
Diluted earnings per share	\$ 2.34	\$ 1.67	\$ 8.99	\$ 7.14

Note 2 – Financial Instruments

Cash, Cash Equivalents and Marketable Securities

The following tables show the Company's cash and available-for-sale securities by significant investment category as of June 30, 2018 and September 30, 2017 (in millions):

	June 30, 2018				Cash and Cash Equivalents	Short-Term Marketable Securities	Long-Term Marketable Securities
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value			
Cash	\$ 9,973	\$ —	\$ —	\$ 9,973	\$ 9,973	\$ —	\$ —
Level 1 ⁽¹⁾ :							
Money market funds	7,722	—	—	7,722	7,722	—	—
Mutual funds	799	—	(112)	687	—	687	—
Subtotal	8,521	—	(112)	8,409	7,722	687	—
Level 2 ⁽²⁾ :							
U.S. Treasury securities	47,056	1	(1,055)	46,002	350	7,262	38,390
U.S. agency securities	6,994	—	(44)	6,950	4,477	483	1,990
Non-U.S. government securities	11,774	40	(282)	11,532	—	1,124	10,408
Certificates of deposit and time deposits	5,662	—	—	5,662	3,649	1,412	601
Commercial paper	7,064	—	—	7,064	5,653	1,411	—
Corporate securities	130,945	129	(2,246)	128,828	147	25,874	102,807
Municipal securities	956	—	(8)	948	—	172	776
Mortgage- and asset-backed securities	18,919	9	(553)	18,375	—	574	17,801
Subtotal	229,370	179	(4,188)	225,361	14,276	38,312	172,773
Total ⁽³⁾	\$ 247,864	\$ 179	\$ (4,300)	\$ 243,743	\$ 31,971	\$ 38,999	\$ 172,773

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September 30, 2017

	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short-Term Marketable Securities	Long-Term Marketable Securities
Cash	\$7,982	\$ —	\$ —	\$7,982	\$ 7,982	\$ —	\$ —
Level 1 ⁽¹⁾ :							
Money market funds	6,534	—	—	6,534	6,534	—	—
Mutual funds	799	—	(88)	711	—	711	—
Subtotal	7,333	—	(88)	7,245	6,534	711	—
Level 2 ⁽²⁾ :							
U.S. Treasury securities	55,254	58	(230)	55,082	865	17,228	36,989
U.S. agency securities	5,162	2	(9)	5,155	1,439	2,057	1,659
Non-U.S. government securities	7,827	210	(37)	8,000	9	123	7,868
Certificates of deposit and time deposits	5,832	—	—	5,832	1,142	3,918	772
Commercial paper	3,640	—	—	3,640	2,146	1,494	—
Corporate securities	152,724	969	(242)	153,451	172	27,591	125,688
Municipal securities	961	4	(1)	964	—	114	850
Mortgage- and asset-backed securities	21,684	35	(175)	21,544	—	656	20,888
Subtotal	253,084	1,278	(694)	253,668	5,773	53,181	194,714
Total	\$268,399	\$ 1,278	\$ (782)	\$268,895	\$ 20,289	\$ 53,892	\$ 194,714

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

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

(3) As of June 30, 2018, total cash, cash equivalents and marketable securities included \$8.8 billion, related to the State Aid Decision (see Note 4, "Income Taxes") and other agreements, which was restricted from general use.

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

The following tables show information about the Company's marketable securities that had been in a continuous unrealized loss position for less than 12 months and for 12 months or greater as of June 30, 2018 and September 30, 2017 (in millions):

	June 30, 2018		
	Continuous Unrealized Losses		
	Less than 12 Months	12 Months or Greater	Total
Fair value of marketable securities	\$150,468	\$36,960	\$187,428
Unrealized losses	\$(3,134)	\$(1,166)	\$(4,300)
	September 30, 2017		
	Continuous Unrealized Losses		
	Less than 12 Months	12 Months	Total

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or
Greater

Fair value of marketable securities	\$ 101,986	\$ 8,290	\$ 110,276
Unrealized losses	\$(596)	\$(186)	\$(782)

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The Company typically invests in highly rated securities, and its investment policy generally limits the amount of credit exposure to any one issuer. The policy generally requires securities to be investment grade, with the primary objective of minimizing the potential risk of principal loss. Fair values were determined for each individual security in the investment portfolio. When evaluating an investment for other-than-temporary impairment, the Company reviews factors such as the length of time and extent to which fair value has been below its cost basis, the financial condition of the issuer and any changes thereto, changes in market interest rates and the Company's intent to sell, or whether it is more likely than not it will be required to sell the investment before recovery of the investment's cost basis. As of June 30, 2018, the Company does not consider any of its investments to be other-than-temporarily impaired.

Derivative Financial Instruments

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

To help protect gross margins from fluctuations in foreign currency exchange rates, certain of the Company's subsidiaries whose functional currency is the U.S. dollar may hedge a portion of forecasted foreign currency revenue, and subsidiaries whose functional currency is not the U.S. dollar and who sell in local currencies may hedge a portion of forecasted inventory purchases not denominated in the subsidiaries' functional currencies. The Company may enter into forward contracts, option contracts or other instruments to manage this risk and may designate these instruments as cash flow hedges. The Company generally 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. In addition, the Company may use non-derivative financial instruments, such as its foreign currency-denominated debt, as economic hedges of its net investments in certain foreign subsidiaries. In both of these cases, the Company designates these instruments as net investment hedges.

To help protect the Company's foreign currency-denominated term debt or marketable securities from fluctuations in foreign currency exchange rates, the Company may enter into forward contracts, cross-currency swaps or other instruments. These instruments may offset a portion of the foreign currency remeasurement gains or losses, or changes in fair value. The Company may designate these instruments as either cash flow or fair value hedges. As of June 30, 2018, the Company's hedged term debt- and marketable securities-related foreign currency transactions are expected to be recognized within 24 years.

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

To help protect the Company's foreign currency-denominated term debt or marketable securities from fluctuations in interest rates, the Company may enter into interest rate swaps, options or other instruments. These instruments may offset a portion of the changes in interest income or expense, or changes in fair value. The Company designates these instruments as either cash flow or fair value hedges. As of June 30, 2018, the Company's hedged interest rate transactions are expected to be recognized within 9 years.

Cash Flow Hedges

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

of cash flow hedges are recognized in other income/(expense), net.

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

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Net Investment Hedges

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

Fair Value Hedges

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

Non-Designated Derivatives

Derivatives that are not designated as hedging instruments are adjusted to fair value through earnings in the financial statement line item to which the derivative relates. As a result, during the three- and nine-month periods ended June 30, 2018, respectively, the Company recognized a gain of \$135 million and a loss of \$7 million in net sales, a gain of \$151 million and a loss of \$61 million in cost of sales and a gain of \$254 million and a loss of \$119 million in other income/(expense), net. During the three- and nine-month periods ended July 1, 2017, respectively, the Company recognized a loss of \$77 million and a gain of \$129 million in net sales, gains of \$12 million and \$91 million in cost of sales and gains of \$49 million and \$481 million in other income/(expense), net.

The Company records all derivatives in the Condensed Consolidated Balance Sheets at fair value. The Company’s accounting treatment for these derivative instruments is based on its hedge designation. The following tables show the Company’s derivative instruments at gross fair value as of June 30, 2018 and September 30, 2017 (in millions):

	June 30, 2018		
	Fair Value of Derivatives Designated as Hedge Instruments	Fair Value of Derivatives Not Designated as Hedge Instruments	Total Fair Value

Derivative assets ⁽¹⁾:

Foreign exchange contracts	\$ 850	\$ 385	\$ 1,235
Interest rate contracts	\$ —	\$ —	\$ —

Derivative liabilities ⁽²⁾:

Foreign exchange contracts	\$ 357	\$ 221	\$ 578
Interest rate contracts	\$ 1,271	\$ —	\$ 1,271

	September 30, 2017		
	Fair Value of Derivatives Designated as Hedge Instruments	Fair Value of Derivatives Not Designated as Hedge Instruments	Total Fair Value

Derivative assets ⁽¹⁾:

Foreign exchange contracts	\$ 1,049	\$ 363	\$ 1,412
Interest rate contracts	\$ 218	\$ —	\$ 218

Derivative liabilities ⁽²⁾:

Foreign exchange contracts	\$ 759	\$ 501	\$ 1,260
Interest rate contracts	\$ 303	\$ —	\$ 303

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

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The following table shows the pre-tax gains and losses of the Company's derivative and non-derivative instruments designated as cash flow, net investment and fair value hedges in OCI and the Condensed Consolidated Statements of Operations for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 (in millions):

	Three Months Ended June 30, 2018		Nine Months Ended June 30, July 1, 2017	
Gains/(Losses) recognized in OCI – effective portion:				
Cash flow hedges:				
Foreign exchange contracts	\$40	\$(143)	\$230	\$1,267
Interest rate contracts	—	(2)	1	7
Total	\$40	\$(145)	\$231	\$1,274
Net investment hedges:				
Foreign currency debt	\$13	\$16	\$(18)	\$53
Gains/(Losses) reclassified from AOCI into net income – effective portion:				
Cash flow hedges:				
Foreign exchange contracts	\$(1,231)	\$585	\$(1,068)	\$1,418
Interest rate contracts	—	—	3	(3)
Total	\$(1,231)	\$585	\$(1,065)	\$1,415
Gains/(Losses) on derivative instruments:				
Fair value hedges:				
Foreign exchange contracts	\$31	\$—	\$31	\$—
Interest rate contracts	(230)	185	(1,178)	(737)
Total	\$(199)	\$185	\$(1,147)	\$(737)
Gains/(Losses) related to hedged items:				
Fair value hedges:				
Marketable securities	\$(31)	\$—	\$(31)	\$—
Fixed-rate debt	230	(185)	1,178	737
Total	\$199	\$(185)	\$1,147	\$737

The following table shows the notional amounts of the Company's outstanding derivative instruments and credit risk amounts associated with outstanding or unsettled derivative instruments as of June 30, 2018 and September 30, 2017 (in millions):

	June 30, 2018		September 30, 2017	
	Notional Amount	Credit Risk Amount	Notional Amount	Credit Risk Amount
Instruments designated as accounting hedges:				
Foreign exchange contracts	\$36,807	\$ 850	\$56,156	\$ 1,049
Interest rate contracts	\$33,250	\$ —	\$33,000	\$ 218
Instruments not designated as accounting hedges:				
Foreign exchange contracts	\$50,936	\$ 385	\$69,774	\$ 363

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

The Company generally enters into master netting arrangements, which are designed to reduce credit risk by permitting net settlement of transactions with the same counterparty. To further limit credit risk, the Company generally enters into collateral security arrangements that provide for collateral to be received or posted when the net fair value of certain financial instruments fluctuates from contractually established thresholds. The Company presents its derivative assets and derivative liabilities at their gross fair values in its Condensed Consolidated Balance Sheets. As of June 30, 2018, the net cash collateral posted by the Company related to derivative instruments under its collateral security arrangements was \$211 million, which was recorded as other current assets in the Condensed Consolidated Balance Sheet. As of September 30, 2017, the net cash collateral received by the Company related to derivative instruments under its collateral security arrangements was \$35 million, which was recorded as accrued expenses in the Condensed Consolidated Balance Sheet.

Under master netting arrangements with the respective counterparties to the Company's derivative contracts, the Company is allowed to net settle transactions with a single net amount payable by one party to the other. As of June 30, 2018 and September 30, 2017, the potential effects of these rights of set-off associated with the Company's derivative contracts, including the effects of collateral, would be a reduction to both derivative assets and derivative liabilities of \$1.5 billion and \$1.4 billion, respectively, resulting in a net derivative liability of \$403 million and a net derivative asset of \$32 million, respectively.

Accounts Receivable

Trade Receivables

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

The Company had no customers that individually represented 10% or more of total trade receivables as of June 30, 2018. As of September 30, 2017, the Company had two customers that individually represented 10% or more of total trade receivables, each of which accounted for 10%. The Company's cellular network carriers accounted for 45% and 59% of total trade receivables as of June 30, 2018 and September 30, 2017, respectively.

Vendor Non-Trade Receivables

The Company has non-trade receivables from certain of its manufacturing vendors resulting from the sale of components to these vendors who manufacture sub-assemblies or assemble final products for the Company. The Company purchases these components directly from suppliers. As of June 30, 2018, the Company had three vendors that individually represented 10% or more of total vendor non-trade receivables, which accounted for 54%, 12% and 11%. As of September 30, 2017, the Company had three vendors that individually represented 10% or more of total vendor non-trade receivables, which accounted for 42%, 19% and 10%.

Note 3 – Condensed Consolidated Financial Statement Details

The following tables show the Company's condensed consolidated financial statement details as of June 30, 2018 and September 30, 2017 (in millions):

Inventories

	June 30, September 30,	
	2018	2017
Components	\$ 4,287	\$ 3,025
Finished goods	1,649	1,830
Total inventories	\$ 5,936	\$ 4,855

Property, Plant and Equipment, Net

	June 30, September 30,	
	2018	2017
Land and buildings	\$15,409	\$ 13,587
Machinery, equipment and internal-use software	62,060	54,210
Leasehold improvements	7,899	7,279
Gross property, plant and equipment	85,368	75,076
Accumulated depreciation and amortization	(47,251)	(41,293)
Total property, plant and equipment, net	\$38,117	\$ 33,783

Other Non-Current Liabilities

	June 30, September 30,	
	2018	2017
Long-term taxes payable	\$34,029	\$ 257
Deferred tax liabilities	398	31,504
Other non-current liabilities	11,267	8,654
Total other non-current liabilities	\$45,694	\$ 40,415

Other Income/(Expense), Net

The following table shows the detail of other income/(expense), net for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 (in millions):

	Three Months		Nine Months	
	Ended		Ended	
	June 30,	July 1,	June 30,	July 1,
	2018	2017	2018	2017
Interest and dividend income	\$1,418	\$1,327	\$4,375	\$3,833
Interest expense	(846)	(602)	(2,372)	(1,657)
Other income/(expense), net	100	(185)	(301)	(228)
Total other income/(expense), net	\$672	\$540	\$1,702	\$1,948

Note 4 – Income Taxes

U.S. Tax Cuts and Jobs Act and Provisional Estimates

On December 22, 2017, the U.S. enacted the Tax Cuts and Jobs Act (the “Act”), which significantly changed U.S. tax law. The Act lowered the Company’s U.S. statutory federal income tax rate from 35% to 21% effective January 1, 2018, while also imposing a deemed repatriation tax on previously deferred foreign income. The Act also created a new minimum tax on certain future foreign earnings. During the first quarter of 2018, the Company’s income tax expense included a provisional estimate of \$2.6 billion in accordance with the U.S. Securities and Exchange Commission Staff Accounting Bulletin No. 118. This \$2.6 billion provisional estimate included \$1.8 billion related to the impact of remeasuring the Company’s deferred tax balances to reflect the new lower tax rate, and approximately \$800 million associated with the net impact of the deemed repatriation tax. During the third quarter of 2018, the Company reduced its estimate of the deemed repatriation tax by \$1.0 billion and adjusted the estimated impact of the deemed repatriation tax on unrecognized tax benefits by \$700 million, resulting in the reduction of the Company’s provisional estimate from \$2.6 billion to \$900 million. The adjustments to the provisional estimate for the deemed repatriation tax and unrecognized tax benefits are discussed below and their impact was included in the Company’s income tax expense during the third quarter of 2018.

Deferred Tax Balances

As a result of the Act, the Company remeasured certain deferred tax assets and liabilities based on the revised rates at which they are expected to reverse, including items for which the related income tax effects were originally recognized in OCI. In addition, the Company elected to record certain deferred tax assets and liabilities related to the new minimum tax on certain future foreign earnings. The provisional estimate of \$1.8 billion noted above incorporates assumptions based upon the best available interpretation of the Act and may change as the Company receives additional clarification and implementation guidance.

During the second quarter of 2018, the FASB issued ASU No. 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (“ASU 2018-02”). ASU 2018-02 allows an entity to elect to reclassify the income tax effects of the Act on items within AOCI to retained earnings. The Company elected to apply the provision of ASU 2018-02 at the beginning of the second quarter of 2018 with a reclassification of net tax benefits related to cumulative foreign currency translation and unrealized gains/losses on derivative instruments and marketable securities, resulting in a \$278 million decrease in AOCI and a corresponding increase in retained earnings in the Condensed Consolidated Balance Sheet.

Deemed Repatriation Tax

As of September 30, 2017, the Company had a U.S. deferred tax liability of \$36.4 billion for deferred foreign income. During the first quarter of 2018 the Company replaced \$36.1 billion of its U.S. deferred tax liability with a provisional deemed repatriation tax payable of \$38.0 billion, which was based on the Company’s cumulative post-1986 deferred foreign income. The Company’s estimate of the deemed repatriation tax is based, in part, on the amount of cash and other specified assets anticipated to be held by the Company’s foreign subsidiaries as of September 29, 2018. Therefore, the provisional tax payable is subject to change as the asset amounts are finalized. During the third quarter of 2018, the Company reduced its provisional tax payable by \$1.0 billion to \$37.0 billion due, in part, to revised estimates of the amount of cash and other specified assets anticipated to be held by the Company’s foreign subsidiaries as of September 29, 2018. The Company plans to pay the tax in installments in accordance with the Act.

Unrecognized Tax Benefits

As of June 30, 2018, the Company had gross unrecognized tax benefits of \$9.4 billion. These gross unrecognized tax benefits have been offset by certain tax deposits and reduced by the estimated impact of the deemed repatriation tax. As of December 30, 2017, the estimated impact of the deemed repatriation tax on unrecognized tax benefits was \$1.1 billion. During the third quarter of 2018, the Company increased the estimated impact of the deemed repatriation tax on unrecognized tax benefits by \$700 million, resulting in a revised total estimated impact of \$1.8 billion. Upon recognition, \$7.3 billion of the unrecognized tax benefits would impact the Company’s effective tax rate. The Company had accrued \$1.3 billion of gross interest and penalties as of June 30, 2018. Both the net unrecognized tax benefits and the interest and penalties are classified as other non-current liabilities in the Condensed Consolidated Balance Sheet.

The Company is subject to taxation and files income tax returns in the U.S. federal jurisdiction and in many state and foreign jurisdictions. The U.S. Internal Revenue Service concluded its review of the years 2013 through 2015 during the third quarter of 2018. All years prior to 2016 are now closed. The Company is also subject to audits by state, local and foreign tax authorities. In major states and major foreign jurisdictions, the years subsequent to 2003 generally remain open and could be subject to examination by the taxing authorities. The Company believes that an adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner inconsistent with its expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs. Although timing of resolution and/or closure of audits is not certain, the Company believes it is reasonably possible that its gross unrecognized tax benefits could decrease (either by payment, release or a combination of both) in the next 12 months by as much as \$500 million.

European Commission State Aid Decision

On August 30, 2016, the European Commission announced its decision that Ireland granted state aid to the Company by providing tax opinions in 1991 and 2007 concerning the tax allocation of profits of the Irish branches of two subsidiaries of the Company (the "State Aid Decision"). The State Aid Decision ordered Ireland to calculate and recover additional taxes from the Company for the period June 2003 through December 2014. The recovery amount was calculated to be €13 billion, plus interest of €1 billion. Irish legislative changes, effective as of January 2015, eliminated the application of the tax opinions from that date forward. The Company believes the State Aid Decision to be without merit and appealed to the General Court of the Court of Justice of the European Union. Ireland has also appealed the State Aid Decision. The Company believes that any incremental Irish corporate income taxes potentially due related to the State Aid Decision would be creditable against U.S. taxes, subject to any foreign tax credit limitations in the Act. During the third quarter of 2018, the Company began funding amounts into escrow, where they will remain pending conclusion of all appeals. As of June 30, 2018, €4.5 billion of the recovery amount was funded into escrow and was restricted from general use. Refer to Note 2, "Financial Instruments" for more information. Subsequent to June 30, 2018, the Company has funded an additional €4.5 billion of the recovery amount into escrow.

Note 5 – Debt

Commercial Paper

The Company issues unsecured short-term promissory notes ("Commercial Paper") pursuant to a commercial paper program. The Company uses net proceeds from the commercial paper program for general corporate purposes, including dividends and share repurchases. As of both June 30, 2018 and September 30, 2017, the Company had \$12.0 billion of Commercial Paper outstanding with maturities generally less than nine months. The weighted-average interest rate of the Company's Commercial Paper was 2.03% as of June 30, 2018 and 1.20% as of September 30, 2017. The following table provides a summary of cash flows associated with the issuance and maturities of Commercial Paper for the nine months ended June 30, 2018 and July 1, 2017 (in millions):

	Nine Months Ended June 30, July 1, 2018 2017	
Maturities 90 days or less:		
Proceeds from/(Repayments of) commercial paper, net	\$2,619	\$(143)
Maturities greater than 90 days:		
Proceeds from commercial paper	9,782	12,633
Repayments of commercial paper	(12,411)	(8,624)
Proceeds from/(Repayments of) commercial paper, net	(2,629)	4,009
Total change in commercial paper, net	\$(10)	\$3,866

Term Debt

As of June 30, 2018, the Company had outstanding floating- and fixed-rate notes with varying maturities for an aggregate principal amount of \$104.1 billion (collectively the "Notes"). The Notes are senior unsecured obligations, and

interest is payable in arrears, quarterly for the U.S. dollar-denominated and Australian dollar-denominated floating-rate notes, semi-annually for the U.S. dollar-denominated, Australian dollar-denominated, British pound-denominated, Japanese yen-denominated and Canadian dollar-denominated fixed-rate notes and annually for the euro-denominated and Swiss franc-denominated fixed-rate notes.

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The following table provides a summary of the Company's term debt as of June 30, 2018 and September 30, 2017:

	Maturities	June 30, 2018		September 30, 2017	
		Amount (in millions)	Effective Interest Rate	Amount (in millions)	Effective Interest Rate
2013 debt issuance of \$17.0 billion:					
Floating-rate notes	—	\$—	— %	\$2,000	1.10% 1.10%
Fixed-rate 2.400% – 3.850% notes	2023–2043	8,500	2.44%–3.91 %	12,500	1.08%–3.91 %
2014 debt issuance of \$12.0 billion:					
Floating-rate notes	2019 2019	1,000	2.66% 2.66 %	1,000	1.61% 1.61 %
Fixed-rate 2.100% – 4.450% notes	2019–2044	8,500	2.66%–4.48 %	8,500	1.61%–4.48 %
2015 debt issuances of \$27.3 billion:					
Floating-rate notes	2019–2020	1,517	1.87%–2.66 %	1,549	1.56%–1.87 %
Fixed-rate 0.350% – 4.375% notes	2019–2045	24,395	0.28%–4.51 %	24,522	0.28%–4.51 %
2016 debt issuances of \$24.9 billion:					
Floating-rate notes	2019–2021	1,350	2.50%–3.46 %	1,350	1.45%–2.44 %
Fixed-rate 1.100% – 4.650% notes	2019–2046	23,079	1.13%–4.78 %	23,645	1.13%–4.78 %
2017 debt issuances of \$28.7 billion:					
Floating-rate notes	2019–2022	3,250	2.43%–2.87 %	3,250	1.38%–1.81 %
Fixed-rate 0.875% – 4.300% notes	2019–2047	25,533	1.54%–4.30 %	25,705	1.51%–4.30 %
First quarter 2018 debt issuance of \$7.0 billion:					
Fixed-rate 1.800% notes	2019	1,000	1.83 %	—	— %
Fixed-rate 2.000% notes	2020	1,000	2.03 %	—	— %
Fixed-rate 2.400% notes	2023	750	2.66 %	—	— %
Fixed-rate 2.750% notes	2025	1,500	2.77 %	—	— %
Fixed-rate 3.000% notes	2027	1,500	3.07 %	—	— %
Fixed-rate 3.750% notes	2047	1,250	3.80 %	—	— %
Total term debt		104,124		104,021	
Unamortized premium/(discount) and issuance costs, net		(227)		(225)	
Hedge accounting fair value adjustments		(1,271)		(93)	
Less: Current portion of long-term debt		(5,498)		(6,496)	
Total long-term debt		\$97,128		\$97,207	

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

A portion of the Company's Japanese yen-denominated notes is designated as a hedge of the foreign currency exposure of the Company's net investment in a foreign operation. As of June 30, 2018 and September 30, 2017, the carrying value of the debt designated as a net investment hedge was \$349 million and \$1.6 billion, respectively. For further discussion regarding the Company's use of derivative instruments, see the Derivative Financial Instruments section of Note 2, "Financial Instruments."

The effective interest rates for the Notes include the interest on the Notes, amortization of the discount or premium and, if applicable, adjustments related to hedging. The Company recognized \$780 million and \$2.2 billion of interest expense on its term debt for the three- and nine-month periods ended June 30, 2018, respectively. The Company recognized \$574 million and \$1.6 billion of interest expense on its term debt for the three- and nine-month periods ended July 1, 2017, respectively.

As of June 30, 2018 and September 30, 2017, the fair value of the Company's Notes, based on Level 2 inputs, was \$103.1 billion and \$106.1 billion, respectively.

Note 6 – Shareholders’ Equity

Share Repurchase Program

During the third quarter of 2018, the Company repurchased 112.8 million shares of its common stock for \$20.0 billion in connection with two separate share repurchase programs. Of the \$20.0 billion, \$10.4 billion was repurchased under the Company’s previous share repurchase program of up to \$210 billion, thereby completing that program. On May 1, 2018, the Company announced the Board of Directors had authorized a new program to repurchase up to \$100 billion of the Company’s common stock. The remaining \$9.6 billion repurchased during the third quarter of 2018 was in connection with the new share repurchase program. The Company’s new share repurchase program does not obligate it to acquire any specific number of shares. Under this program, shares may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”).

Note 7 – Comprehensive Income

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

The following table shows the pre-tax amounts reclassified from AOCI into the Condensed Consolidated Statements of Operations, and the associated financial statement line item, for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 (in millions):

Comprehensive Income Components	Financial Statement Line Item	Three Months Ended		Nine Months Ended	
		June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Unrealized (gains)/losses on derivative instruments:					
Foreign exchange contracts	Net sales	\$162	\$(148)	\$433	\$(657)
	Cost of sales	206	(73)	200	(630)
	Other income/(expense), net	864	(364)	441	(127)
Interest rate contracts	Other income/(expense), net	—	—	(3)	3
		1,232	(585)	1,071	(1,411)
Unrealized (gains)/losses on marketable securities	Other income/(expense), net	31	(48)	(49)	(37)
Total amounts reclassified from AOCI		\$1,263	\$(633)	\$1,022	\$(1,448)

The following table shows the changes in AOCI by component for the nine months ended June 30, 2018 (in millions):

	Cumulative Foreign Currency Translation	Unrealized Gains/Losses on Derivative Instruments	Unrealized Gains/Losses on Marketable Securities	Total
Balances as of September 30, 2017	\$ (354)	\$ (124)	\$ 328	\$(150)
Other comprehensive income/(loss) before reclassifications	(291)	230	(4,576)	(4,637)
Amounts reclassified from AOCI	—	1,071	(49)	1,022
Tax effect	4	(258)	1,186	932
Other comprehensive income/(loss)	(287)	1,043	(3,439)	(2,683)
Cumulative effect of change in accounting principle ⁽¹⁾	(176)	29	(131)	(278)
Balances as of June 30, 2018	\$ (817)	\$ 948	\$ (3,242)	\$(3,111)

Refer to Note 4, “Income Taxes” for more information on the Company’s adoption of ASU 2018-02 at the beginning of the second quarter of 2018.

Note 8 – Benefit Plans

Stock Plans

The Company had 280.4 million shares reserved for future issuance under its stock plans as of June 30, 2018.

Restricted stock units (“RSUs”) granted generally vest over four years, based on continued employment, and are settled upon vesting in shares of the Company’s common stock on a one-for-one basis. Each share issued with respect to RSUs granted under the Company’s stock plans reduces the number of shares available for grant under the plans by two shares. RSUs canceled and shares withheld to satisfy tax withholding obligations increase the number of shares available for grant under the plans utilizing a factor of two times the number of RSUs canceled or shares withheld.

Rule 10b5-1 Trading Plans

During the three months ended June 30, 2018, Section 16 officers Angela Ahrendts, Timothy D. Cook, Chris Kondo, Luca Maestri, Daniel Riccio, Philip Schiller and Jeffrey Williams had equity trading plans in place in accordance with Rule 10b5-1(c)(1) under the Exchange Act. An equity trading plan is a written document that pre-establishes the amounts, prices and dates (or formula for determining the amounts, prices and dates) of future purchases or sales of the Company’s stock, including shares acquired pursuant to the Company’s employee and director equity plans.

Restricted Stock Units

A summary of the Company’s RSU activity and related information for the nine months ended June 30, 2018 is as follows:

	Number of RSUs (in thousands)	Weighted-Average Grant Date Fair Value Per RSU	Aggregate Fair Value (in millions)
Balance as of September 30, 2017	97,571	\$ 110.33	
RSUs granted	43,340	\$ 160.79	
RSUs vested	(41,292)	\$ 111.62	
RSUs canceled	(4,884)	\$ 126.32	
Balance as of June 30, 2018	94,735	\$ 132.03	\$ 17,536

The fair value as of the respective vesting dates of RSUs was \$3.3 billion and \$6.9 billion for the three- and nine-month periods ended June 30, 2018, respectively, and was \$2.8 billion and \$5.4 billion for the three- and nine-month periods ended July 1, 2017, respectively.

Share-Based Compensation

The following table shows a summary of the share-based compensation expense included in the Condensed Consolidated Statements of Operations for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 (in millions):

	Three Months Ended June 30, July 1, 2018 2017		Nine Months Ended June 30, July 1, 2018 2017	
Cost of sales	\$250	\$216	\$759	\$662
Research and development	675	566	1,987	1,730
Selling, general and administrative	426	411	1,249	1,274
Total share-based compensation expense	\$1,351	\$1,193	\$3,995	\$3,666

The income tax benefit related to share-based compensation expense was \$528 million and \$1.5 billion for the three- and nine-month periods ended June 30, 2018, respectively, and was \$380 million and \$1.3 billion for the three- and nine-month periods ended July 1, 2017, respectively. As of June 30, 2018, the total unrecognized compensation cost related to outstanding RSUs and stock options was \$10.4 billion, which the Company expects to recognize over a weighted-average period of 2.6 years.

Note 9 – Commitments and Contingencies

Accrued Warranty and Indemnification

The following table shows changes in the Company’s accrued warranties and related costs for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 (in millions):

	Three Months Ended June 30, July 1, 2018 2017		Nine Months Ended June 30, July 1, 2018 2017	
Beginning accrued warranty and related costs	\$4,030	\$4,735	\$3,834	\$3,702
Cost of warranty claims	(1,044)	(932)	(2,959)	(3,300)
Accruals for product warranty	567	496	2,678	3,897
Ending accrued warranty and related costs	\$3,553	\$4,299	\$3,553	\$4,299

Agreements entered into by the Company sometimes include indemnification provisions which may subject the Company to costs and damages in the event of a claim against an indemnified third party. Except as disclosed under the heading “Contingencies” below, in the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to indemnification of third parties.

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

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

Concentrations in the Available Sources of Supply of Materials and Product

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

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

The Company has entered into agreements for the supply of many components; however, there can be no guarantee that the Company will be able to extend or renew these agreements on similar terms, or at all. Therefore, the Company

remains subject to significant risks of supply shortages and price increases that could materially adversely affect its financial condition and operating results.

Substantially all of the Company's hardware products are manufactured by outsourcing partners that are located primarily in Asia, with some Mac computers manufactured in the U.S. and Ireland. A significant concentration of this manufacturing is currently performed by a small number of outsourcing partners, often in single locations. Certain of these outsourcing partners are 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 manufacturing purchase obligations typically cover its requirements for periods up to 150 days.

Other Off-Balance Sheet Commitments

Operating Leases

The Company leases various equipment and facilities, including retail space, under noncancelable operating lease arrangements. The Company does not currently utilize any other off-balance sheet financing arrangements. As of June 30, 2018, the Company's total future minimum lease payments under noncancelable operating leases were \$9.6 billion. The Company's retail store and other facility leases typically have original terms not exceeding 10 years and generally contain multi-year renewal options.

Unconditional Purchase Obligations

The Company has entered into certain off-balance sheet arrangements which require the future purchase of goods or services ("unconditional purchase obligations"). The Company's unconditional purchase obligations primarily consist of payments for supplier arrangements, internet and telecommunication services and intellectual property licenses. As of June 30, 2018, the Company's total future payments under noncancelable unconditional purchase obligations having a remaining term in excess of one year were \$8.5 billion.

Contingencies

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

VirnetX

VirnetX, Inc. filed two lawsuits in the U.S. District Court for the Eastern District of Texas (the "Eastern Texas District Court") against the Company alleging that certain Company products infringe four patents (the "VirnetX Patents") relating to network communications technology ("VirnetX I" and "VirnetX II"). On September 30, 2016, a jury returned a verdict in VirnetX I against the Company and awarded damages of \$302 million, which later increased to \$440 million in post-trial proceedings. VirnetX I is currently on appeal at the U.S. Court of Appeals for the Federal Circuit (the "Federal Circuit"). On April 11, 2018, a jury returned a verdict in VirnetX II against the Company and awarded damages of \$503 million. VirnetX II is currently in post-trial proceedings and is expected to proceed to appeal thereafter. The Company has challenged the validity of the VirnetX Patents at the U.S. Patent and Trademark Office (the "PTO"). In response, the PTO has declared the VirnetX Patents invalid. VirnetX has appealed, and those appeals are currently pending at the Federal Circuit. The Federal Circuit has consolidated the Company's appeal of the Eastern Texas District Court VirnetX I verdict and VirnetX's appeals from the PTO invalidity proceedings. The Company believes it will prevail on the merits.

Qualcomm

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

quarter of 2017. The Company believes it will prevail on the merits of the case and has accrued its best estimate for the ultimate resolution of this matter.

Note 10 – Segment Information and Geographic Data

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

The Company manages its business primarily on a geographic basis. The Company’s reportable segments consist of the Americas, Europe, Greater China, Japan and Rest of Asia Pacific. Americas includes both North and South America. Europe includes European countries, as well as India, the Middle East and Africa. Greater China includes China, Hong Kong and Taiwan. Rest of Asia Pacific includes Australia and those Asian countries not included in the Company’s other reportable segments. Although the reportable segments provide similar hardware and software products and similar services, each one is managed separately to better align with the location of the Company’s customers and distribution partners and the unique market dynamics of each geographic region. The accounting policies of the various segments are the same as those described in Note 1, “Summary of Significant Accounting Policies” of the Notes to Consolidated Financial Statements in Part II, Item 8 of the 2017 Form 10-K.

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

The following table shows information by reportable segment for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 (in millions):

	Three Months Ended June 30, July 1, 2018 2017		Nine Months Ended June 30, July 1, 2018 2017	
Americas:				
Net sales	\$24,542	\$20,376	\$84,576	\$73,501
Operating income	\$7,496	\$6,420	\$26,580	\$23,582
Europe:				
Net sales	\$12,138	\$10,675	\$47,038	\$41,929
Operating income	\$3,892	\$2,984	\$15,044	\$12,571
Greater China:				
Net sales	\$9,551	\$8,004	\$40,531	\$34,963
Operating income	\$3,414	\$3,002	\$15,285	\$13,402
Japan:				
Net sales	\$3,867	\$3,624	\$16,572	\$13,875
Operating income	\$1,765	\$1,624	\$7,193	\$6,334
Rest of Asia Pacific:				
Net sales	\$3,167	\$2,729	\$13,978	\$12,387
Operating income	\$1,127	\$892	\$4,980	\$4,430

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A reconciliation of the Company's segment operating income to the Condensed Consolidated Statements of Operations for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 is as follows (in millions):

	Three Months		Nine Months	
	Ended		Ended	
	June 30,	July 1,	June 30,	July 1,
	2018	2017	2018	2017
Segment operating income	\$17,694	\$14,922	\$69,082	\$60,319
Research and development expense	(3,701)	(2,937)	(10,486)	(8,584)
Other corporate expenses, net	(1,381)	(1,217)	(3,816)	(3,511)
Total operating income	\$12,612	\$10,768	\$54,780	\$48,224

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

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

Forward-looking statements provide current expectations of future events based on certain assumptions and include any statement that does not directly relate to any historical or current fact. Forward-looking statements can also be identified by words such as "future," "anticipates," "believes," "estimates," "expects," "intends," "plans," "predicts," "will," "could," "can," "may," and similar terms. Forward-looking statements are not guarantees of future performance and the Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in Part II, Item 1A of this Form 10-Q under the heading "Risk Factors," which are incorporated herein by reference. The following discussion should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended September 30, 2017 (the "2017 Form 10-K") filed with the U.S. Securities and Exchange Commission (the "SEC") and the condensed consolidated financial statements and notes thereto included in Part I, Item 1 of this Form 10-Q. All information presented herein is based on the Company's fiscal calendar. Unless otherwise stated, references to particular years, quarters, months or periods refer to the Company's fiscal years ended in September and the associated quarters, months and periods of those fiscal years. Each of the terms the "Company" and "Apple" as used herein refers collectively to Apple Inc. and its wholly-owned subsidiaries, unless otherwise stated. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Available Information

The Company's Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), are filed with the SEC. The Company is subject to the informational requirements of the Exchange Act and files or furnishes reports, proxy statements, and other information with the SEC. Such reports and other information filed by the Company with the SEC are available free of charge 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 information contained on the websites referenced in this Form 10-Q is not incorporated by reference into this filing. Further, the Company's references to website URLs are intended to be inactive textual references only.

Overview and Highlights

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

Business Strategy

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

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

Business Seasonality and Product Introductions

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

Fiscal Period

The Company's fiscal year is the 52- or 53-week period that ends on the last Saturday of September. The first quarter of 2018 spanned 13 weeks, whereas a 14th week was added to the first quarter of 2017, as is done every five or six years, to realign fiscal quarters with calendar quarters.

Third Quarter Fiscal 2018 Highlights

Net sales increased 17% or \$7.9 billion during the third quarter of 2018 compared to the same quarter in 2017, primarily driven by higher net sales of iPhone, Services and Other Products. Additionally, the strength in foreign currencies relative to the U.S. dollar had a favorable impact on net sales during the third quarter of 2018 compared to the same quarter in 2017. Net sales increased year-over-year in each of the geographic reportable segments.

During the third quarter of 2018, the Company announced iOS 12, macOS Mojave, watchOS 5 and tvOS 12, updates to its operating systems which are expected to be available in the fall of 2018.

The Company spent \$20.0 billion to repurchase shares of its common stock and paid dividends and dividend equivalents of \$3.7 billion during the third quarter of 2018.

Sales Data

The following table shows net sales by reportable segment and net sales and unit sales by product for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 (dollars in millions and units in thousands):

	Three Months Ended			Nine Months Ended		
	June 30, 2018	July 1, 2017	Change	June 30, 2018	July 1, 2017	Change
Net Sales by Reportable Segment:						
Americas	\$24,542	\$20,376	20 %	\$84,576	\$73,501	15 %
Europe	12,138	10,675	14 %	47,038	41,929	12 %
Greater China	9,551	8,004	19 %	40,531	34,963	16 %
Japan	3,867	3,624	7 %	16,572	13,875	19 %
Rest of Asia Pacific	3,167	2,729	16 %	13,978	12,387	13 %
Total net sales	\$53,265	\$45,408	17 %	\$202,695	\$176,655	15 %

Net Sales by Product:

iPhone ⁽¹⁾	\$29,906	\$24,846	20 %	\$129,514	\$112,473	15 %
iPad ⁽¹⁾	4,741	4,969	(5) %	14,716	14,391	2 %
Mac ⁽¹⁾	5,330	5,592	(5) %	18,073	18,680	(3) %
Services ⁽²⁾	9,548	7,266	31 %	27,209	21,479	27 %
Other Products ⁽¹⁾⁽³⁾	3,740	2,735	37 %	13,183	9,632	37 %
Total net sales	\$53,265	\$45,408	17 %	\$202,695	\$176,655	15 %

Unit Sales by Product:

iPhone	41,300	41,026	1 %	170,833	170,079	— %
iPad	11,553	11,424	1 %	33,836	33,427	1 %
Mac	3,720	4,292	(13) %	12,910	13,865	(7) %

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

Includes revenue from Digital Content and Services, AppleCare®, Apple Pay, licensing and other services.

(2) Services net sales in the third quarter of 2018 included a favorable one-time item of \$236 million in connection with the final resolution of various lawsuits.

(3) Includes sales of AirPods, Apple TV, Apple Watch, Beats® products, HomePod, iPod touch and other Apple-branded and third-party accessories.

Product Performance

iPhone

The following table presents iPhone net sales and unit sales information for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 (dollars in millions and units in thousands):

	Three Months Ended			Nine Months Ended		
	June 30, 2018	July 1, 2017	Change	June 30, 2018	July 1, 2017	Change
Net sales	\$29,906	\$24,846	20 %	\$129,514	\$112,473	15 %
Percentage of total net sales	56 %	55 %		64 %	64 %	
Unit sales	41,300	41,026	1 %	170,833	170,079	— %

iPhone net sales increased during the third quarter and first nine months of 2018 compared to the same periods in 2017 due primarily to a different mix of iPhones resulting in higher average selling prices.

iPad

The following table presents iPad net sales and unit sales information for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 (dollars in millions and units in thousands):

	Three Months Ended			Nine Months Ended		
	June 30, 2018	July 1, 2017	Change	June 30, 2018	July 1, 2017	Change
Net sales	\$4,741	\$4,969	(5)%	\$14,716	\$14,391	2 %
Percentage of total net sales	9 %	11 %		7 %	8 %	
Unit sales	11,553	11,424	1 %	33,836	33,427	1 %

iPad net sales decreased during the third quarter of 2018 compared to the same period in 2017 due primarily to a different mix of iPads resulting in lower average selling prices. iPad net sales increased year-over-year during the first nine months of 2018 due primarily to higher iPad unit sales and the strength in foreign currencies relative to the U.S. dollar.

Mac

The following table presents Mac net sales and unit sales information for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 (dollars in millions and units in thousands):

	Three Months Ended			Nine Months Ended		
	June 30, 2018	July 1, 2017	Change	June 30, 2018	July 1, 2017	Change
Net sales	\$5,330	\$5,592	(5)%	\$18,073	\$18,680	(3)%
Percentage of total net sales	10 %	12 %		9 %	11 %	
Unit sales	3,720	4,292	(13)%	12,910	13,865	(7)%

Mac net sales decreased during the third quarter and first nine months of 2018 compared to the same periods in 2017 due primarily to lower Mac unit sales. The launch of MacBook Pro® in the first quarter of 2017 and the updated Mac portables in the third quarter of 2017 contributed to higher Mac net sales and unit sales during the first nine months of 2017.

Services

The following table presents Services net sales information for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 (dollars in millions):

	Three Months Ended			Nine Months Ended		
	June 30, 2018	July 1, 2017	Change	June 30, 2018	July 1, 2017	Change
Net sales	\$9,548	\$7,266	31 %	\$27,209	\$21,479	27 %
Percentage of total net sales	18 %	16 %		13 %	12 %	

Services net sales increased during the third quarter and first nine months of 2018 compared to the same periods in 2017 due primarily to licensing, App Store and AppleCare. During the third quarter of 2018, the Company recognized a favorable one-time item of \$236 million in connection with the final resolution of various lawsuits.

Segment Operating Performance

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

Americas

The following table presents Americas net sales information for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 (dollars in millions):

	Three Months Ended			Nine Months Ended		
	June 30, 2018	July 1, 2017	Change	June 30, 2018	July 1, 2017	Change
Net sales	\$24,542	\$20,376	20 %	\$84,576	\$73,501	15 %
Percentage of total net sales	46 %	45 %		42 %	42 %	

Americas net sales increased during the third quarter and first nine months of 2018 compared to the same periods in 2017 due primarily to higher net sales of iPhone and Services.

Europe

The following table presents Europe net sales information for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 (dollars in millions):

	Three Months Ended			Nine Months Ended		
	June 30, 2018	July 1, 2017	Change	June 30, 2018	July 1, 2017	Change
Net sales	\$12,138	\$10,675	14 %	\$47,038	\$41,929	12 %
Percentage of total net sales	23 %	24 %		23 %	24 %	

Europe net sales increased during the third quarter and first nine months of 2018 compared to the same periods in 2017 due primarily to higher net sales of iPhone and Services. Additionally, the strength in foreign currencies relative to the U.S. dollar had a favorable impact on Europe net sales.

Greater China

The following table presents Greater China net sales information for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 (dollars in millions):

	Three Months Ended			Nine Months Ended		
	June 30, 2018	July 1, 2017	Change	June 30, 2018	July 1, 2017	Change
Net sales	\$9,551	\$8,004	19 %	\$40,531	\$34,963	16 %
Percentage of total net sales	18 %	18 %		20 %	20 %	

Greater China net sales increased during the third quarter of 2018 compared to the same period in 2017 due primarily to higher net sales of iPhone and Other Products. Greater China net sales increased year-over-year during the first nine months of 2018 due primarily to higher net sales of iPhone and Services. The strength in foreign currencies relative to the U.S. dollar also had a favorable impact on Greater China net sales during the third quarter and first nine months of 2018.

Japan

The following table presents Japan net sales information for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 (dollars in millions):

	Three Months Ended			Nine Months Ended		
	June 30, 2018	July 1, 2017	Change	June 30, 2018	July 1, 2017	Change
Net sales	\$3,867	\$3,624	7 %	\$16,572	\$13,875	19 %
Percentage of total net sales	7 %	8 %		8 %	8 %	

Japan net sales increased during the third quarter of 2018 compared to the same period in 2017 due primarily to higher net sales of Services. Japan net sales increased year-over-year during the first nine months of 2018 due primarily to higher net sales of iPhone and Services. Additionally, the value of the Japanese Yen relative to the U.S. dollar had a favorable impact on Japan net sales during the third quarter of 2018 and an unfavorable impact during the first nine months of 2018.

Rest of Asia Pacific

The following table presents Rest of Asia Pacific net sales information for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 (dollars in millions):

	Three Months Ended			Nine Months Ended		
	June 30, 2018	July 1, 2017	Change	June 30, 2018	July 1, 2017	Change
Net sales	\$3,167	\$2,729	16 %	\$13,978	\$12,387	13 %
Percentage of total net sales	6 %	6 %		7 %	7 %	

Rest of Asia Pacific net sales increased during the third quarter and first nine months of 2018 compared to the same periods in 2017 due primarily to higher net sales of iPhone and Services. Additionally, the strength in foreign currencies relative to the U.S. dollar had a favorable impact on Rest of Asia Pacific net sales.

Gross Margin

Gross margin for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 was as follows (dollars in millions):

	Three Months Ended		Nine Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Net sales	\$53,265	\$45,408	\$202,695	\$176,655
Cost of sales	32,844	27,920	124,940	108,400
Gross margin	\$20,421	\$17,488	\$77,755	\$68,255
Gross margin percentage	38.3	% 38.5	% 38.4	% 38.6

Gross margin increased during the third quarter and first nine months of 2018 compared to the same periods in 2017 due primarily to higher Services net sales and a favorable shift in the mix of iPhones with higher average selling prices, partially offset by higher product cost structures. Additionally, to a lesser extent the strength in foreign currencies relative to the U.S. dollar and higher year-over-year product unit sales had a favorable impact on gross margin.

Gross margin percentage decreased during the third quarter and first nine months of 2018 compared to the same periods in 2017 due primarily to higher product cost structures, partially offset by a favorable shift in mix of products and Services. Additionally, the strength in foreign currencies relative to the U.S. dollar had a favorable impact on gross margin percentage.

The Company anticipates gross margin percentage during the fourth quarter of 2018 to be between 38.0% and 38.5%. The foregoing statement regarding the Company's expected gross margin percentage in the fourth quarter of 2018 is forward-looking and could differ from actual results. The Company's future gross margins can be impacted by multiple factors including, but not limited to, those set forth in Part II, Item 1A of this Form 10-Q under the heading "Risk Factors" and those described in this paragraph. In general, the Company believes gross margins will remain under downward pressure due to a variety of factors, including: continued industry-wide global product pricing pressures and product pricing actions that the Company may take in response to such pressures; increased competition; the Company's ability to effectively stimulate demand for certain of its products; compressed product life cycles; product transitions; potential increases in the cost of components and outside manufacturing services; the Company's ability to manage product quality and warranty costs effectively; and a potential shift in the Company's sales mix towards products with lower gross margins. Due to the Company's significant international operations, its financial condition and operating results, including gross margins, could be significantly affected by fluctuations in exchange rates.

Operating Expenses

Operating expenses for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 were as follows (dollars in millions):

	Three Months Ended		Nine Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Research and development	\$3,701	\$2,937	\$10,486	\$8,584
Percentage of total net sales	7	% 6	% 5	% 5
Selling, general and administrative	\$4,108	\$3,783	\$12,489	\$11,447
Percentage of total net sales	8	% 8	% 6	% 6
Total operating expenses	\$7,809	\$6,720	\$22,975	\$20,031
Percentage of total net sales	15	% 15	% 11	% 11

Research and Development

The growth in R&D expense during the third quarter and first nine months of 2018 compared to the same periods in 2017 was driven primarily by increases in headcount-related expenses and material costs to support expanded R&D activities. The Company continues to believe that focused investments in R&D are critical to its future growth and competitive position in the marketplace, and to the development of new and updated products and services that are central to the Company's core business strategy.

Selling, General and Administrative

The growth in selling, general and administrative expense during the third quarter and first nine months of 2018 compared to the same periods in 2017 was driven primarily by increases in headcount-related expenses, professional services and infrastructure-related costs.

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Other Income/(Expense), Net

Other income/(expense), net for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 was as follows (dollars in millions):

	Three Months Ended			Nine Months Ended		
	June 30, 2018	July 1, 2017	Change	June 30, 2018	July 1, 2017	Change
Interest and dividend income	\$1,418	\$1,327		\$4,375	\$3,833	
Interest expense	(846)	(602)		(2,372)	(1,657)	
Other income/(expense), net	100	(185)		(301)	(228)	
Total other income/(expense), net	\$672	\$540	24 %	\$1,702	\$1,948	(13)%

The increase in other income/(expense), net during the third quarter of 2018 compared to the same period in 2017 was due primarily to the impact of foreign exchange–related items, partially offset by higher interest expense on debt. The year-over-year decrease in other income/(expense), net during the first nine months of 2018 was due primarily to higher interest expense on debt and the impact of foreign exchange–related items, partially offset by higher interest income. The weighted-average interest rate earned by the Company on its cash, cash equivalents and marketable securities was 2.25% and 2.03% in the third quarter of 2018 and 2017, respectively, and 2.16% and 1.96% in the first nine months of 2018 and 2017, respectively.

Provision for Income Taxes

Provision for income taxes and effective tax rates for the three- and nine-month periods ended June 30, 2018 and July 1, 2017 were as follows (dollars in millions):

	Three Months Ended		Nine Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Provision for income taxes	\$1,765	\$2,591	\$11,076	\$12,535
Effective tax rate	13.3 %	22.9 %	19.6 %	25.0 %

On December 22, 2017, the U.S. enacted the Tax Cuts and Jobs Act (the “Act”), which significantly changed U.S. tax law. The Act lowered the Company’s U.S. statutory federal income tax rate from 35% to 21% effective January 1, 2018, while also imposing a deemed repatriation tax on previously deferred foreign income. By operation of law, the Company will apply a blended U.S. statutory federal income tax rate of 24.5% for 2018 (the “2018 blended U.S. tax rate”). The Act also created a new minimum tax on certain future foreign earnings.

The Company’s effective tax rate of 13.3% for the third quarter of 2018 was lower than the 2018 blended U.S. tax rate due primarily to the reduction in its provisional tax expense estimate. The Company’s effective tax rate of 19.6% for the first nine months of 2018 was lower than the 2018 blended U.S. tax rate due primarily to the lower tax rate on foreign earnings, partially offset by the remeasurement of deferred tax assets and liabilities as a result of the Act. The Company’s effective tax rate of 13.3% for the third quarter of 2018 was lower than the same period in 2017 due primarily to the lower 2018 blended U.S. tax rate as a result of the Act and the reduction in its provisional tax expense estimate, partially offset by higher taxes on foreign earnings during the third quarter of 2018. The Company’s effective tax rate of 19.6% for the first nine months of 2018 was lower than the same period in 2017 due to the lower 2018 blended U.S. tax rate, partially offset by the remeasurement of deferred tax assets and liabilities as a result of the Act. As a result of adopting Accounting Standards Update (“ASU”) No. 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, in 2018, the Company records any excess tax benefits or deficiencies from its equity awards as part of the provision for income taxes. The Company anticipates that these excess tax benefits or deficiencies will have the greatest impact on its effective tax rates in the first and third quarters, as the majority of the Company’s equity awards vest in those quarters.

The Company is subject to taxation and files income tax returns in the U.S. federal jurisdiction and in many state and foreign jurisdictions. The U.S. Internal Revenue Service (the “IRS”) concluded its review of the years 2013 through 2015 during the third quarter of 2018. All years prior to 2016 are now closed. The Company is also subject to audits by state, local and foreign tax authorities. In major states and major foreign jurisdictions, the years subsequent to 2003 generally remain open and could be subject to examination by the taxing authorities. The Company 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 inconsistent with its expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs.

On August 30, 2016, the European Commission announced its decision that Ireland granted state aid to the Company by providing tax opinions in 1991 and 2007 concerning the tax allocation of profits of the Irish branches of two subsidiaries of the Company (the “State Aid Decision”). The State Aid Decision ordered Ireland to calculate and recover additional taxes from the Company for the period June 2003 through December 2014. The recovery amount was calculated to be €13 billion, plus interest of €1 billion. Irish legislative changes, effective as of January 2015, eliminated the application of the tax opinions from that date forward. The Company believes the State Aid Decision to be without merit and appealed to the General Court of the Court of Justice of the European Union. Ireland has also appealed the State Aid Decision. The Company believes that any incremental Irish corporate income taxes potentially due related to the State Aid Decision would be creditable against U.S. taxes, subject to any foreign tax credit limitations in the Act. During the third quarter of 2018, the Company began funding amounts into escrow, where they will remain pending conclusion of all appeals.

On July 24, 2018, the U.S. Ninth Circuit Court of Appeals reversed the U.S. Tax Court's decision in *Altera Corp v. Commissioner*. As a result of this reversal, the Company expects to include share-based compensation in cost-sharing arrangements with its foreign subsidiaries. The Company is still evaluating the effect of this reversal and anticipates recognizing the impact during the fourth quarter of 2018.

Recent Accounting Pronouncements

Hedging

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

Restricted Cash

In November 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash (“ASU 2016-18”)*, which enhances and clarifies the guidance on the classification and presentation of restricted cash in the statement of cash flows. The Company will adopt ASU 2016-18 in its first quarter of 2019 utilizing the retrospective transition method. Currently, the Company’s restricted cash balance is not significant.

Income Taxes

In October 2016, the FASB issued ASU No. 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory (“ASU 2016-16”)*, which requires the recognition of the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs. The Company will adopt ASU 2016-16 in its first quarter of 2019 utilizing the modified retrospective transition method. Currently, the Company estimates recording up to \$4 billion of net deferred tax assets on its Condensed Consolidated Balance Sheets upon adoption. However, the ultimate impact of adopting ASU 2016-16 will depend on the balance of intellectual property transferred between its subsidiaries as of the adoption date, as well as the deferred tax impact of the new minimum tax on certain future foreign earnings. The Company will recognize incremental deferred income tax expense thereafter as these net deferred tax assets are utilized.

Leases

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) (“ASU 2016-02”), which modifies lease accounting for lessees to increase transparency and comparability by recording lease assets and liabilities for operating leases and disclosing key information about leasing arrangements. The Company will adopt ASU 2016-02 in its first quarter of 2020 utilizing the modified retrospective transition method. While the Company is currently evaluating the impact of adopting ASU 2016-02, based on the lease portfolio as of June 30, 2018, the Company anticipates recording lease assets and liabilities of approximately \$8.8 billion on its Condensed Consolidated Balance Sheets, with no material impact to its Condensed Consolidated Statements of Operations. However, the ultimate impact of adopting ASU 2016-02 will depend on the Company’s lease portfolio as of the adoption date.

Financial Instruments

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities (“ASU 2016-01”), which updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The Company will adopt ASU 2016-01 in its first quarter of 2019 utilizing the modified retrospective transition method. Based on the composition of the Company’s investment portfolio, the adoption of ASU 2016-01 is not expected to have a material impact on its consolidated financial statements.

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

Revenue Recognition

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

Subsequently, the FASB has issued the following standards related to ASU 2014-09: ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (“ASU 2016-08”); ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing (“ASU 2016-10”); ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients (“ASU 2016-12”); and ASU No. 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers (“ASU 2016-20”). The Company must adopt ASU 2016-08, ASU 2016-10, ASU 2016-12 and ASU 2016-20 with ASU 2014-09 (collectively, the “new revenue standards”).

The new revenue standards may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. The Company will adopt the new revenue standards in its first quarter of 2019 utilizing the full retrospective transition method. The new revenue standards are not expected to have a material impact on the amount and timing of revenue recognized in the Company’s consolidated financial statements.

Liquidity and Capital Resources

The following tables present selected financial information and statistics as of June 30, 2018 and September 30, 2017 and for the first nine months of 2018 and 2017 (in millions):

	June 30, 2018	September 30, 2017
Cash, cash equivalents and marketable securities ⁽¹⁾	\$243,743	\$ 268,895
Property, plant and equipment, net	\$38,117	\$ 33,783
Commercial paper	\$11,974	\$ 11,977
Total term debt	\$102,626	\$ 103,703
Working capital	\$27,213	\$ 27,831
	Nine Months Ended	
	June 30, 2018	July 1, 2017
Cash generated by operating activities ⁽²⁾	\$57,911	\$48,476
Cash generated by/(used in) investing activities	\$19,067	\$(36,504)
Cash used in financing activities ⁽²⁾	\$(65,296)	\$(13,885)

(1) As of June 30, 2018, total cash, cash equivalents and marketable securities included \$8.8 billion, related to the State Aid Decision and other agreements, which was restricted from general use.

(2) Refer to Note 1, “Summary of Significant Accounting Policies” in the Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of this Form 10-Q for more information on the prior period reclassification related to

the Company's adoption of ASU 2016-09.

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

In connection with the State Aid Decision, the Company began funding amounts into escrow during the third quarter of 2018, where they will remain pending conclusion of all appeals. As of June 30, 2018, €4.5 billion of the recovery amount was funded into escrow and was restricted from general use. Subsequent to June 30, 2018, the Company has funded an additional €4.5 billion of the recovery amount into escrow. The Company expects to fund the remaining recovery amount during the fourth quarter of 2018.

The Company's marketable securities investment portfolio is primarily invested in highly rated securities, and its investment policy generally limits the amount of credit exposure to any one issuer. The policy generally requires securities to be investment grade, with the primary objective of minimizing the potential risk of principal loss. During the nine months ended June 30, 2018, cash generated by operating activities of \$57.9 billion was a result of \$45.4 billion of net income and an increase in the net change in operating assets and liabilities of \$33.9 billion, partially offset by non-cash adjustments to net income of \$21.4 billion. Cash generated by investing activities of \$19.1 billion during the nine months ended June 30, 2018 consisted primarily of proceeds from maturities and sales of marketable securities, net of purchases, of \$31.8 billion, partially offset by cash used to acquire property, plant and equipment of \$10.3 billion. Cash used in financing activities of \$65.3 billion during the nine months ended June 30, 2018 consisted primarily of cash used to repurchase common stock of \$53.6 billion, cash used to pay dividends and dividend equivalents of \$10.2 billion and cash used to repay term debt of \$6.5 billion, partially offset by proceeds from the issuance of term debt, net of \$7.0 billion.

During the nine months ended July 1, 2017, cash generated by operating activities of \$48.5 billion was a result of \$37.6 billion of net income, non-cash adjustments to net income of \$16.0 billion and a decrease in the net change in operating assets and liabilities of \$5.1 billion, which included a one-time payment of \$1.9 billion related to a multi-year license agreement. Cash used in investing activities of \$36.5 billion during the nine months ended July 1, 2017 consisted primarily of cash used for purchases of marketable securities, net of sales and maturities, of \$27.7 billion and cash used to acquire property, plant and equipment of \$8.6 billion. Cash used in financing activities of \$13.9 billion during the nine months ended July 1, 2017 consisted primarily of cash used to repurchase common stock of \$25.1 billion, cash used to pay dividends and dividend equivalents of \$9.5 billion and cash used to repay term debt of \$3.5 billion, partially offset by proceeds from the issuance of term debt, net of \$21.7 billion and proceeds from commercial paper, net of \$3.9 billion.

Capital Assets

The Company's capital expenditures were \$11.1 billion during the first nine months of 2018. The Company anticipates utilizing approximately \$17.0 billion for capital expenditures during 2018, which includes product tooling and manufacturing process equipment; data centers; corporate facilities and infrastructure, including information systems hardware, software and enhancements; and retail store facilities.

Debt

The Company issues unsecured short-term promissory notes ("Commercial Paper") pursuant to a commercial paper program. The Company uses the net proceeds from the commercial paper program for general corporate purposes, including dividends and share repurchases. As of June 30, 2018, the Company had \$12.0 billion of Commercial Paper outstanding, with a weighted-average interest rate of 2.03% and maturities generally less than nine months.

As of June 30, 2018, the Company had outstanding floating- and fixed-rate notes with varying maturities for an aggregate principal amount of \$104.1 billion (collectively the "Notes"). During the first nine months of 2018, the Company repaid \$6.5 billion of its Notes. The Company has entered, and in the future may enter, into interest rate swaps to manage interest rate risk on the Notes. In addition, the Company has entered, and in the future may enter, into foreign currency swaps to manage foreign currency risk on the Notes.

Further information regarding the Company's debt issuances and related hedging activity can be found in Part I, Item 1 of this Form 10-Q in the Notes to Condensed Consolidated Financial Statements in Note 2, "Financial Instruments" and Note 5, "Debt."

Capital Return Program

During the third quarter of 2018, the Company repurchased 112.8 million shares of its common stock for \$20.0 billion in connection with two separate share repurchase programs. Of the \$20.0 billion, \$10.4 billion was repurchased under the Company's previous share repurchase program of up to \$210 billion, thereby completing that program. On May 1, 2018, the Company announced the Board of Directors had authorized a new program to repurchase up to \$100 billion of the Company's common stock. The remaining \$9.6 billion repurchased during the third quarter of 2018 was in connection with the new share repurchase program.

On May 1, 2018, the Company also announced the Board of Directors raised the Company's quarterly cash dividend from \$0.63 to \$0.73 per share, beginning with the dividend paid during the third quarter of 2018. The Company intends to increase its dividend on an annual basis, subject to declaration by the Board of Directors. The Company plans to use current cash and cash generated from ongoing operating activities to fund its share repurchase program and quarterly cash dividend.

Off-Balance Sheet Arrangements and Contractual Obligations

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

Operating Leases

As of June 30, 2018, the Company's total future minimum lease payments under noncancelable operating leases were \$9.6 billion. The Company's retail store and other facility leases typically have original terms not exceeding 10 years and generally contain multi-year renewal options.

Manufacturing Purchase Obligations

The Company utilizes several outsourcing partners to manufacture sub-assemblies for the Company's products and to perform final assembly and testing of finished products. These outsourcing partners acquire components and build product based on demand information supplied by the Company, which typically covers periods up to 150 days. The Company also obtains individual components for its products from a wide variety of individual suppliers. As of June 30, 2018, the Company expects to pay \$31.4 billion under manufacturing-related supplier arrangements, substantially all of which is noncancelable.

Other Purchase Obligations

The Company's other purchase obligations consist of noncancelable obligations to acquire capital assets, including product tooling and manufacturing process equipment, and noncancelable obligations related to advertising, licensing, R&D, internet and telecommunications services and other obligations. As of June 30, 2018, the Company had other purchase obligations of \$8.5 billion.

Other Non-Current Liabilities

The Company's other non-current liabilities in the Condensed Consolidated Balance Sheets consist primarily of long-term taxes payable of \$34.0 billion, and net unrecognized tax benefits and related interest and penalties of \$6.8 billion. The Company plans to pay the tax payable in installments in accordance with the Act. The Company is unable to make a reasonably reliable estimate of the timing of payments related to unrecognized tax benefits due to uncertainties in the timing of tax audit outcomes.

Indemnification

Agreements entered into by the Company sometimes include indemnification provisions which may subject the Company to costs and damages in the event of a claim against an indemnified third party. Except as disclosed in Part I, Item 1 of this Form 10-Q in the Notes to Condensed Consolidated Financial Statements in Note 9, "Commitments and Contingencies" under the heading "Contingencies," in the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to indemnification of third parties.

The Company offers an iPhone Upgrade Program, which is available to customers who purchase a qualifying iPhone in the U.S., the U.K. and mainland China. The iPhone Upgrade Program provides customers the right to trade in that iPhone for a specified amount when purchasing a new iPhone, provided certain conditions are met. The Company

accounts for the trade-in right as a guarantee liability and recognizes arrangement revenue net of the fair value of such right, with subsequent changes to the guarantee liability recognized within revenue.

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

Critical Accounting Policies and Estimates

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

Note 1, "Summary of Significant Accounting Policies" in Part I, Item 1 of this Form 10-Q and in the Notes to Consolidated Financial Statements in Part II, Item 8 of the 2017 Form 10-K, and "Critical Accounting Policies and Estimates" in Part II, Item 7 of the 2017 Form 10-K describe the significant accounting policies and methods used in the preparation of the Company's condensed consolidated financial statements. With the exception of Income Taxes, there have been no material changes to the Company's critical accounting policies and estimates since the 2017 Form 10-K.

Income Taxes

The Company records a tax provision for the anticipated tax consequences of its reported operating results. 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 will be in effect for the years in which those tax assets and liabilities 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 Company's deferred tax assets. In the event that the Company determines all or part of its net deferred tax assets are not realizable in the future, the Company will record 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.

On December 22, 2017, the U.S. enacted the Act, which significantly changed U.S. tax law. The Act lowered the Company's U.S. statutory federal income tax rate from 35% to 21% effective January 1, 2018, while also imposing a deemed repatriation tax on previously deferred foreign income. The Act also created a new minimum tax on certain future foreign earnings. During the first quarter of 2018, the Company's income tax expense included a provisional estimate of \$2.6 billion in accordance with the SEC Staff Accounting Bulletin No. 118. This \$2.6 billion provisional estimate included \$1.8 billion related to the impact of remeasuring the Company's deferred tax balances to reflect the new lower tax rate, and approximately \$800 million associated with the net impact of the deemed repatriation tax.

During the third quarter of 2018, the Company reduced its estimate of the deemed repatriation tax by \$1.0 billion and adjusted the estimated impact of the deemed repatriation tax on unrecognized tax benefits by \$700 million, resulting in the reduction of the Company's provisional estimate from \$2.6 billion to \$900 million. The impact of the adjustments to the provisional estimate for the deemed repatriation tax and unrecognized tax benefits was included in the Company's income tax expense during the third quarter of 2018. Resolution of the provisional estimates of the Act's effects different from the assumptions made by the Company could have a material impact on the Company's financial condition and operating results.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes to the Company's market risk during the first nine months of 2018. For a discussion of the Company's exposure to market risk, refer to the Company's market risk disclosures set forth in Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk" of the 2017 Form 10-K.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on an evaluation under the supervision and with the participation of the Company's management, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act were effective as of June 30, 2018 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 third quarter of 2018, which were identified in connection with management's evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

The Company is subject to legal proceedings and claims that have not been fully resolved and that have arisen in the ordinary course of business. Except as described in Part I, Item 1 of this Form 10-Q in the Notes to Condensed Consolidated Financial Statements in Note 9, “Commitments and Contingencies” under the heading “Contingencies,” in the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies for asserted legal and other claims.

The outcome of litigation is inherently uncertain. If one or more legal matters were resolved against the Company in a reporting period for amounts in excess of management’s expectations, the Company’s 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 third quarter of 2018 that did not individually or in the aggregate have a material impact on the Company’s financial condition or operating results.

Item 1A. Risk Factors

The following description of risk factors includes any material changes to, and supersedes the description of, risk factors associated with the Company’s business previously disclosed in Part I, Item 1A of the 2017 Form 10-K and in Part II, Item 1A of the Forms 10-Q for the quarters ended December 30, 2017 and March 31, 2018, in each case under the heading “Risk Factors.” The business, financial condition and operating results of the Company can be affected by a number of factors, whether currently known or unknown, including but not limited to those described below, any one or more of which could, directly or indirectly, cause the Company’s actual financial condition and operating results to vary materially from past, or from anticipated future, financial condition and operating results. Any of these factors, in whole or in part, could materially and adversely affect the Company’s business, financial condition, operating results and stock price.

The following discussion of risk factors contains forward-looking statements. These risk factors may be important to understanding other statements in this Form 10-Q. The following information should be read in conjunction with the condensed consolidated financial statements and related notes in Part I, Item 1, “Financial Statements” and Part I, Item 2, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this Form 10-Q. Because of the following factors, as well as other factors affecting the Company’s financial condition and operating results, past financial performance should not be considered to be a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

Global and regional economic conditions could materially adversely affect the Company’s business, results of operations, financial condition and growth.

The Company has international operations with sales outside the U.S. representing a majority of the Company’s total net sales. In addition, a majority of the Company’s supply chain, and its manufacturing and assembly activities, are located outside the U.S. As a result, the Company’s operations and performance depend significantly on global and regional economic conditions.

Adverse macroeconomic conditions, including inflation, slower growth or recession, new or increased tariffs, changes to fiscal and monetary policy, tighter credit, higher interest rates, high unemployment and currency fluctuations could materially adversely affect demand for the Company’s products and services. In addition, consumer confidence and spending could be adversely affected in response to financial market volatility, negative financial news, conditions in the real estate and mortgage markets, declines in income or asset values, changes to fuel and other energy costs, labor and healthcare costs and other economic factors.

In addition to an adverse impact on demand for the Company’s products, uncertainty about, or a decline in, global or regional economic conditions could have a significant impact on the Company’s suppliers, contract manufacturers, logistics providers, distributors, cellular network carriers and other channel partners. Potential effects include financial instability; inability to obtain credit to finance operations and purchases of the Company’s products; and insolvency. A downturn in the economic environment could also lead to increased credit and collectibility risk on the Company’s trade receivables; the failure of derivative counterparties and other financial institutions; limitations on the Company’s

ability to issue new debt; reduced liquidity; and declines in the fair value of the Company's financial instruments. These and other economic factors could materially adversely affect the Company's business, results of operations, financial condition and growth.

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 competition and resulting downward pressure on gross margins, frequent introduction of new products, short product life cycles, evolving industry standards, continual improvement in product price/performance characteristics, rapid adoption of technological and product advancements by competitors and price sensitivity on the part of consumers. The Company's ability to compete successfully depends heavily on its ability to ensure a continuing and timely introduction of innovative new products, services and technologies to the marketplace. The Company believes it is unique in that it designs and develops nearly the entire solution for its products, including the hardware, operating system, numerous software applications and related services. As a result, the Company must make significant investments in R&D. The Company currently holds a significant number of patents and copyrights and has registered and/or has applied to register numerous patents, trademarks and service marks. In contrast, many of the Company's competitors seek to compete primarily through aggressive pricing and very low cost structures, and emulating the Company's products and infringing on its intellectual property. If the Company is unable to continue to develop and sell innovative new products with attractive margins or if competitors infringe on the Company's intellectual property, the Company's ability to maintain a competitive advantage could be adversely affected.

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

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

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

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

Due to the highly volatile and competitive nature of the industries in which the Company competes, the Company must continually introduce new products, services and technologies, enhance existing products and services, effectively stimulate customer demand for new and upgraded products and successfully manage the transition to these new and upgraded products. The success of new product introductions depends on a number of factors including, but

not limited to, timely and successful product development, market acceptance, the Company's ability to manage the risks associated with new product production ramp-up issues, the availability of application software for new products, the effective management of purchase commitments and inventory levels in line with anticipated product demand, the availability of products in appropriate quantities and at expected costs to meet anticipated demand and the risk that new products may have quality or other defects or deficiencies in the early stages of introduction. Accordingly, the Company cannot determine in advance the ultimate effect of new product introductions and transitions.

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 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 retail and online stores.

Some carriers providing cellular network service for iPhone 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.

The Company has invested and will continue to invest in programs to enhance reseller sales, including staffing selected resellers' stores with Company employees and contractors, and improving product placement displays. These programs could require a substantial investment while providing no assurance of return or incremental revenue. The financial condition of these resellers could weaken, these resellers could stop distributing the Company's products, or uncertainty regarding demand for some or all of the Company's products could cause resellers to reduce their ordering and marketing of the Company's products.

The Company faces substantial inventory and other asset risk in addition to purchase commitment cancellation risk. The Company records a write-down for product and component inventories that have become obsolete or exceed anticipated demand or net realizable value and accrues necessary cancellation fee reserves for orders of excess products and components. The Company also reviews its long-lived assets, including capital assets held at its suppliers' facilities and inventory prepayments, for impairment whenever events or circumstances indicate the carrying amount of an asset may not be recoverable. If the Company determines that impairment has occurred, it records a write-down equal to the amount by which the carrying value of the asset 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. Manufacturing purchase obligations typically cover forecasted component and manufacturing requirements for periods up to 150 days. Because the Company's markets are volatile, competitive and subject to rapid technology and price changes, there is a risk the Company will forecast incorrectly and order or produce excess or insufficient amounts of components or products, or not fully utilize firm purchase commitments.

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

Because the Company currently obtains components from single or limited sources, the Company is subject to significant supply and pricing risks. Many components, including those that are available from multiple sources, are at times subject to industry-wide shortages and significant commodity pricing fluctuations. While the Company has entered into agreements for the supply of many components, there can be no assurance that the Company will be able to extend or renew these agreements on similar terms, or at all. A number of suppliers of components may suffer from poor financial conditions, which can lead to business failure for the supplier or consolidation within a particular industry, further limiting the Company's ability to obtain sufficient quantities of components on commercially reasonable terms. The effects of global or regional economic conditions on the Company's suppliers, described in "Global and regional economic conditions could materially adversely affect the Company's business, results of operations, financial condition and growth" 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's new products often utilize custom components available from only one source. When a component or product uses new technologies, initial capacity constraints may exist until the suppliers' yields have matured or manufacturing capacity has increased. Continued availability of these components at acceptable prices, or at all, may be affected for any number of reasons, including if those suppliers decide to concentrate on the production of common components instead of components customized to meet the Company's requirements. The supply of components for a new or existing product could be delayed or constrained, or a key manufacturing vendor could delay shipments of completed products to the Company.

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

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

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

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

The Company's products and services may be affected from time to time by design and manufacturing defects that could materially adversely affect the Company's business and result in harm to the Company's reputation.

The Company offers complex hardware and software products and services that can be affected by design and manufacturing defects. Sophisticated operating system software and applications, such as those offered by the Company, often have issues that can unexpectedly interfere with the intended operation of hardware or software products. Defects may also exist in components and products the Company purchases from third parties. Component defects could make the Company's products unsafe and create a risk of environmental or property damage and personal injury. These risks may increase as the Company's products are introduced into specialized applications, including healthcare. In addition, the Company's service offerings may have quality issues and from time to time experience outages, service slowdowns or errors. As a result, the Company's services may not perform as anticipated and may not meet customer expectations. There can be no assurance the Company will be able to detect and fix all issues and defects in the hardware, software and services it offers. Failure to do so could result in widespread technical and performance issues affecting the Company's products and services. In addition, the Company may be exposed to product liability claims, recalls, product replacements or modifications, write-offs of inventory, property, plant and equipment, and/or intangible assets, and significant warranty and other expenses, including litigation costs and regulatory fines. Quality problems could also adversely affect the experience for users of the Company's products and services, and result in harm to the Company's reputation, loss of competitive advantage, poor market acceptance, reduced demand for products and services, delay in new product and services introductions and lost revenue.

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

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

continue to offer a wide variety of content at reasonable prices with acceptable usage rules, or continue to expand its geographic reach. Failure to obtain the right to make third-party digital content available, or to make such content available 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 Mac's prospects, developers could be less inclined to develop or upgrade software for the Company's Mac products and more inclined to devote their resources to developing and upgrading software for the larger Windows market.

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

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

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

The Company is subject to various legal proceedings and claims that have arisen in the ordinary course of business and have not yet been fully resolved, and new claims may arise in the future. In addition, agreements entered into by the Company sometimes include indemnification provisions which may subject the Company to costs and damages in the event of a claim against an indemnified third party.

Claims against the Company based on allegations of patent infringement or other violations of intellectual property rights have generally increased over time and may continue to increase. In particular, the Company has historically faced a significant number of patent claims relating to its cellular-enabled products, and new claims may arise in the future. For example, technology and other patent-holding companies frequently assert their patents and seek royalties and often enter into litigation based on allegations of patent infringement or other violations of intellectual property rights. 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 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 licensing agreements or other arrangements to settle litigation and resolve such disputes. No assurance can be given that such agreements can be obtained on acceptable terms or that litigation will not occur. These agreements may also significantly increase the Company's operating expenses.

Except as described in Part I, Item 1 of this Form 10-Q in the Notes to Condensed Consolidated Financial Statements in Note 9, "Commitments and Contingencies" under the heading "Contingencies," in the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies for asserted legal and other claims, including matters related to infringement of intellectual property rights.

The outcome of litigation is inherently uncertain. If one or more legal matters were resolved against the Company or an indemnified third party 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.

While the Company maintains insurance coverage for certain types of claims, such insurance coverage may be insufficient to cover all losses or all types of claims that may arise.

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

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

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

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

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

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

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

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

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

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

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 or network disruptions 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 and other continuity measures may be ineffective or inadequate, and the Company's business continuity and disaster recovery planning may not be sufficient for all eventualities. Such failures or disruptions could adversely impact the Company's business by, among other things, preventing access to the Company's online services, interfering with customer transactions or impeding the manufacturing and shipping of the Company's products. These events could materially adversely affect the Company's reputation, financial condition and operating results.

There may be losses or unauthorized access to or releases of confidential information, including personally identifiable information, that could subject the Company to significant reputational, financial, legal and operational consequences.

The Company's business requires it to use and store confidential information, including, among other things, personally identifiable information ("PII") with respect to the Company's customers and employees. The Company devotes significant resources to network and data security, including through the use of encryption and other security measures intended to protect its systems and data. But these measures cannot provide absolute security, and losses or unauthorized access to or releases of confidential information may still occur, which could materially adversely affect the Company's reputation, financial condition and operating results.

The Company's business also requires it to share confidential information with suppliers and other third parties. Although the Company takes steps to secure confidential information that is provided to third parties, such measures may not be effective and losses or unauthorized access to or releases of confidential information may still occur, which could materially adversely affect the Company's reputation, financial condition and operating results. For example, the Company may experience a security breach impacting the Company's information technology systems that compromises the confidentiality, integrity or availability of confidential information. Such an incident could, among other things, impair the Company's ability to attract and retain customers for its products and services, impact the Company's stock price, materially damage supplier relationships, and expose the Company to litigation or

government investigations, which could result in penalties, fines or judgments against the Company. Although malicious attacks perpetrated to gain access to confidential information, including 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 value of the confidential information it creates, owns, manages, stores and processes.

The Company has implemented systems and processes intended to secure its information technology systems and prevent unauthorized access to or loss of sensitive data, including through the use of encryption and authentication technologies. As with all companies, these security measures may not be sufficient for all eventualities and may be vulnerable to hacking, employee error, malfeasance, system error, 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 its services and systems for unusual activity and may freeze accounts under suspicious circumstances, which, among other things, may result in the delay or loss of customer orders or impede customer access to the Company's products and services.

In addition to the risks relating to general confidential information described above, the Company may also be subject to specific obligations relating to health data and payment card data. Health data may be subject to additional privacy, security and breach notification requirements, and the Company may be subject to audit by governmental authorities regarding the Company's compliance with these obligations. If the Company fails to adequately comply with these rules and requirements, or if health data is handled in a manner not permitted by law or under the Company's agreements with healthcare institutions, the Company could be subject to litigation or government investigations, may be liable for associated investigatory expenses, and could also incur significant fees or fines.

Under payment card rules and obligations, if cardholder information is potentially compromised, the Company could be liable for associated investigatory expenses and could also incur significant fees or fines if the Company fails to follow payment card industry data security standards. The Company could also experience a significant increase in payment card transaction costs or lose the ability to process payment cards if it fails to follow payment card industry data security standards, which would materially adversely affect the Company's reputation, financial condition and operating results.

While the Company maintains insurance coverage that is intended to address certain aspects of data security risks, such insurance coverage may be insufficient to cover all losses or all types of claims that may arise.

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

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

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

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

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

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

Political events, international trade disputes, war, terrorism, natural disasters, public health issues, industrial accidents and other business interruptions could harm or disrupt international commerce and the global economy, and could have a material adverse effect on the Company and its customers, suppliers, contract manufacturers, logistics providers, distributors, cellular network carriers and other channel partners.

International trade disputes could result in tariffs and other protectionist measures that could adversely affect the Company's business. Tariffs could increase the cost of the Company's products and the components and raw materials that go into making them. These increased costs could adversely impact the gross margin that the Company earns on sales of its products. Tariffs could also make the Company's products more expensive for customers, which could make the Company's products less competitive and reduce consumer demand. Countries may also adopt other protectionist measures that could limit the Company's ability to offer its products and services. Political uncertainty surrounding international trade disputes and protectionist measures could also have a negative effect on consumer confidence and spending, which could adversely affect the Company's business.

Many of the Company's operations and facilities as well as critical business operations of the Company's suppliers and contract manufacturers are in locations that are prone to earthquakes and other natural disasters. In addition, such operations and facilities are subject to the risk of interruption by fire, power shortages, nuclear power plant accidents and other industrial accidents, terrorist attacks and other hostile acts, labor disputes, public health issues and other events beyond the Company's control. Global climate change could result in certain types of natural disasters occurring more frequently or with more intense effects. Such events could make it difficult or impossible for the Company to manufacture and deliver products to its customers, create delays and inefficiencies in the Company's supply and manufacturing chain, and result in slowdowns and outages to the Company's service offerings. Following an interruption to its business, the Company could require substantial recovery time, experience significant expenditures in order to resume operations, and lose significant revenue. Because the Company relies on sole or limited sources for the supply and manufacture of many critical components, a business interruption affecting such sources would exacerbate any negative consequences to the Company.

The Company's operations are also subject to the risks of industrial accidents at its suppliers and contract manufacturers. While the Company's suppliers are required to maintain safe working environments and operations, an industrial accident could occur and could result in disruption to the Company's business and harm to the Company's reputation. 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 suppliers and contract manufacturers.

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

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

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

The Company's stock price is subject to volatility.

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

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 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 significant realized losses.

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 resellers. The Company also sells its products directly to small and mid-sized businesses and education, enterprise and government customers. A substantial majority of the Company's outstanding trade receivables are not covered by collateral, third-party bank support or financing arrangements, or credit insurance. The Company's exposure to credit and collectibility 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 June 30, 2018, a significant portion of the Company's trade receivables was concentrated within cellular network carriers, and its vendor non-trade receivables and prepayments related to long-term supply agreements were concentrated among a few individual vendors located primarily in Asia. While the Company has procedures to monitor and limit exposure to credit risk on its trade and vendor non-trade receivables, as well as long-term prepayments, there can be no assurance such procedures will effectively limit its credit risk and avoid losses.

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

The Company is subject to taxes in the U.S. and numerous foreign jurisdictions, including Ireland, where a number of the Company's subsidiaries are organized. Due to economic and political conditions, tax rates in various jurisdictions may be subject to significant change. The Company's effective tax rates could be affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, or changes in tax laws or their interpretation, including in the U.S. and Ireland.

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

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

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

Share repurchase activity during the three months ended June 30, 2018 was as follows (in millions, except number of shares, which are reflected in thousands, and per share amounts):

Periods	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs ⁽¹⁾
April 1, 2018 to May 5, 2018:				
Open market and privately negotiated purchases ⁽¹⁾⁽²⁾	67,707	\$ 170.46	67,707	
May 6, 2018 to June 2, 2018:				
Open market and privately negotiated purchases ⁽¹⁾	22,026	\$ 187.56	22,026	
June 3, 2018 to June 30, 2018:				
Open market and privately negotiated purchases ⁽¹⁾	23,045	\$ 187.78	23,045	
Total	112,778			\$ 90,417

On May 1, 2018, the Company announced that the Board of Directors had authorized a new program to repurchase up to \$100 billion of the Company's common stock, of which \$9.6 billion had been utilized as of June 30, 2018.

The remaining \$90.4 billion in the table represents the amount available to repurchase shares under the new (1) authorized repurchase program as of June 30, 2018. The Company's new share repurchase program does not obligate it to acquire any specific number of shares. Under this program, shares may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 under the Exchange Act.

(2) During the third quarter of 2018, the Company repurchased \$10.4 billion of its common stock under its previous share repurchase program of up to \$210 billion, thereby completing that program.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Exhibit Description	Incorporated by Reference	
		Form Exhibit	Filing Date/ Period End Date
31.1*	<u>Rule 13a-14(a) / 15d-14(a) Certification of Chief Executive Officer.</u>		
31.2*	<u>Rule 13a-14(a) / 15d-14(a) Certification of Chief Financial Officer.</u>		
32.1**	<u>Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer.</u>		
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.		
	*Filed herewith.		
	**Furnished herewith.		

SIGNATURE

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

August 1, 2018 Apple Inc.

By: /s/ Luca Maestri
Luca Maestri
Senior Vice President,
Chief Financial Officer

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