APPLE INC
Form 10-Q
January 25, 2010

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended December 26, 2009

or

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

Commission file number: 000-10030

APPLE INC.

(Exact name of Registrant as specified in its charter)

California	**94-2404110**
(State or other jurisdiction	**(I.R.S. Employer Identification No.)**
of incorporation or organization)	
1 Infinite Loop	
Cupertino, California	**95014**
(Address of principal executive offices)	**(Zip Code)**

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

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

Yes x 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 x No ¨

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

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

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

Yes ¨ No x

906,794,589 shares of common stock issued and outstanding as of January 15, 2010

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

APPLE INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(in millions, except share amounts which are reflected in thousands and per share amounts)

	Three Months Ended	
	December 26, 2009 (a)	**December 27, 2008 (a)**
Net sales	$ 15,683	$ 11,880
Cost of sales	9,272	7,373
Gross margin	6,411	4,507
Operating expenses:		
Research and development	398	315
Selling, general and administrative	1,288	1,091
Total operating expenses	1,686	1,406
Operating income	4,725	3,101
Other income and expense	33	158
Income before provision for income taxes	4,758	3,259
Provision for income taxes	1,380	1,004
Net income	$ 3,378	$ 2,255
Earnings per common share:		
Basic	$ 3.74	$ 2.54
Diluted	$ 3.67	$ 2.50
Shares used in computing earnings per share:		
Basic	903,542	889,142
Diluted	919,783	901,494

(a) See Note 2, Retrospective Adoption of New Accounting Principles of this Form 10-Q.

See accompanying Notes to Condensed Consolidated Financial Statements.

APPLE INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

(in millions, except share amounts)

	December 26, 2009 (a)	September 26, 2009 (a)
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 7,609	$ 5,263
Short-term marketable securities	17,187	18,201
Accounts receivable, less allowances of $54 and $52, respectively	3,090	3,361
Inventories	576	455
Deferred tax assets	1,180	1,135
Other current assets	3,690	3,140
Total current assets	33,332	31,555
Long-term marketable securities	15,024	10,528
Property, plant and equipment, net	3,115	2,954
Goodwill	253	206
Acquired intangible assets, net	241	247
Other assets	1,961	2,011
Total assets	$ 53,926	$ 47,501
LIABILITIES AND SHAREHOLDERS EQUITY:		
Current liabilities:		
Accounts payable	$ 6,511	$ 5,601
Accrued expenses	3,996	3,852
Deferred revenue	2,590	2,053
Total current liabilities	13,097	11,506
Deferred revenue non-current	922	853
Other non-current liabilities	4,139	3,502
Total liabilities	18,158	15,861
Commitments and contingencies		
Shareholders equity:		
Common stock, no par value; 1,800,000,000 shares authorized; 906,282,182 and 899,805,500 shares issued and outstanding, respectively	8,962	8,210
Retained earnings	26,695	23,353
Accumulated other comprehensive income	111	77
Total shareholders equity	35,768	31,640
Total liabilities and shareholders equity	$ 53,926	$ 47,501

(a) See Note 2, Retrospective Adoption of New Accounting Principles of this Form 10-Q.

See accompanying Notes to Condensed Consolidated Financial Statements.

APPLE INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(in millions)

	Three Months Ended	
	December 26, 2009 (a)	**December 27, 2008 (a)**
Cash and cash equivalents, beginning of the period	$ 5,263	$ 11,875
Operating activities:		
Net income	3,378	2,255
Adjustments to reconcile net income to cash generated by operating activities:		
Depreciation, amortization and accretion	209	168
Stock-based compensation expense	205	170
Deferred income tax expense	425	276
Loss on disposition of property, plant and equipment	6	7
Changes in operating assets and liabilities:		
Accounts receivable, net	271	226
Inventories	(121)	113
Other current assets	(517)	1,097
Other assets	47	7
Accounts payable	956	(767)
Deferred revenue	606	200
Other liabilities	316	186
Cash generated by operating activities	5,781	3,938
Investing activities:		
Purchases of marketable securities	(12,922)	(13,082)
Proceeds from maturities of marketable securities	6,216	2,226
Proceeds from sales of marketable securities	3,199	2,668
Purchases of other long-term investments	(6)	(38)
Payment for acquisition of property, plant and equipment	(376)	(339)
Payment for acquisition of intangible assets	(5)	(14)
Other	(64)	(60)
Cash used in investing activities	(3,958)	(8,639)
Financing activities:		
Proceeds from issuance of common stock	374	77
Excess tax benefits from stock-based compensation	252	19
Cash used to net share settle equity awards	(103)	(34)
Cash generated by financing activities	523	62
Increase/(decrease) in cash and cash equivalents	2,346	(4,639)
Cash and cash equivalents, end of the period	$ 7,609	$ 7,236
Supplemental cash flow disclosure:		
Cash paid for income taxes, net	$ 980	$ 550

(a) See Note 2, Retrospective Adoption of New Accounting Principles of this Form 10-Q.

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) design, manufacture, and market personal computers, mobile communication devices, and portable digital music and video players and sell a variety of related software, third-party digital content and applications, services, peripherals, and networking solutions. The Company sells its products worldwide through its online stores, its retail stores, its direct sales force, and third-party wholesalers, resellers and value-added resellers. In addition, the Company sells a variety of third-party Macintosh (Mac), iPhone and iPod compatible products including application software, printers, storage devices, speakers, headphones, and various other accessories and supplies through its online and retail stores. The Company sells to consumer, small and mid-sized business (SMB), education, enterprise, government and creative customers.

Basis of Presentation and Preparation

The accompanying condensed consolidated financial statements include the accounts of the Company. Intercompany accounts and transactions have been eliminated. The preparation of these condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the amounts reported in these condensed consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates. Certain prior year amounts in the condensed consolidated financial statements and notes thereto 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 for the fiscal year ended September 26, 2009, included in its Annual Report on Form 10-K (the 2009 Form 10-K). Unless otherwise stated, references to particular years or quarters refer to the Company s fiscal years ended in September and the associated quarters of those fiscal years.

The Company has evaluated subsequent events through the date and time the financial statements were issued on January 25, 2010.

Retrospective Adoption of New Accounting Principles

In September 2009, the Financial Accounting Standards Board (FASB) amended the accounting standards related to revenue recognition for arrangements with multiple deliverables and arrangements that include software elements (new accounting principles). The new accounting principles permit prospective or retrospective adoption, and the Company elected retrospective adoption during the first quarter of 2010.

Under the historical accounting principles, the Company was required to account for sales of both iPhone and Apple TV using subscription accounting because the Company indicated it might from time-to-time provide future unspecified software upgrades and features for those products free of charge. Under subscription accounting, revenue and associated product cost of sales for iPhone and Apple TV were deferred at the time of sale and recognized on a straight-line basis over each product s estimated economic life. This resulted in the deferral of significant amounts of revenue and cost of sales related to iPhone and Apple TV.

The new accounting principles generally require the Company to account for the sale of both iPhone and Apple TV as two deliverables. The first deliverable is the hardware and software essential to the functionality of the hardware device delivered at the time of sale, and the second deliverable is the right included with the purchase of iPhone and Apple TV to receive on a when-and-if-available basis future unspecified software upgrades and features relating to the product s essential software. The new accounting principles result in the recognition of substantially all of the revenue and product costs from the sales of iPhone and Apple TV at the time of sale. Additionally, the Company is required to estimate a standalone selling price for the unspecified software upgrade rights included with the sale of iPhone and Apple TV and recognizes that amount ratably over the 24-month estimated life of the related hardware device.

The Company had the option of adopting the new accounting principles on a prospective or retrospective basis. Prospective adoption would have required the Company to apply the new accounting principles to sales beginning in fiscal year 2010 without reflecting the impact of the new accounting principles on iPhone and Apple TV sales made prior to September 2009. Accordingly, the Company s financial results for the two years following adoption would have included the impact of amortizing the significant amounts of deferred revenue and cost of sales related to historical iPhone and Apple TV sales. The Company believes prospective adoption would have resulted in financial information that was not comparable between financial periods because of the significant amount of past iPhone sales; therefore, the Company elected retrospective adoption. Retrospective adoption required the Company to revise its previously issued financial statements as if the new accounting principles had always been applied. The Company believes retrospective adoption provides the most comparable and useful financial information for financial statement users, is more consistent with the information the Company s management uses to evaluate its business, and better reflects the underlying economic performance of the Company.

The financial statements and notes to the financial statements presented herein have been adjusted to reflect the retrospective adoption of the new accounting principles. Refer to Note 2, Retrospective Adoption of New Accounting Principles in this Form 10-Q for additional information on the impact of adoption.

Earnings Per Common Share

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

The following table sets forth the computation of basic and diluted earnings per common share for the three months ended December 26, 2009 and December 27, 2008 (in thousands, except net income in millions and per share amounts):

	Three Months Ended	
	December 26, 2009	**December 27, 2008**
Numerator:		
Net income	$ 3,378	$ 2,255
Denominator:		
Weighted-average shares outstanding	903,542	889,142
Effect of dilutive securities	16,241	12,352
Weighted-average shares diluted	919,783	901,494
Basic earnings per common share	$ 3.74	$ 2.54
Diluted earnings per common share	$ 3.67	$ 2.50

Potentially dilutive securities representing approximately 1.8 million and 18.8 million shares of common stock for the quarters ended December 26, 2009 and December 27, 2008, respectively, were excluded from the computation of diluted earnings per common share for these periods because their effect would have been antidilutive.

Revenue Recognition

Net sales consist primarily of revenue from the sale of hardware, software, digital content and applications, peripherals, and service and support contracts. The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection is probable. Product is considered delivered to the customer once it has been shipped and title and risk of loss have been

transferred. For most of the Company s product sales, these criteria are met at the time the product is shipped. For online sales to individuals, for some sales to education customers in the U.S., and for certain other sales, the Company defers revenue until the customer receives the product because the Company legally retains a portion of the risk of loss on these sales during transit. The Company recognizes revenue from the sale of hardware products (e.g., Mac computers, iPhones, iPods and peripherals), software bundled with hardware that is essential to the functionality of the hardware, and third-party digital content sold on the iTunes Store in accordance with general revenue recognition accounting guidance. The Company recognizes revenue in accordance with industry specific software accounting guidance for the following types of sales transactions: (i) standalone sales of software products, (ii) sales of software upgrades and (iii) sales of software bundled with hardware not essential to the functionality of the hardware.

Revenue from service and support contracts is deferred and recognized ratably over the service coverage periods. These contracts typically include extended phone support, repair services, web-based support resources, diagnostic tools, and extend the service coverage offered under the Company s standard limited warranty.

The Company sells software and peripheral products obtained from other companies. The Company generally establishes its own pricing and retains related inventory risk, is the primary obligor in sales transactions with its customers, and assumes the credit risk for amounts billed to its customers. Accordingly, the Company generally recognizes revenue for the sale of products obtained from other companies based on the gross amount billed.

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end-user rebates, and other sales programs and volume-based incentives. The estimated cost of these programs is accrued as a reduction to revenue in the period the Company has sold the product and committed to a plan. The Company also records reductions to revenue for expected future product returns based on the Company s historical experience. Revenue is recorded net of taxes collected from customers that are remitted to governmental authorities, with the collected taxes recorded as current liabilities until remitted to the relevant government authority.

Revenue Recognition for Arrangements with Multiple Deliverables

For multi-element arrangements that include tangible products that contain software that is essential to the tangible product s functionality and undelivered software elements that relate to the tangible product s essential software, the Company allocates revenue to all deliverables based on their relative selling prices. In such circumstances, the new accounting principles establish a hierarchy to determine the selling price to be used for allocating revenue to deliverables as follows: (i) vendor-specific objective evidence of fair value (VSOE), (ii) third-party evidence of selling price (TPE), and (iii) best estimate of the selling price (ESP). VSOE generally exists only when the Company sells the deliverable separately and is the price actually charged by the Company for that deliverable.

For both iPhone and Apple TV, the Company has indicated it may from time-to-time provide future unspecified software upgrades and features free of charge to customers. The Company has identified two deliverables generally contained in arrangements involving the sale of iPhone and Apple TV. The first deliverable is the hardware and software essential to the functionality of the hardware device delivered at the time of sale, and the second deliverable is the right included with the purchase of iPhone and Apple TV to receive on a when-and-if-available basis future unspecified software upgrades and features relating to the product s essential software. The Company has allocated revenue between these two deliverables using the relative selling price method. Because the Company has neither VSOE nor TPE for the two deliverables the allocation of revenue has been based on the Company s ESPs. Amounts allocated to the delivered hardware and the related essential software are recognized at the time of sale provided the other conditions for revenue recognition have been met. Amounts allocated to the unspecified software upgrade rights are deferred and recognized on a straight-line basis over the 24-month estimated life of the related hardware. All product cost of sales, including estimated warranty costs, are generally recognized at the time of sale. Costs for engineering and sales and marketing are expensed as incurred.

For all periods presented, the Company s ESP for the software upgrade right included with each iPhone and Apple TV sold is $25 and $10, respectively. The Company s process for determining its ESP for deliverables without VSOE or TPE considers multiple factors that may vary depending upon the unique facts and circumstances related to each deliverable. The Company believes its customers, particularly consumers, would be reluctant to buy unspecified software upgrade rights related to iPhone and Apple TV. This view is primarily based on the fact that upgrade rights do not obligate the Company to provide upgrades at a particular time or at all, and do not specify to customers which upgrades or features will be delivered in the future. Therefore, the Company has concluded that if it were to sell upgrade rights on a standalone basis, such as those included with iPhone and Apple TV, the selling price would be relatively low. Key factors considered by the Company in developing the ESPs for iPhone and Apple TV upgrade rights include prices charged by the Company for similar offerings, the Company s historical pricing practices, the nature of the upgrade rights (e.g., unspecified and when-and-if-available), and the relative ESP of the upgrade rights as compared to the total selling price of the product. In addition, when developing ESPs for products other than iPhone and Apple TV, the Company may consider other factors as appropriate including the pricing of competitive alternatives if they exist, and product-specific business objectives.

The Company accounts for multiple element arrangements that consist only of software or software-related products, including the sale of upgrades to previously sold software, in accordance with industry specific accounting guidance for software and software-related transactions. For such transactions, revenue on arrangements that include multiple elements is allocated to each element based on the relative fair value of each element, and fair value is generally determined by VSOE. If the Company cannot objectively determine the fair value of any undelivered element included in such multiple-element arrangements, the Company defers revenue until all elements are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered elements. When the fair value of a delivered element has not been established, but fair value exists for the undelivered elements, the Company uses the residual method to recognize revenue if the fair value of all undelivered elements is determinable. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is allocated to the delivered elements and is recognized as revenue.

Except as described for iPhone and Apple TV, the Company generally does not offer specified or unspecified upgrade rights to its customers in connection with software sales or the sale of extended warranty and support contracts. A limited number of the Company s software products are available with maintenance agreements that grant customers rights to unspecified future upgrades over the maintenance term on a when and if available basis. Revenue associated with such maintenance is recognized ratably over the maintenance term.

Fair Value Measurements

During 2009, the Company adopted the FASB s new accounting standard on fair value measurements and disclosures for all financial assets and liabilities. The new accounting principles defined fair value, provided a framework for measuring fair value, and expanded the disclosures required for fair value measurements. During the first quarter of 2010, the Company adopted the new fair value accounting principles for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis, which did not have a material effect on the Company s financial condition or operating results.

Business Combinations

In December 2007, the FASB issued new accounting standards for business combinations, which established principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree in a business combination. This new accounting standard also established principles regarding how goodwill acquired in a business combination or a gain from a bargain purchase should be recognized and measured, as well as provides guidelines on the disclosure requirements. In April 2009, the FASB amended this new accounting standard to require that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value, if the fair value can be determined during the measurement period. The Company adopted the new business combination accounting standard in the first quarter of 2010 and applied these principles prospectively to any business combinations completed in or after the first quarter of 2010. The adoption of the new business combination accounting standard did not have a material effect on the Company s financial condition or operating results.

Note 2 Retrospective Adoption of New Accounting Principles

In September 2009, the FASB amended the accounting standards related to revenue recognition for arrangements with multiple deliverables and arrangements that include software elements. In the first quarter of 2010, the Company adopted the new accounting principles on a retrospective basis. The Company believes retrospective adoption provides the most comparable and useful financial information for financial statement users, is more consistent with the information the Company s management uses to evaluate its business, and better reflects the underlying economic performance of the Company. The financial statements and notes to the financial statements presented herein have been adjusted to reflect the retrospective adoption of the new accounting principles. Note 1, Summary of Significant Accounting Policies under the subheadings *Basis of Presentation and Preparation* and *Revenue Recognition* of this Form 10-Q provides additional information on the Company s change in accounting resulting from the adoption of the new accounting principles and the Company s revenue recognition accounting policy.

The following table presents the effects of the retrospective adoption of the new accounting principles to the Company s previously reported Condensed Consolidated Balance Sheet as of September 26, 2009 (in millions, except share amounts):

		September 26, 2009	
	As Reported	**Adjustments**	**As Amended**
Current assets:			
Cash and cash equivalents	$ 5,263	$	$ 5,263
Short-term marketable securities	18,201		18,201
Accounts receivable, less allowance of $52	3,361		3,361
Inventories	455		455
Deferred tax assets	2,101	(966)	1,135
Other current assets	6,884	(3,744)	3,140
Total current assets	36,265	(4,710)	31,555
Long-term marketable securities	10,528		10,528
Property, plant and equipment, net	2,954		2,954
Goodwill	206		206
Acquired intangible assets, net	247		247
Other assets	3,651	(1,640)	2,011
Total assets	$ 53,851	$ (6,350)	$ 47,501
Current liabilities:			
Accounts payable	$ 5,601	$	$ 5,601
Accrued expenses	3,376	476	3,852
Deferred revenue	10,305	(8,252)	2,053
Total current liabilities	19,282	(7,776)	11,506
Deferred revenue non-current	4,485	(3,632)	853
Other non-current liabilities	2,252	1,250	3,502
Total liabilities	26,019	(10,158)	15,861
Commitments and contingencies			
Shareholders equity:			
Common stock, no par value; 1,800,000,000 shares authorized; 899,805,500 shares issued and outstanding	8,210		8,210
Retained earnings	19,538	3,815	23,353
Accumulated other comprehensive income	84	(7)	77
Total shareholders equity	27,832	3,808	31,640
Total liabilities and shareholders equity	$ 53,851	$ (6,350)	$ 47,501

The following table presents the effects of the retrospective adoption of the new accounting principles to the Company s previously reported Condensed Consolidated Statements of Operations for the three months ended December 27, 2008 (in millions, except share amounts):

	Three Months Ended December 27, 2008		
	As Reported	**Adjustments**	**As Amended**
Net sales	$ 10,167	$ 1,713	$ 11,880
Cost of sales	6,635	738	7,373
Gross margin	3,532	975	4,507
Operating expenses:			
Research and development	315		315
Selling, general and administrative	1,091		1,091
Total operating expenses	1,406		1,406
Operating income	2,126	975	3,101
Other income and expense	158		158
Income before provision for income taxes	2,284	975	3,259
Provision for income taxes	679	325	1,004
Net income	$ 1,605	$ 650	$ 2,255
Earnings per common share:			
Basic	$ 1.81	$ 0.73	$ 2.54
Diluted	$ 1.78	$ 0.72	$ 2.50
Shares used in computing earnings per share:			
Basic	889,142		889,142
Diluted	901,494		901,494

Note 3 Financial Instruments

Cash, Cash Equivalents and Marketable Securities

The following table summarizes the fair value of the Company s cash and available-for-sale securities held in its marketable securities investment portfolio, recorded as cash, cash equivalents or short-term or long-term marketable securities as of December 26, 2009 and September 26, 2009 (in millions):

	December 26, 2009	September 26, 2009
Cash	$ 1,470	$ 1,139
Money market funds	2,135	1,608
U.S. Treasury securities	821	289
U.S. agency securities	379	273
Certificates of deposit and time deposits	897	572
Commercial paper	1,870	1,381
Corporate securities	30	
Municipal securities	7	1
Total cash equivalents	6,139	4,124
U.S. Treasury securities	2,600	2,843
U.S. agency securities	5,885	8,582
Non-U.S. government securities	282	219
Certificates of deposit and time deposits	1,213	1,142
Commercial paper	3,581	2,816
Corporate securities	3,467	2,466
Municipal securities	159	133
Total short-term marketable securities	17,187	18,201
U.S. Treasury securities	421	484
U.S. agency securities	3,599	2,252
Non-U.S. government securities	679	102
Corporate securities	9,831	7,320
Municipal securities	494	370
Total long-term marketable securities	15,024	10,528
Total cash, cash equivalents and marketable securities	$ 39,820	$ 33,992

The following tables summarize the Company s available-for-sale securities adjusted cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category as of December 26, 2009 and September 26, 2009 (in millions):

	December 26, 2009			
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value
Money market funds	$ 2,135	$	$	$ 2,135
U.S. Treasury securities	3,839	4	(1)	3,842
U.S. agency securities	9,850	14	(1)	9,863
Non-U.S. government securities	959	2		961
Certificates of deposit and time deposits	2,110			2,110
Commercial paper	5,451			5,451
Corporate securities	13,293	49	(14)	13,328
Municipal securities	658	3	(1)	660
Total cash equivalents and marketable securities	$ 38,295	$ 72	$ (17)	$ 38,350

	September 26, 2009			
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value
Money market funds	$ 1,608	$	$	$ 1,608
U.S. Treasury securities	3,610	6		3,616
U.S. agency securities	11,085	22		11,107
Non-U.S. government securities	320	1		321
Certificates of deposit and time deposits	1,714			1,714
Commercial paper	4,197			4,197
Corporate securities	9,760	42	(16)	9,786
Municipal securities	502	2		504
Total cash equivalents and marketable securities	$ 32,796	$ 73	$ (16)	$ 32,853

The Company had net unrealized gains on its investment portfolio of $55 million and $57 million as of December 26, 2009 and September 26, 2009, respectively. The net unrealized gains as of December 26, 2009 and September 26, 2009 related primarily to long-term marketable securities. The Company may sell certain of its marketable securities prior to their stated maturities for strategic purposes, in anticipation of credit deterioration, or for duration management. The Company recognized no material net gains or losses during the first quarter of 2010 or 2009 related to such sales.

The following tables show the gross unrealized losses and fair value for investments in an unrealized loss position as of December 26, 2009 and September 26, 2009, aggregated by investment category and the length of time that individual securities have been in a continuous loss position (in millions):

	December 26, 2009					
	Less than 12 Months		12 Months or Greater		Total	
Security Description	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Loss
U.S. Treasury securities	$ 1,592	$ (1)	$	$	$ 1,592	$ (1)
U.S. agency securities	1,891	(1)			1,891	(1)
Corporate securities	3,476	(7)	579	(7)	4,055	(14)
Municipal securities	181	(1)			181	(1)
Total	$ 7,140	$ (10)	$ 579	$ (7)	$ 7,719	$ (17)

	September 26, 2009					
	Less than 12 Months		12 Months or Greater		Total	
Security Description	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Loss
Corporate securities	$ 1,667	$ (3)	$ 719	$ (13)	$ 2,386	$ (16)
Total	$ 1,667	$ (3)	$ 719	$ (13)	$ 2,386	$ (16)

The unrealized losses on the Company s marketable securities were caused primarily by changes in market interest rates. The Company considers the declines in market value of its marketable securities investment portfolio to be temporary in nature. The Company typically invests in highly-rated securities, and its policy generally limits the amount of credit exposure to any one issuer. The Company s investment policy requires investments to be investment grade, primarily rated single-A or better, with the objective of minimizing the potential risk of principal loss. Fair values were determined for each individual security in the investment portfolio. When evaluating the investments for other-than-temporary impairment, the Company reviews factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer and any changes thereto, and the Company s intent to sell, or whether it is more likely than not it will be required to sell, the investment before recovery of the investment s amortized cost basis. During the first quarters of 2010 and 2009, the Company did not recognize any material impairment charges. As of December 26, 2009, the Company does not consider any of its investments to be other-than-temporarily impaired.

Derivative Financial Instruments

The Company uses derivatives to partially offset its business exposure to foreign currency exchange risk. The Company may enter into foreign currency forward and option contracts to offset some of the foreign exchange risk of expected future cash flows on certain forecasted revenue and cost of sales, of net investments in certain foreign subsidiaries, and on certain existing assets and liabilities. To help protect gross margins from fluctuations in foreign currency exchange rates, certain of the Company s subsidiaries whose functional currency is the U.S. dollar, hedge a portion of forecasted foreign currency revenue. The Company s subsidiaries whose functional currency is not the U.S. dollar and who sell in local currencies, may hedge a portion of forecasted inventory purchases not denominated in the subsidiaries functional currencies. The Company typically hedges portions of its forecasted foreign currency exposure associated with revenue and inventory purchases for three to six months. To help protect the net investment in a foreign operation from adverse changes in foreign currency exchange rates, the Company may enter into foreign currency forward and option contracts to offset the changes in the carrying amounts of these investments due to fluctuations in foreign currency exchange rates. The Company may also enter into foreign currency forward and option contracts to partially offset the foreign currency exchange gains and losses generated by the re-measurement of certain assets and liabilities denominated in non-functional currencies. However, the Company may choose not to hedge certain foreign currency exchange exposures for a variety of reasons, including but not limited to immateriality, accounting considerations and the prohibitive economic cost of hedging particular exposures. There can be no assurance the hedges will offset more than a portion of the financial impact resulting from movements in foreign currency exchange rates.

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

The Company had a net deferred gain associated with cash flow hedges of approximately $19 million and $1 million, net of taxes, recorded in other comprehensive income as of December 26, 2009 and September 26, 2009, respectively. Other comprehensive income associated with cash flow hedges of foreign currency revenue is recognized as a component of net sales in the same period as the related revenue is recognized, and other comprehensive income related to cash flow hedges of inventory purchases is recognized as a component of cost of sales in the same period as the related costs are recognized. As of December 26, 2009, the hedged transactions are expected to occur within six months.

Derivative instruments designated as cash flow hedges must be de-designated as hedges when it is probable the forecasted hedged transaction will not occur in the initially identified time period or within a subsequent two month time period. Deferred gains and losses in other comprehensive income associated with such derivative instruments are reclassified immediately into earnings through other income and expense. Any subsequent changes in fair value of such derivative instruments also are reflected in current earnings unless they are re-designated as hedges of other transactions. The Company did not recognize any material net gains or losses related to the loss of hedge designation on discontinued cash flow hedges during the first quarter of 2010 or 2009.

The Company had an unrealized net gain on net investment hedges of $5 million and unrealized net loss on net investment hedges of $2 million, net of taxes, included in the cumulative translation adjustment account of accumulated other comprehensive income (AOCI) as of December 26, 2009 and September 26, 2009, respectively. The ineffective portions and amounts excluded from the effectiveness test of net investment hedges are recorded in current earnings in other income and expense.

The Company recognized in earnings a net loss of $34 million and a net gain of $158 million on foreign currency forward and option contracts not designated as hedging instruments during the first quarter of 2010 and 2009, respectively.

The following table shows the notional principal and credit risk amounts of the Company s derivative instruments outstanding as of December 26, 2009 and September 26, 2009 (in millions):

	December 26, 2009		September 26, 2009	
	Notional Principal	Credit Risk Amounts	Notional Principal	Credit Risk Amounts
Instruments qualifying as accounting hedges:				
Foreign exchange contracts	$ 3,874	$ 63	$ 4,422	$ 31
Instruments other than accounting hedges:				
Foreign exchange contracts	$ 5,290	$ 79	$ 3,416	$ 10

The notional principal amounts for derivative instruments provide one measure of the transaction volume outstanding as of December 26, 2009 and September 26, 2009, 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 these transactions if all counterparties failed to perform according to the terms of the contract, based on then-current currency exchange rates at each respective date. The Company s gross exposure on these transactions may be further mitigated by collateral received from certain counterparties. The Company s exposure to credit loss and market risk will vary over time as a function of currency exchange rates. Although the table above reflects the notional principal and credit risk amounts of the Company s foreign exchange instruments, it does not reflect the gains or losses associated with the exposures and transactions that the foreign exchange instruments are intended to hedge. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

The Company generally enters into master netting arrangements, which reduce credit risk by permitting net settlement of transactions with the same counterparty. To further limit credit risk, the Company generally enters into collateral security arrangements that provide for collateral to be received when the net fair value of certain financial instruments exceeds contractually established thresholds. The Company presents its derivative assets and derivative liabilities at their gross fair values. As of December 26, 2009, the Company recorded cash collateral related to the derivative instruments under its master netting arrangements of $59 million as accrued expenses in the Condensed Consolidated Balance Sheet. The Company did not record a material amount of cash collateral related to the derivative instruments under its master netting arrangements as of September 26, 2009. The Company did not have any derivative instruments with credit risk-related contingent features that would require it to post additional collateral as of December 26, 2009 or September 26, 2009.

The estimates of fair value are based on applicable and commonly used pricing models and prevailing financial market information as of December 26, 2009 and September 26, 2009. Refer to Note 4, Fair Value Measurements of this Form 10-Q, for additional information on the fair value measurements for all financial assets and liabilities, including derivative assets and derivative liabilities, that are measured at fair value in the condensed consolidated financial statements on a recurring basis. The following tables show the Company s derivative instruments measured at gross fair value as reflected in the Condensed Consolidated Balance Sheets as of December 26, 2009 and September 26, 2009 (in millions):

	December 26, 2009		
	Fair Value of Derivatives Designated as Hedge Instruments	**Fair Value of Derivatives Not Designated as Hedge Instruments**	**Total Fair Value**
Derivative assets (a):			
Foreign exchange contracts	$ 59	$ 76	$ 135
Derivative liabilities (b):			
Foreign exchange contracts	$ 7	$ 30	$ 37

	September 26, 2009		
	Fair Value of Derivatives Designated as Hedge Instruments	**Fair Value of Derivatives Not Designated as Hedge Instruments**	**Total Fair Value**
Derivative assets (a):			
Foreign exchange contracts	$ 27	$ 10	$ 37
Derivative liabilities (b):			
Foreign exchange contracts	$ 24	$ 1	$ 25

(a) All derivative assets are recorded as other current assets in the Condensed Consolidated Balance Sheets.
(b) All derivative liabilities are recorded as accrued expenses in the Condensed Consolidated Balance Sheets.

The following tables show the effect of the Company s derivative instruments designated as cash flow and net investment hedges in the Condensed Consolidated Statements of Operations for the three-month periods ended December 26, 2009 and December 27, 2008 (in millions):

	Three Months Ended December 26, 2009				
	Gain or (Loss) Recognized in OCI - Effective Portion (a)	**Location of Gain or (Loss) Reclassified from AOCI into Income - Effective Portion**	**Gain or (Loss) Reclassified from AOCI into Income - Effective Portion (a)**	**Location of Gain or (Loss) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing**	**Gain or (Loss) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing**
Cash flow hedges:					
Foreign exchange contracts	$ 10	Net sales	$ 2	Other income and expense	$ (9)
Foreign exchange contracts	2	Cost of sales	(22)	Other income and expense	(5)
Net investment hedges:					
Foreign exchange contracts	(1)	Other income and expense		Other income and expense	
Total	$ 11		$ (20)		$ (14)

	Three Months Ended December 27, 2008				
	Gain or (Loss) Recognized in OCI - Effective Portion (a)	**Location of Gain or (Loss) Reclassified from AOCI into Income - Effective Portion**	**Gain or (Loss) Reclassified from AOCI into Income - Effective Portion (a)**	**Location of Gain or (Loss) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing**	**Gain or (Loss) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing**
Cash flow hedges:					
Foreign exchange contracts	$ 271	Net sales	$ 223	Other income and expense	$ (23)
Foreign exchange contracts	96	Cost of sales	84	Other income and expense	1
Net investment hedges:					
Foreign exchange contracts	(38)	Other income and expense		Other income and expense	2
Total	$ 329		$ 307		$ (20)

(a) Refer to Note 7, Shareholders Equity and Stock-Based Compensation of this Form 10-Q, which summarizes the activity in accumulated other comprehensive income related to derivatives.

Note 4 Fair Value Measurements

The Company defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities, which are required to be recorded at fair value, the Company considers the principal or most advantageous market in which the Company would transact and the market-based risk measurements or assumptions that market participants would use in pricing the asset or liability, such as inherent risk, transfer restrictions and credit risk.

The Company applies the following fair value hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

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

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

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

The Company s valuation techniques used to measure the fair value of money market funds and certain marketable equity securities were derived from quoted prices in active markets for identical assets or liabilities. The valuation techniques used to measure the fair value of all other financial instruments, all of which have counterparties with high credit ratings, were valued based on quoted market prices or model driven valuations using significant inputs derived from or corroborated by observable market data.

Assets/Liabilities Measured at Fair Value on a Recurring Basis

The following tables present the Company s assets and liabilities measured at fair value on a recurring basis as of December 26, 2009 and September 26, 2009 (in millions):

	December 26, 2009			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total (a)
Assets:				
Money market funds	$ 2,135	$	$	$ 2,135
U.S. Treasury securities		3,842		3,842
U.S. agency securities		9,863		9,863
Non-U.S. government securities		961		961
Certificates of deposit and time deposits		2,110		2,110
Commercial paper		5,451		5,451
Corporate securities		13,328		13,328
Municipal securities		660		660
Marketable equity securities	81			81
Derivative assets		135		135
Total assets measured at fair value	$ 2,216	$ 36,350	$	$ 38,566
Liabilities:				
Derivative liabilities	$	$ 37	$	$ 37
Total liabilities measured at fair value	$	$ 37	$	$ 37

	September 26, 2009			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total (a)
Assets:				
Money market funds	$ 1,608	$	$	$ 1,608
U.S. Treasury securities		3,616		3,616
U.S. agency securities		11,107		11,107
Non-U.S. government securities		321		321
Certificates of deposit and time deposits		1,714		1,714
Commercial paper		4,197		4,197
Corporate securities		9,786		9,786
Municipal securities		504		504
Marketable equity securities	61			61
Derivative assets		37		37
Total assets measured at fair value	$ 1,669	$ 31,282	$	$ 32,951
Liabilities:				
Derivative liabilities	$	$ 25	$	$ 25
Total liabilities measured at fair value	$	$ 25	$	$ 25

(a) The total fair value amounts for assets and liabilities also represent the related carrying amounts.

The following tables summarize the Company s assets and liabilities measured at fair value on a recurring basis presented on the Company s Condensed Consolidated Balance Sheets as of December 26, 2009 and September 26, 2009 (in millions):

	December 26, 2009			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total (a)
Assets:				
Cash equivalents	$ 2,135	$ 4,004	$	$ 6,139
Short-term marketable securities		17,187		17,187
Long-term marketable securities		15,024		15,024
Other current assets		135		135
Other assets	81			81
Total assets measured at fair value	$ 2,216	$ 36,350	$	$ 38,566
Liabilities:				
Other current liabilities	$	$ 37	$	$ 37

Total liabilities measured at fair value	$	$ 37	$	$ 37

	September 26, 2009			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total (a)
Assets:				
Cash equivalents	$ 1,608	$ 2,516	$	$ 4,124
Short-term marketable securities		18,201		18,201
Long-term marketable securities		10,528		10,528
Other current assets		37		37
Other assets	61			61
Total assets measured at fair value	$ 1,669	$ 31,282	$	$ 32,951
Liabilities:				
Other current liabilities	$	$ 25	$	$ 25
Total liabilities measured at fair value	$	$ 25	$	$ 25

(a) The total fair value amounts for assets and liabilities also represent the related carrying amounts.

Note 5 Condensed Consolidated Financial Statement Details

The following tables show the Company s condensed consolidated financial statement details as of December 26, 2009 and September 26, 2009 (in millions):

Other Current Assets

	December 26, 2009	September 26, 2009
Vendor non-trade receivables	$ 1,791	$ 1,696
Inventory component prepayments current	232	309
Other current assets	1,667	1,135
Total other current assets	$ 3,690	$ 3,140

Property, Plant and Equipment

	December 26, 2009	September 26, 2009
Land and buildings	$ 1,041	$ 955
Machinery, equipment and internal-use software	2,084	1,932
Office furniture and equipment	122	115
Leasehold improvements	1,739	1,665
Gross property, plant and equipment	4,986	4,667
Accumulated depreciation and amortization	(1,871)	(1,713)

Net property, plant and equipment	$ 3,115	$ 2,954

Other Assets

	December 26, 2009	September 26, 2009
Inventory component prepayments non-current	$ 812	$ 844
Capitalized software development costs, net	93	106
Deferred tax assets non-current	130	163
Other assets	926	898
Total other assets	$ 1,961	$ 2,011

Accrued Expenses

	December 26, 2009	September 26, 2009
Accrued warranty and related costs	$ 584	$ 577
Accrued marketing and distribution	335	359
Accrued compensation and employee benefits	293	357
Income taxes payable	258	430
Deferred margin on component sales	243	225
Other current liabilities	2,283	1,904
Total accrued expenses	$ 3,996	$ 3,852

Non-Current Liabilities

	December 26, 2009	September 26, 2009
Deferred tax liabilities	$ 2,769	$ 2,216
Other non-current liabilities	1,370	1,286
Total other non-current liabilities	$ 4,139	$ 3,502

Note 6 Income Taxes

As of December 26, 2009, the Company recorded gross unrecognized tax benefits of $1.0 billion, of which $333 million, if recognized, would affect the Company s effective tax rate. As of September 26, 2009, the total amount of gross unrecognized tax benefits was $971 million, of which $307 million, if recognized, would affect the Company s effective tax rate. The Company s total gross unrecognized tax benefits are classified as other non-current liabilities in the Condensed Consolidated Balance Sheets. The Company had $295 million and $291 million of gross interest and penalties accrued as of December 26, 2009 and September 26, 2009, respectively, which are classified as other non-current liabilities in the Condensed Consolidated Balance Sheets.

Management believes that an adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company s tax audits are resolved in a manner not consistent with management s expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs. Although timing of the resolution and/or closure of audits is not certain, the Company believes it is reasonably possible that tax audit resolutions could reduce its unrecognized tax benefits by between $105 million and $145 million in the next 12 months.

Note 7 Shareholders Equity and Stock-Based Compensation

Preferred Stock

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

Comprehensive Income

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

The following table summarizes the components of total comprehensive income, net of taxes, during the three months ended December 26, 2009 and December 27, 2008 (in millions):

	Three Months Ended	
	December 26, 2009	December 27, 2008
Net income	$ 3,378	$ 2,255
Other comprehensive income:		
Change in unrecognized gains on derivative instruments	18	41
Change in foreign currency translation	5	(105)
Net change in unrealized gains/losses on marketable securities	11	49
Total comprehensive income	$ 3,412	$ 2,240

The following table summarizes activity in other comprehensive income related to derivatives, net of taxes, held by the Company during the three months ended December 26, 2009 and December 27, 2008 (in millions):

	Three Months Ended	
	December 26, 2009	December 27, 2008
Change in fair value of derivatives	$ 6	$ 223
Adjustment for net gains/losses realized and included in net income	12	(182)
Change in unrecognized gains on derivative instruments	$ 18	$ 41

The following table summarizes the components of accumulated other comprehensive income, net of taxes, as of December 26, 2009 and September 26, 2009 (in millions):

	December 26, 2009	September 26, 2009
Net unrealized gains/losses on marketable securities	$ 59	$ 48
Net unrecognized gains on derivative instruments	19	1
Cumulative foreign currency translation	33	28
Accumulated other comprehensive income	$ 111	$ 77

Employee Benefit Plans

Rule 10b5-1 Trading Plans

During the first quarter of 2010, executive officers Timothy D. Cook, Ronald B. Johnson, Peter Oppenheimer, Philip W. Schiller and Bertrand Serlet had trading plans pursuant to Rule 10b5-1(c)(1) of the Securities Exchange Act of 1934, as amended (the Exchange Act). A trading plan is a written document that pre-establishes the amounts, prices and dates (or formula for determining the amounts, prices and dates) of future purchases or sales of the Company s stock including the exercise and sale of employee stock options and shares acquired pursuant to the Company s employee stock purchase plan and upon vesting of RSUs.

Restricted Stock Units

A summary of the Company s RSU activity and related information for the three months ended December 26, 2009, is as follows (in thousands, except per share amounts):

	Number of Shares	Weighted-Average Grant Date Fair Value	Aggregate Intrinsic Value
Balance at September 26, 2009	12,263	$ 122.52	
Restricted stock units granted	4,067	$ 191.39	
Restricted stock units vested	(1,534)	$ 126.34	
Restricted stock units cancelled	(264)	$ 147.26	
Balance at December 26, 2009	14,532	$ 140.94	$ 3,037,868

RSUs that vested during the three months ended December 26, 2009 and December 27, 2008 had a fair value of $292 million and $86 million, respectively, as of the vesting date.

Stock Option Activity

A summary of the Company s stock option and RSU activity and related information for the three months ended December 26, 2009, is as follows (in thousands, except per share amounts and contractual term in years):

		Outstanding Options			
	Shares Available for Grant	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance at September 26, 2009	37,261	34,375	$ 81.17		
Restricted stock units granted	(8,134)		$		
Options granted			$		
Options cancelled	150	(150)	$ 133.87		
Restricted stock units cancelled	528		$		
Options exercised		(4,981)	$ 62.84		
Plan shares expired			$		
Balance at December 26, 2009	29,805	29,244	$ 84.02	3.35	$ 3,655,921
Exercisable at December 26, 2009		21,172	$ 64.09	2.88	$ 3,068,900
Expected to vest after December 26, 2009		7,919	$ 136.32	4.58	$ 575,916

Aggregate intrinsic value represents the value of the Company s closing stock price on the last trading day of the fiscal period in excess of the weighted-average exercise price multiplied by the number of options outstanding or exercisable. The aggregate intrinsic value excludes the effect of stock options that have a zero or negative intrinsic value. The total intrinsic value of options at the time of exercise was $690 million and $55 million for the three-month periods ended December 26, 2009 and December 27, 2008, respectively.

RSUs granted are deducted from the shares available for grant under the Company s stock option plans utilizing a factor of two times the number of RSUs granted. Similarly, RSUs cancelled are added back to the shares available for grant under the Company s stock option plans utilizing a factor of two times the number of RSUs cancelled. Outstanding RSU balances are not included in the outstanding options balances in the stock option activity table.

Stock-Based Compensation

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

The Company did not grant any stock options during the three months ended December 26, 2009. The weighted-average assumptions used for the three months ended December 26, 2009 and December 27, 2008, and the resulting estimates of weighted-average fair value per share of options granted and of employee stock purchase plan rights (stock purchase rights) during those periods are as follows:

	Three Months Ended	
	December 26, 2009	December 27, 2008
Expected life - stock options		3.41 years
Expected life - stock purchase rights	6 months	6 months
Interest rate - stock options		1.76%
Interest rate - stock purchase rights	0.35%	2.16%
Expected volatility - stock options		53.40%
Expected volatility - stock purchase rights	40.79%	47.03%
Expected dividend yields		
Weighted-average fair value of options granted during the period	$	$ 38.25
Weighted-average fair value of stock purchase rights during the period	$ 35.21	$ 44.52

The following table provides a summary of the stock-based compensation expense included in the Condensed Consolidated Statements of Operations for the three months ended December 26, 2009 and December 27, 2008 (in millions):

	Three Months Ended	
	December 26, 2009	December 27, 2008
Cost of sales	$ 37	$ 28
Research and development	74	60
Selling, general, and administrative	94	82
Total stock-based compensation expense	$ 205	$ 170

Stock-based compensation expense capitalized as part of software development costs was not significant as of December 26, 2009 or September 26, 2009. The income tax benefit related to stock-based compensation expense was $82 million and $66 million for the three months ended December 26, 2009 and December 27, 2008, respectively. As of December 26, 2009, the total unrecognized compensation cost related to outstanding stock options and RSUs expected to vest was $2.1 billion, which the Company expects to recognize over a weighted-average period of 2.94 years.

Note 8 Commitments and Contingencies

Lease Commitments

The Company leases various equipment and facilities, including retail space, under noncancelable operating lease arrangements. The Company does not currently utilize any other off-balance sheet financing arrangements. The major facility leases are generally for terms of one to 20 years and generally provide renewal options for terms of one to five additional years. Leases for retail space are for terms of five to 20 years, the majority of which are for ten years, and often contain multi-year renewal options. As of September 26, 2009, the Company s total future minimum lease payments under noncancelable operating leases were $1.9 billion, of which $1.5 billion related to leases for retail space. As of December 26, 2009, total future minimum lease payments under noncancelable operating leases related to leases for retail space increased $100 million to $1.6 billion.

Accrued Warranty and Indemnifications

The following table reconciles changes in the Company s accrued warranties and related costs for the three months ended December 26, 2009 and December 27, 2008 (in millions):

	Three Months Ended	
	December 26, 2009	December 27, 2008
Beginning accrued warranty and related costs	$ 577	$ 671
Cost of warranty claims	(135)	(143)
Accruals for product warranties	142	165
Ending accrued warranty and related costs	$ 584	$ 693

The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against it or an indemnified third-party and, in the opinion of management, does not have a potential liability related to unresolved infringement claims subject to indemnification that would materially adversely affect its financial condition or operating results. Therefore, the Company did not record a liability for infringement costs as of either December 26, 2009 or September 26, 2009.

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

Concentrations in the Available Sources of Supply of Materials and Product

Although most components essential to the Company s business are generally available from multiple sources, certain key components including but not limited to microprocessors, enclosures, certain liquid crystal displays (LCDs), certain optical drives and application-specific integrated circuits (ASICs) are currently obtained by the Company from single or limited sources, which subjects the Company to significant supply and pricing risks. Many of these and other key components that are available from multiple sources including but not limited to NAND flash memory, dynamic random access memory (DRAM) and certain LCDs, are subject at times to industry-wide shortages and significant commodity pricing fluctuations. In addition, the Company has entered into certain agreements for the supply of key components including but not limited to microprocessors, NAND flash memory, DRAM and LCDs at favorable pricing, but there is no guarantee that the Company will be able to extend or renew these agreements on similar favorable terms, or at all, upon expiration or otherwise obtain favorable pricing in the future. Therefore, the Company remains subject to significant risks of supply shortages and/or price increases that can materially adversely affect its financial condition and operating results.

The Company and other participants in the personal computer, mobile communication and consumer electronics industries also compete for various components with other industries that have experienced increased demand for their products. In addition, the Company uses some custom components that are not common to the rest of the personal computer, mobile communication and consumer electronics industries, and new products introduced by the Company often utilize custom components available from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. 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 a key single-sourced component for a new or existing product were delayed or constrained, if such components were available only at significantly higher prices, or if a key manufacturing vendor delayed shipments of completed products to the Company, the Company s financial condition and operating results could be materially adversely affected. The Company s business and financial performance could also be 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 decided to concentrate on the production of common components instead of components customized to meet the Company s requirements.

Significant portions of the Company s Mac computers, iPhones, iPods, logic boards and other assembled products are now manufactured by outsourcing partners, primarily in various parts of Asia. A significant concentration of this outsourced manufacturing is currently performed by only a few of the Company s outsourcing partners, often in single locations. Certain of these outsourcing partners are the sole-sourced supplier of components and manufacturing outsourcing for many of the Company s key products including but not limited to final assembly of substantially all of the Company s portable Mac computers, iPhones, iPods and most of the Company s desktop products. Although the Company works closely with its outsourcing partners on manufacturing schedules, the Company s operating results could be adversely affected if its outsourcing partners were unable to meet their production commitments. The Company s purchase commitments typically cover its requirements for periods ranging from 30 to 150 days.

Contingencies

The Company is subject to certain other legal proceedings and claims that have arisen in the ordinary course of business and have not been fully adjudicated, which are discussed in Part II, Item 1 of this Form 10-Q under the heading Legal Proceedings. In the opinion of management, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate materially adversely affect its financial condition or operating results. However, the results of legal proceedings cannot be predicted with certainty. If the Company failed to prevail in any of these legal matters or if several of these legal matters were resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

Production and marketing of products in certain states and countries may subject the Company to environmental, product safety and other regulations including, in some instances, the requirement to provide customers the ability to return product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have been passed in several jurisdictions in which the Company operates, including various countries within Europe and Asia and certain states and provinces within North America. Although the Company does not anticipate any material adverse effects in the future based on the nature of its operations and the thrust of such laws, there is no assurance that such existing laws or future laws will not materially adversely affect the Company s financial condition or operating results.

Note 9 Segment Information and Geographic Data

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

The Company manages its business primarily on a geographic basis. Accordingly, the Company determined its operating and reporting segments, which are generally based on the nature and location of its customers, to be the Americas, Europe, Japan, Asia-Pacific and Retail operations. The Americas, Europe, Japan and Asia Pacific segments exclude activities related to the Retail segment. The Americas segment includes both North and South America. The Europe segment includes European countries, as well as the Middle East and Africa. The Asia-Pacific segment includes Australia and Asia, but does not include Japan. The Retail segment operates Apple-owned retail stores in the U.S. and in international markets. Each reportable operating segment provides similar hardware and software products and similar services to the same types of customers. The accounting policies of the various segments are the same as those described in Note 1, Summary of Significant Accounting Policies of this Form 10-Q and in the Notes to Consolidated Financial Statements in the Company s 2009 Form 10-K.

The Company evaluates the performance of its operating segments based on net sales and operating income. Net sales for geographic segments are generally based on the location of customers, while Retail segment net sales are based on sales from the Company s retail stores. Operating income for each segment includes net sales to third parties, related cost of sales and operating expenses directly attributable to the segment. Advertising expenses are generally included in the geographic segment in which the expenditures are incurred. Operating income for each segment excludes other income and expense and certain expenses managed outside the operating segments. Costs excluded from segment operating income include various corporate expenses, such as manufacturing costs and variances not included in standard costs, research and development, corporate marketing expenses, stock-based compensation expense, 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. Segment assets exclude corporate assets, such as cash, short-term and long-term investments, manufacturing and corporate facilities, miscellaneous corporate infrastructure, goodwill and other acquired intangible assets. Except for the Retail segment, capital asset purchases for long-lived assets are not reported to management by segment. Cash payments for capital asset purchases by the Retail segment were $107 million and $71 million during the first quarters of 2010 and 2009, respectively.

The Company has certain retail stores that 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. The Company allocates certain operating expenses associated with its high-profile stores to corporate marketing expense to reflect the estimated Company-wide benefit. The allocation of these operating costs to corporate expense is based on the amount incurred for a high-profile store in excess of that incurred by a more typical Company retail location. The Company had opened a total of 12 high-profile stores as of December 26, 2009. Expenses allocated to corporate marketing resulting from the operations of high-profile stores were $17 million and $16 million in the first quarters of 2010 and 2009, respectively.

Summary information by operating segment for the three months ended December 26, 2009 and December 27, 2008 is as follows (in millions):

	Three Months Ended	
	December 26, 2009	**December 27, 2008**
Americas:		
Net sales	$ 6,092	$ 5,301
Operating income	$ 1,811	$ 1,766
Europe:		
Net sales	$ 5,024	$ 3,585
Operating income	$ 2,165	$ 1,224
Japan:		
Net sales	$ 783	$ 498
Operating income	$ 354	$ 140
Asia-Pacific:		
Net sales	$ 1,813	$ 750
Operating income	$ 820	$ 228
Retail:		
Net sales	$ 1,971	$ 1,746
Operating income	$ 481	$ 409

A reconciliation of the Company s segment operating income to the condensed consolidated financial statements for the three months ended December 26, 2009 and December 27, 2008 is as follows (in millions):

	Three Months Ended	
	December 26, 2009	December 27, 2008
Segment operating income	$ 5,631	$ 3,767
Stock-based compensation expense	(205)	(170)
Other corporate expenses, net (a)	(701)	(496)
Total operating income	$ 4,725	$ 3,101

(a) Other corporate expenses include research and development, corporate marketing expenses, manufacturing costs and variances not included in standard costs, and other separately managed general and administrative expenses, including certain corporate expenses associated with support of the Retail segment.

Note 10 Related Party Transactions and Certain Other Transactions

The Company entered into a Reimbursement Agreement with its CEO, Steve Jobs, for the reimbursement of expenses incurred by Mr. Jobs in the operation of his private plane when used for Apple business. The Company recognized a total of $16,000 and $4,000 in expenses pursuant to the Reimbursement Agreement during the first quarters of 2010 and 2009, respectively. All expenses recognized pursuant to the Reimbursement Agreement have been included in selling, general, and administrative expenses in the Condensed Consolidated Statements of Operations.

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

This section and other parts of this Form 10-Q contain forward-looking statements that involve risks and uncertainties. Forward-looking statements can be identified by words such as anticipates, expects, believes, plans, predicts, and similar terms. Forward-looking statements are not guarantees of future performance and the Company s actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in Part II, Item 1A, Risk Factors, which are incorporated herein by reference. The following discussion should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended September 26, 2009 and any amendments thereto (the 2009 Form 10-K) filed with the U.S. Securities and Exchange Commission (SEC) and the Condensed Consolidated Financial Statements and notes thereto included elsewhere in this Form 10-Q. All information presented herein is based on the Company s fiscal calendar. Unless otherwise stated, references in this report to particular years or quarters refer to the Company s fiscal years ended in September and the associated quarters of those fiscal years. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Available Information

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

Retrospective Adoption of New Accounting Principles

In September 2009, the Financial Accounting Standards Board (FASB) amended the accounting standards related to revenue recognition for arrangements with multiple deliverables and arrangements that include software elements (new accounting principles). The Company adopted the new accounting principles on a retrospective basis during the first quarter of 2010.

Under the historical accounting principles, the Company was required to account for sales of both iPhone and Apple TV using subscription accounting because the Company indicated it might from time-to-time provide future unspecified software upgrades and features for those products free of charge. Under subscription accounting, revenue and associated product cost of sales for iPhone and Apple TV were deferred at the time of sale and recognized on a straight-line basis over each product s estimated economic life. This resulted in the deferral of significant amounts of revenue and cost of sales related to iPhone and Apple TV.

The new accounting principles generally require the Company to account for the sale of both iPhone and Apple TV as two deliverables. The first deliverable is the hardware and software essential to the functionality of the hardware device delivered at the time of sale, and the second deliverable is the right included with the purchase of iPhone and Apple TV to receive on a when-and-if-available basis future unspecified software upgrades and features relating to the product s essential software. The new accounting principles result in the recognition of substantially all of the revenue and product costs from the sales of iPhone and Apple TV at the time of sale. Additionally, the Company is required to estimate a standalone selling price for the unspecified software upgrade rights included with the sale of iPhone and Apple TV and recognizes that amount ratably over the 24-month estimated life of the related hardware device.

Note 1, Summary of Significant Accounting Policies under the subheadings *Basis of Presentation and Preparation* and *Revenue Recognition* and Note 2, Retrospective Adoption of New Accounting Principles of this Form 10-Q provides additional information on the Company s change in accounting resulting from the adoption of the new accounting principles and the Company s revenue recognition accounting policy.

Executive Overview

The Company designs, manufactures, and markets personal computers, mobile communication devices, and portable digital music and video players and sells a variety of related software, services, peripherals, and networking solutions. The Company s products and services include the Mac® line of desktop and portable computers, iPhone®, the iPod® line of portable digital music and video players, Apple TV®, Xserve®, a portfolio of consumer and professional software applications, the Mac OS® X operating system, third-party digital content and applications through the iTunes Store®, and a variety of accessory, service and support offerings. The Company sells its products worldwide through its online stores, its retail stores, its direct sales force, and third-party wholesalers, retailers, and value-added resellers. In addition, the Company sells a variety of third-party Mac, iPhone and iPod compatible products, including application software, printers, storage devices, speakers, headphones, and various other accessories and peripherals through its online and retail stores. The Company sells to consumer, small and mid-sized business (SMB), education, enterprise, government, and creative markets. A further description of the Company s products may be found below under the heading Products and Part II, Item 1A, Risk Factors, as well as in Part I, Item 1, Business, of the Company s 2009 Form 10-K.

The Company is focused on providing innovative products and solutions to consumer, SMB, education, enterprise, government and creative customers that greatly enhance their evolving digital lifestyles and work environments. The Company s overall business strategy is to control the design and development of the hardware and software for all of its products, including the personal computer, mobile communications and consumer electronics devices. The Company s business strategy leverages its unique ability to design and develop its own operating system, hardware, application software, and services to provide its customers new products and solutions with superior ease-of-use, seamless integration, and innovative industrial design. The Company believes continual investment in research and development is critical to the development and enhancement of innovative products and technologies. In conjunction with its strategy, the Company continues to build and host a robust platform for the discovery and delivery of third-party digital content and applications through the iTunes Store. Most recently the Company launched the App Store that allows users to browse, search for, and purchase third-party applications through either a Mac or Windows-based computer or by wirelessly downloading directly to an iPhone or iPod touch. The Company also desires to support a community for the development of third-party products that complement the Company s offerings through its developer programs. The Company is therefore uniquely positioned to offer superior and well-integrated digital lifestyle and productivity solutions.

The Company participates in several highly competitive markets, including personal computers with its Mac line of personal computers, mobile communications with iPhone, consumer electronics with its iPod product families, and distribution of third-party digital content and applications through its online iTunes Store. While the Company is widely recognized as a leading innovator in the personal computer, mobile communications and consumer electronics markets as well as a leader in the emerging market for distribution of digital content and applications, these markets are highly competitive and subject to aggressive pricing. To remain competitive, the Company believes that increased investment in research and development and marketing and advertising is necessary to maintain or expand its position in the markets where it competes. The Company s research and development spending is focused on further developing its existing Mac line of personal computers, its operating system, application software, iPhone and iPod line of portable digital music and video players; developing new digital lifestyle consumer and professional software applications; and investing in new product areas and technologies. The Company also believes increased investment in marketing and advertising programs is critical to increasing product and brand awareness.

The Company utilizes a variety of direct and indirect distribution channels. The Company believes that sales of its innovative and differentiated products are enhanced by knowledgeable salespersons who can convey the value of the hardware, software, and peripheral integration, demonstrate the unique digital lifestyle solutions that are available on Mac computers, and demonstrate the compatibility of the Mac with the Windows platform and networks. The Company further believes providing a high-quality sales and after-sales support experience is critical to attracting new and retaining existing customers. To ensure a high-quality buying experience for its products in which service and education are emphasized, the Company continues to expand and improve its distribution capabilities by opening its own retail stores in the U.S. and in international markets. The Company had 283 stores open as of December 26, 2009.

The Company has also invested in programs to enhance reseller sales, including the Apple® Sales Consultant Program, which places Apple employees and contractors at selected third-party reseller locations, and the Apple Premium Reseller Program, through which independently run businesses focus on the Apple platform and provide a high level of customer service and product expertise. The Company believes providing direct contact with its targeted customers is an efficient way to demonstrate the advantages of its Mac computers and other products over those of its competitors. The Company also sells to customers directly through its online stores around the world and through its direct sales force.

The Company distributes iPhones in over 80 countries, through its direct channels, its cellular network carriers distribution channels and certain third-party resellers. The Company has signed multi-year agreements with various cellular network carriers authorizing them to distribute and provide cellular network services for iPhones. These agreements are generally not exclusive with a specific carrier, except in the U.S., Germany, Spain and certain other countries.

The Company s iPods are sold through a significant number of distribution points to provide broad access. iPods can be purchased in certain department stores, member-only warehouse stores, large retail chains and specialty retail stores, as well as through the channels for Mac distribution listed above.

Products

The Company offers a range of personal computing products, mobile communication devices, and portable digital music and video players, as well as a variety of related software, services, peripherals, networking solutions and various third-party hardware and software products. The Company designs, develops, and markets to Mac and Windows users its iPhone mobile communication devices and its family of iPod digital music and video players, along with related accessories and services, including the online distribution of third-party digital content and applications through the Company s iTunes Store. In addition, the Company offers its own software products, including Mac OS X, the Company s proprietary operating system software for the Mac; server software and related solutions; professional application software; and consumer, education, and business oriented application software.

A detailed discussion of the Company s other products may be found in Part I, Item 1, Business, of the Company s 2009 Form 10-K.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles (GAAP) and the Company s discussion and analysis of its financial condition and operating results require the Company s management to make judgments, assumptions, and estimates that affect the amounts reported in its condensed consolidated financial statements and accompanying notes. Note 1, Summary of Significant Accounting Policies of this Form 10-Q and in the Notes to Consolidated Financial Statements in the Company s 2009 Form 10-K describes the significant accounting policies and methods used in the preparation of the Company s condensed consolidated financial statements. Management bases its estimates on historical experience and on various other assumptions it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates and such differences may be material.

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

Revenue Recognition

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

For multi-element arrangements that include tangible products containing software essential to the tangible product s functionality and undelivered software elements relating to the tangible product s essential software, the Company allocates revenue to all deliverables based on their relative selling prices. In such circumstances, the new accounting principles establish a hierarchy to determine the selling price to be used for allocating revenue to deliverables as follows: (i) vendor-specific objective evidence of fair value (VSOE), (ii) third-party evidence of selling price (TPE) and (iii) best estimate of the selling price (ESP).

For iPhone, the Company indicated it might from time-to-time provide future unspecified software upgrades and features free of charge to customers. The Company has identified two deliverables generally contained in arrangements involving the sale of iPhone. The first deliverable is the hardware and software essential to the functionality of the hardware device delivered at the time of sale, and the second deliverable is the right included with the purchase of iPhone to receive on a when-and-if-available basis future unspecified software upgrades and features relating to the product s essential software. The Company has allocated revenue between these two deliverables using the relative selling price method. Because the Company has neither VSOE nor TPE for the two deliverables, the allocation of revenue has been based on the Company s ESPs. Amounts allocated to the delivered hardware and the related essential software are recognized at the time of sale provided the other conditions for revenue recognition have been met. Amounts allocated to the unspecified software upgrade right are deferred and recognized on a straight-line basis over the 24-month estimated life of the related hardware. All product cost of sales, including estimated warranty costs, are generally recognized at the time of sale. Costs for engineering and sales and marketing are expensed as incurred. If the estimated life of the hardware product should change, the future rate of amortization of the revenue allocated to the software upgrade right will also change.

For all periods presented, the Company s ESP for the software upgrade right included with each iPhone sold is $25. The Company s process for determining its ESP for deliverables without VSOE or TPE involves management s judgment. The Company s process considers multiple factors that may vary depending upon the unique facts and circumstances related to each deliverable. The Company believes its customers, particularly consumers, would be reluctant to buy unspecified software upgrade rights related to iPhone. This view is primarily based on the fact that upgrade rights do not obligate the Company to provide upgrades at a particular time or at all, and do not specify to customers which upgrades or features will be delivered in the future. Therefore, the Company has concluded if it were to sell upgrade rights on a standalone basis, such as those included with iPhone, the selling price would be relatively low. Key factors considered by the Company in developing the ESPs for iPhone upgrade rights include prices charged by the Company for similar offerings, the Company s historical pricing practices, the nature of the upgrade rights (e.g., unspecified and when-and-if-available), and the relative ESP of the upgrade rights as compared to the total selling price of the product. If the facts and circumstances underlying the factors considered change or should future facts and circumstances lead the Company to consider additional factors, the Company s ESP for software upgrades related to future iPhone sales could change in future periods.

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end-user rebates, and other sales programs and volume-based incentives. For transactions involving price protection, the Company recognizes revenue net of the estimated amount to be refunded, provided the refund amount can be reasonably and reliably estimated and the other conditions for revenue recognition have been met. The Company s policy requires that, if refunds cannot be reliably estimated, revenue is not recognized until reliable estimates can be made or the price protection lapses. For customer incentive programs, the estimated cost of these programs is recognized at the later of the date at which the Company has sold the product or the date at which the program is offered. The Company also records reductions to revenue for expected future product returns based on the Company s historical experience. Future market conditions and product transitions may require the Company to increase customer incentive programs and incur incremental price protection obligations that could result in additional reductions to revenue at the time such programs are offered. Additionally, certain customer incentive programs require management to estimate the number of customers who will actually redeem the incentive.

Management s estimates are based on historical experience and the specific terms and conditions of particular incentive programs. If a greater than estimated proportion of customers redeem such incentives, the Company would be required to record additional reductions to revenue, which would have a negative impact on the Company s results of operations.

Valuation and Impairment of Marketable Securities

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

Allowance for Doubtful Accounts

The Company distributes its products through third-party distributors, cellular network carriers, and resellers and directly to certain education, consumer, and enterprise customers. The Company generally does not require collateral from its customers; however, the Company will require collateral in certain instances to limit credit risk. In addition, when possible the Company does attempt to limit credit risk on trade receivables with credit insurance for certain customers in Latin America, Europe, Asia, and Australia, 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. However, considerable trade receivables that are not covered by collateral, third-party financing arrangements, or credit insurance are outstanding with the Company s distribution and retail channel partners.

The allowance for doubtful accounts is based on management s assessment of the ability to collect specific customer accounts and includes consideration of the credit-worthiness and financial condition of those specific customers. The Company records an allowance to reduce the specific receivables to the amount that it reasonably believes to be collectible. The Company also records an allowance for all other trade receivables based on multiple factors, including historical experience with bad debts, the general economic environment, the financial condition of the Company s distribution channels, and the aging of such receivables. If there is a deterioration of a major customer s financial condition, if the Company becomes aware of additional information related to the credit-worthiness of a major customer, or if future actual default rates on trade receivables in general differ from those currently anticipated, the Company may have to adjust its allowance for doubtful accounts, which would affect its results of operations in the period the adjustments are made.

Inventory Valuation and Inventory Purchase Commitments

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

The Company records accruals for estimated cancellation fees related to component orders that have been cancelled or are expected to be cancelled. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. These commitments typically cover the Company s requirements for periods ranging from 30 to 150 days. If there is an abrupt and substantial decline in demand for one or more of the Company s products or an unanticipated change in technological requirements for any of the Company s products, the Company may be required to record additional accruals for cancellation fees that would negatively affect its results of operations in the period when the cancellation fees are identified and recorded.

Warranty Costs

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

The Company periodically provides updates to its applications and operating system software to maintain the software s compliance with specifications. The estimated cost to develop such updates is accounted for as warranty cost that is recognized at the time related software revenue is recognized. Factors considered in determining appropriate accruals related to such updates include the number of units delivered, the number of updates expected to occur, and the historical cost and estimated future cost of the resources necessary to develop these updates.

Income Taxes

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

The Company recognizes and measures uncertain tax positions in accordance with GAAP, whereby the Company only recognizes the tax benefit from an uncertain tax position 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 the tax effects of the deferred tax liabilities, will be sufficient to fully recover the deferred tax assets. In the event that the Company determines all or part of the net deferred tax assets are not realizable in the future, the Company will make an adjustment to the valuation allowance that would be charged to earnings in the period such determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of GAAP and complex tax laws. Resolution of these uncertainties in a manner inconsistent with management s expectations could have a material impact on the Company s financial condition and operating results.

Legal and Other Contingencies

As discussed in Part II, Item 1 of this Form 10-Q under the heading Legal Proceedings and in Note 8 Commitments and Contingencies in Notes to Condensed Consolidated Financial Statements, the Company is subject to various legal proceedings and claims that arise in the ordinary course of business. In accordance with GAAP, the Company records a liability when it is probable that a loss has been incurred and the amount is reasonably estimable. There is significant judgment required in both the probability determination and as to whether an exposure can be reasonably estimated. In management s opinion, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate materially adversely affect its financial condition or operating results. However, the outcomes of legal proceedings and claims brought against the Company are subject to significant uncertainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

Net Sales

The following table summarizes net sales and Mac unit sales by operating segment and net sales and unit sales by product during the three months ended December 26, 2009 and December 27, 2008 (in millions, except unit sales in thousands and per unit amounts):

	Three Months Ended		
	December 26, 2009	December 27, 2008	Change
Net Sales by Operating Segment:			
Americas net sales	$ 6,092	$ 5,301	15%
Europe net sales	5,024	3,585	40%
Japan net sales	783	498	57%
Asia-Pacific net sales	1,813	750	142%
Retail net sales	1,971	1,746	13%
Total net sales	$ 15,683	$ 11,880	32%
Mac Unit Sales by Operating Segment:			
Americas Mac unit sales	1,187	912	30%
Europe Mac unit sales	1,068	795	34%
Japan Mac unit sales	105	99	6%
Asia-Pacific Mac unit sales	313	203	54%
Retail Mac unit sales	689	515	34%
Total Mac unit sales	3,362	2,524	33%
Net Sales by Product:			
Desktops (a)	$ 1,692	$ 1,045	62%
Portables (b)	2,758	2,520	9%
Total Mac net sales	4,450	3,565	25%
iPod	3,391	3,371	1%
Other music related products and services (c)	1,164	1,011	15%
iPhone and related products and services (d)	5,578	2,940	90%
Peripherals and other hardware (e)	469	387	21%
Software, service and other sales (f)	631	606	4%
Total net sales	$ 15,683	$ 11,880	32%
Unit Sales by Product:			
Desktops (a)	1,234	728	70%
Portables (b)	2,128	1,796	18%
Total Mac unit sales	3,362	2,524	33%
Net sales per Mac unit sold (g)	$ 1,324	$ 1,412	(6%)
iPod unit sales	20,970	22,727	(8%)
Net sales per iPod unit sold (h)	$ 162	$ 148	9%
iPhone unit sales	8,737	4,363	100%

(a) Includes iMac, Mac mini, Mac Pro and Xserve product lines.
(b) Includes MacBook, MacBook Air and MacBook Pro product lines.
(c) Consists of iTunes Store sales, iPod services, and Apple-branded and third-party iPod accessories.
(d) Derived from handset sales, carrier agreements, and Apple-branded and third-party iPhone accessories.
(e) Includes sales of displays, wireless connectivity and networking solutions, and other hardware accessories.
(f) Includes sales of Apple-branded operating system, application software, third-party software, AppleCare, and Internet services.
(g) Derived by dividing total Mac net sales by total Mac unit sales.
(h) Derived by dividing total iPod net sales by total iPod unit sales.

Net sales during the first quarter of 2010 increased $3.8 billion or 32% compared to the same quarter in 2009. Several factors contributed positively to this increase, including the following:

Net sales of iPhone and related products and services were $5.6 billion in the first quarter of 2010, an increase of $2.6 billion or 90% compared to the first quarter of 2009. iPhone net sales accounted for 36% of the Company s total net revenue. iPhone handset unit sales totaled 8.7 million during the first quarter 2010, which represents an increase of 4.4 million or 100% compared to the first quarter of 2009. This growth is attributed primarily to expanded distribution and strong overall demand for iPhones. iPhone 3GS was released in the U.S. on June 19, 2009 and in many other countries over the remainder of 2009. iPhone revenue includes handset revenue recognized and revenue from sales of iPhone accessories and carrier agreements.

Mac net sales increased $885 million or 25% during the first quarter of 2010 compared to the first quarter of 2009. Mac unit sales increased by 838,000 units or 33%. Net sales related to the Company s Mac shipments accounted for 28% of the Company s total net revenue. During the first quarter of 2010, Mac desktop systems net sales and unit sales increased by 62% and 70%, respectively, compared to the first quarter of 2009. This growth was driven by strong demand for iMac, which was updated in October 2009. Mac desktop systems experienced double-digit net sales and unit growth in each of the Company s reportable operating segments compared to the same period in 2009. Net sales and unit sales of the Company s Mac portable systems increased by 9% and 18%, respectively, during the first quarter of 2010 compared to the same period in 2009. The growth in the Company s Mac portable systems was due primarily to strong sales of MacBook, which was updated in October 2009.

Net sales of other music related products and services increased $153 million or 15% during the first quarter of 2010 compared to the first quarter of 2009, due primarily to increased net sales from the iTunes Store, which experienced double-digit growth in each of the Company s geographic segments. The Company believes this continued growth is the result of heightened consumer interest in downloading third-party digital content and applications, continued growth in its customer base of iPod and iPhone customers, the expansion of third-party audio and video content available for sale and rent via the iTunes Store, and the continued interest in and growth of the iTunes® App Store. The Company continues to expand its iTunes content and applications offerings around the world.

Net sales of iPods increased by 1% year-over-year, while iPod unit sales decreased by 1.8 million units or 8% during the first quarter of 2010 compared to the first quarter of 2009. Net sales per iPod unit sold increased 9% from $148 in the first quarter of 2009 to $162 in the first quarter of 2010, resulting from the higher product mix of iPod touch.

Segment Operating Performance

The Company manages its business primarily on a geographic basis. The Company s operating and reporting segments consist of the Americas, Europe, Japan, Asia-Pacific and Retail operations. The Americas, Europe, Japan and Asia-Pacific reportable segments do not include activities related to the Retail segment. The Americas segment includes both North and South America. The Europe segment includes European countries as well as the Middle East and Africa. The Asia-Pacific segment includes Australia and Asia, but does not include Japan. The Retail segment operates Apple-owned retail stores in the U.S. and in international markets. Each reportable operating segment provides similar hardware and software products and similar services to the same types of customers. Further information regarding the Company s operating segments may be found in Note 9, Segment Information and Geographic Data in Notes to Condensed Consolidated Financial Statements of this Form 10-Q.

Americas

Net sales in the Americas during the first quarter of 2010 increased $791 million or 15% over the first quarter of 2009. The increase in net sales during the first quarter of 2010 was attributable to increased iPhone revenue, strong demand for Mac desktop and portable systems, and higher sales of third-party digital content and applications from the iTunes Store. Also contributing to the increase in net sales were higher iPod net sales due primarily to strong demand for iPod touch. Americas Mac net sales and unit sales increased 19% and 30%, respectively, during the first quarter of 2010 compared to the first quarter of 2009. The Americas segment represented 39% and 45% of the Company s total net sales in the first quarter of 2010 and 2009, respectively.

Europe

Net sales in Europe increased $1.4 billion or 40% during the first quarter of 2010 compared to the first quarter of 2009. The growth in net sales was due mainly to the significant increase in iPhone revenue primarily attributable to country and carrier expansion, strong demand for Mac desktop and portable systems and strength in the Euro relative to the U.S. dollar. Europe Mac net sales and unit sales increased 35% and 34%, respectively, during the first quarter of 2010 compared to the first quarter of 2009. The Europe segment represented 32% and 30% of total net sales in the first quarter in 2010 and 2009, respectively.

Japan

Japan s net sales increased $285 million or 57% during the first quarter of 2010 compared to the first quarter of 2009. The key contributors to this growth were increased iPhone revenue, stronger demand for Mac desktop systems and strength in the Japanese Yen relative to the U.S. dollar, partially offset by decreased sales of Mac portable systems. Mac unit sales grew in the Japan segment by 6%, while Mac net sales declined by 11% due primarily to lower average selling prices during the first quarter of 2010 compared to the first quarter of 2009. The Japan segment represented 5% and 4% of total net sales in the first quarter in 2010 and 2009, respectively.

Asia-Pacific

Net sales in Asia Pacific increased $1.1 billion or 142% during the first quarter of 2010 compared to the first quarter of 2009. The growth in net sales was mainly attributable to the significant increase in iPhone revenue primarily attributable to country and carrier expansion, increased sales of Mac portable and desktop systems, strong demand for iPod touch, as well as strengthening of the Australian dollar relative to the U.S. dollar. Mac net sales and unit sales grew in the Asia Pacific region by 44% and 54%, respectively, during the first quarter of 2010 compared to the first quarter of 2009. The Asia Pacific segment represented 11% and 6% of total net sales in the first quarter of 2010 and 2009, respectively.

Retail

Retail net sales increased $225 million or 13% during the first quarter of 2010 compared to the first quarter of 2009. The increase in net sales was driven by strong demand for Mac desktop and portable systems, increased iPhone revenue, offset partially by a decrease in net sales of iPods. Mac net sales and unit sales grew in the Retail segment by 21% and 34%, respectively, during the first quarter of 2010 compared to the first quarter of 2009. The Retail segment represented 13% and 15% of total net sales in the first quarter in 2010 and 2009, respectively.

The Company opened ten new retail stores during the first quarter of 2010, including a total of six international stores, ending the quarter with 283 stores open as compared to 251 stores at the end of the first quarter of 2009. With an average of 278 stores and 249 stores opened during the first quarter of 2010 and 2009, respectively, average revenue per store increased to $7.1 million for the first quarter of 2010 from $7.0 million in the first quarter of 2009.

The Retail segment reported operating income of $481 million during the first quarter of 2010 compared to operating income of $409 million during the first quarter in 2009. The increase in Retail operating income is attributable to higher overall net sales and a higher gross margin percentage consistent with that experienced Company-wide.

Expansion of the Retail segment has required and will continue to require a substantial investment in fixed assets and related infrastructure, operating lease commitments, personnel, and other operating expenses. Capital asset purchases associated with the Retail segment were $107 million during the first quarter of 2010, bringing the total capital asset purchases since inception of the Retail segment to $1.9 billion. As of December 26, 2009, the Retail segment had approximately 19,500 full-time equivalent employees and had outstanding lease commitments associated with retail space and related facilities of $1.6 billion. The Company would incur substantial costs if it were to close multiple retail stores and such costs could adversely affect the Company s financial condition and operating results.

Gross Margin

Gross margin for the three months ended December 26, 2009 and December 27, 2008 was as follows (in millions, except gross margin percentages):

	Three Months Ended	
	December 26, 2009	December 27, 2008
Net sales	$ 15,683	$ 11,880
Cost of sales	9,272	7,373
Gross margin	$ 6,411	$ 4,507
Gross margin percentage	40.9%	37.9%

The gross margin percentage in the first quarter of 2010 was 40.9% compared to 37.9% in the first quarter of 2009. The primary contributors of this increase were lower commodity and other product costs, a more favorable sales mix toward products with higher gross margins, and increased leverage on fixed costs, which were partially offset by product price reductions.

The Company expects its gross margin percentage to decrease in future periods compared to levels achieved during 2009 and the first quarter of 2010, and anticipates gross margin levels of about 39% in the second quarter of 2010. This expected decline is due largely to flat or reduced average selling prices on new and innovative products that have higher cost structures that deliver greater value to customers and both expected and potential future cost increases for key components.

The foregoing statements regarding the Company s expected gross margin percentage are forward-looking and could differ from anticipated levels because of several factors, including but not limited to certain of those set forth below in Part II, Item 1A, Risk Factors under the subheading *Future operating results depend upon the Company s ability to obtain key components including but not limited to microprocessors, NAND flash memory, DRAM and LCDs at favorable prices and in sufficient quantities*, which is incorporated herein by reference. There can be no assurance that targeted gross margin percentage levels will be achieved. In general, gross margins and margins on individual products will remain under downward pressure due to a variety of factors, including continued industry wide global product pricing pressures, increased competition, compressed product life cycles, product transitions and expected increases in the cost of key components including but not limited to microprocessors, NAND flash memory, dynamic random access memory (DRAM) and liquid crystal displays (LCDs), as well as potential increases in the costs of outside manufacturing services and a potential shift in the Company s sales mix towards products with lower gross margins. In response to these competitive pressures, the Company expects it will continue to take product pricing actions, which would adversely affect gross margins. Gross margins could also be affected by the Company s ability to manage product quality and warranty costs effectively and to stimulate demand for certain of its products. Due to the Company s significant international operations, financial results can be significantly affected in the short-term by fluctuations in exchange rates.

Operating Expenses

Operating expenses for the three months ended December 26, 2009 and December 27, 2008, were as follows (in millions, except for percentages):

	Three Months Ended	
	December 26, 2009	December 27, 2008
Research and development	$ 398	$ 315
Percentage of net sales	3%	3%
Selling, general, and administrative	$ 1,288	$ 1,091
Percentage of net sales	8%	9%

Research and Development (R&D)

R&D expense increased 26% or $83 million to $398 million in the first quarter of 2010 compared to $315 million in the first quarter of 2009. These increases were due primarily to an increase in headcount in the current year to support expanded R&D activities and higher stock-based compensation expenses. In addition, $22 million of software development costs were capitalized related to Mac OS X Version 10.6 Snow Leopard and excluded from R&D expense during the first quarter of 2009, while no software development costs were capitalized during the first

quarter of 2010. Although total R&D expense increased 26%, it remained flat as a percentage of net sales, which increased 32% in the first quarter of 2010 as compared to the same period in 2009. The Company continues to believe that focused investments in R&D are critical to its future growth and competitive position in the marketplace and are directly related to timely development of new and enhanced products that are central to the Company s core business strategy. As such, the Company expects to continue to invest in R&D to remain competitive.

Selling, General, and Administrative (SG&A)

SG&A expense increased 18% or $197 million to $1.3 billion in the first quarter of 2010 compared to $1.1 billion in the first quarter of 2009. This increase is due primarily to the Company s continued expansion of its Retail segment in both domestic and international markets, higher spending on marketing and advertising and higher stock-based compensation expenses.

Other Income and Expense

Total other income and expense decreased $125 million or 79% to $33 million during the first quarter of 2010 compared to $158 million in the first quarter of 2009. The overall decrease in other income and expense is attributable to the decline in interest rates during the first quarter of 2010 as compared to the first quarter of 2009, partially offset by the Company s higher cash, cash equivalents and marketable securities balances. The weighted-average interest rate earned by the Company on its cash, cash equivalents and marketable securities decreased to 0.75% in the first quarter of 2010 from 2.37% in the first quarter of 2009. During the first quarter of 2010 and 2009, the Company had no debt outstanding and accordingly did not incur any related interest expense.

The Company s investment portfolio had gross unrealized gains of $72 million and $73 million as of December 26, 2009 and September 26, 2009, respectively, which were partially offset by gross unrealized losses of $17 million and $16 million as of December 26, 2009 and September 26, 2009, respectively. The gross unrealized gains as of December 26, 2009 and September 26, 2009 related primarily to long-term marketable securities. The gross unrealized losses on the Company s marketable securities were caused primarily by changes in market interest rates. The Company considers the declines in market value of its marketable securities investment portfolio to be temporary in nature. The Company does not have the intent to sell, nor is it more likely than not the Company will be required to sell, any investment before recovery of its amortized cost basis. Accordingly, no material declines in fair value were recognized in the Company s Condensed Statements of Operations during the first quarter of 2010 and 2009. The Company may sell its marketable securities prior to their stated maturities for strategic purposes, in anticipation of credit deterioration, or for duration management. The Company recognized no material net gains or losses during the first quarters of 2010 or 2009 related to such sales.

Provision for Income Taxes

The Company s effective tax rate during the first quarter of 2010 was approximately 29% compared with approximately 31% for the first quarter of 2009. The Company s effective rate for both periods differs from the statutory federal income tax rate of 35% due primarily to certain undistributed foreign earnings for which no U.S. taxes are provided because such earnings are intended to be indefinitely reinvested outside the U.S. The lower effective tax rate during the first quarter of 2010 as compared to the same quarter in 2009 is due primarily to an increase in foreign earnings on which U.S. income taxes have not been provided.

The Internal Revenue Service (the IRS) has completed its field audit of the Company s federal income tax returns for the years 2002 through 2003 and proposed certain adjustments. The Company has contested certain of these adjustments through the IRS Appeals Office. All IRS audit issues for years prior to 2002 have been resolved. In addition, the Company is subject to audits by state, local, and foreign tax authorities. Management believes that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company s tax audits are resolved in a manner not consistent with management s expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs.

Liquidity and Capital Resources

The following table presents selected financial information and statistics as of December 26, 2009 and September 26, 2009 (in millions):

	December 26, 2009	September 26, 2009
Cash, cash equivalents and marketable securities	$ 39,820	$ 33,992
Accounts receivable, net	$ 3,090	$ 3,361
Inventory	$ 576	$ 455
Working capital	$ 20,235	$ 20,049

As of December 26, 2009, the Company had $39.8 billion in cash, cash equivalents and marketable securities, an increase of $5.8 billion from September 26, 2009. The principal component of this net increase was the cash generated by operating activities of $5.8 billion, which was partially offset by payments for acquisition of property, plant and equipment of $376 million.

The Company s marketable securities investment portfolio is invested primarily in highly rated securities with a minimum rating of single-A. As of December 26, 2009 and September 26, 2009, $21.3 billion and $17.4 billion, respectively, of the Company s cash, cash equivalents and marketable securities were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. The Company believes its existing balances of cash, cash equivalents and marketable securities will be sufficient to satisfy its working capital needs, capital asset purchases, outstanding commitments, and other liquidity requirements associated with its existing operations over the next 12 months.

Capital Assets

The Company s cash payments for capital asset purchases were $376 million during the first quarter of 2010, consisting of approximately $107 million for retail store facilities and $269 million for real estate acquisitions and corporate infrastructure including information systems enhancements. The Company anticipates utilizing approximately $1.9 billion for capital asset purchases during 2010, including approximately $400 million for Retail facilities and approximately $1.5 billion for corporate facilities, infrastructure, and product tooling and manufacturing process equipment.

Historically the Company has opened between 25 and 50 new retail stores per year. During 2010, the Company expects to open a number of new stores near the upper end of this range, over half of which are expected to be located outside of the U.S.

Off-Balance Sheet Arrangements and Contractual Obligations

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

Lease Commitments

As of September 26, 2009, the Company had total outstanding commitments on noncancelable operating leases of $1.9 billion, $1.5 billion of which related to the lease of retail space and related facilities. The Company s major facility leases are generally for terms of one to 20 years and generally provide renewal options for terms of one to five additional years. Leases for retail space are for terms of five to 20 years, the majority of which are for ten years, and often contain multi-year renewal options. Total outstanding commitments on noncancelable operating leases related to the lease of retail space increased to $1.6 billion as of December 26, 2009.

Purchase Commitments with Contract Manufacturers and Component Suppliers

The Company utilizes several contract manufacturers to manufacture sub-assemblies for the Company s products and to perform final assembly and test of finished products. These contract manufacturers acquire components and build product based on demand information supplied by the Company, which typically covers periods ranging from 30 to 150 days. The Company also obtains individual components for its products from a wide variety of individual suppliers. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. Such purchase commitments typically cover the Company s forecasted component and manufacturing requirements for periods ranging from 30 to 150 days. As of December 26, 2009, the Company had outstanding off-balance sheet third-party manufacturing commitments and component purchase commitments of $3.7 billion.

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The Company has entered into prepaid long-term supply agreements to secure the supply of certain inventory components. As of December 26, 2009, the Company had a total of $1.0 billion of inventory component prepayments outstanding.

Asset Retirement Obligations

The Company s asset retirement obligations are associated with commitments to return property subject to operating leases to original condition upon lease termination. As of December 26, 2009, the Company estimated that gross expected future cash flows of approximately $41 million would be required to fulfill these obligations.

Other Obligations

Other outstanding obligations were $298 million as of December 26, 2009, primarily related to advertising, research and development, Internet and telecommunications services, and other obligations.

As of December 26, 2009, the Company had gross unrecognized tax benefits of $1.0 billion and an additional $295 million for gross interest and penalties classified as non-current liabilities in the Condensed Consolidated Balance Sheet. Although timing of the resolution and/or closure of audits is not certain, the Company believes it is reasonably possible that tax audit resolutions could reduce its unrecognized tax benefits by between $105 million and $145 million in the next 12 months. At this time, the Company is unable to make a reasonably reliable estimate of the timing of payments in individual years due to uncertainties in the timing of tax audit outcomes.

Indemnifications

The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against it or an indemnified third-party and, in the opinion of management, does not have a liability related to unresolved infringement claims subject to indemnification that would materially adversely affect its financial condition or operating results. Therefore, the Company did not record a liability for infringement costs as of either December 26, 2009 or September 26, 2009.

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company s market risk profile has not changed significantly during the first three months of 2010.

Interest Rate and Foreign Currency Risk Management

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

Interest Rate Risk

While the Company is exposed to interest rate fluctuations in many of the world s leading industrialized countries, the Company s interest income and expense is most sensitive to fluctuations in the general level of U.S. interest rates. As such, changes in U.S. interest rates affect the interest earned on the Company s cash, cash equivalents and marketable securities, the fair value of those investments, as well as costs associated with foreign currency hedges.

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

The Company s exposure to market risk for changes in interest rates relates primarily to the Company s investment portfolio. The Company typically invests in highly rated securities and its policy generally limits the amount of credit exposure to any one issuer. The Company s investment policy requires investments to be investment grade, primarily rated single-A or better with the objective of minimizing the potential risk of principal loss. All highly liquid investments with initial maturities of three months or less at the date of purchase are classified as cash equivalents. The Company classifies its marketable securities as either short-term or long-term based on each instrument s underlying contractual maturity date. All short-term marketable securities have maturities less than 12 months, while all long-term marketable securities have maturities greater than 12 months. The Company may sell its investments prior to their stated maturities for strategic purposes, in anticipation of credit deterioration, or for duration management. The Company recognized no material net gains or losses during the first quarter of 2010 or 2009 related to such sales.

Foreign Currency Risk

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

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

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on an evaluation under the supervision and with the participation of the Company s management, the Company s principal executive officer and principal financial officer have concluded that the Company s disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (Exchange Act) were effective as of December 26, 2009 to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to the Company s management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company s internal control over financial reporting during the first quarter of 2010, which were identified in connection with management s evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

As of December 26, 2009, the end of the quarterly period covered by this report, the Company was subject to the various legal proceedings and claims discussed below, as well as certain other legal proceedings and claims that have not been fully resolved and that have arisen in the ordinary course of business. In the opinion of management, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate materially adversely affect its financial condition or operating results. However, the results of legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected. The Company settled certain matters during the first quarter of 2010 that did not individually or in the aggregate have a material impact on the Company s financial condition and results of operations.

Bader v. Anderson, et al.

Plaintiff filed this purported shareholder derivative action against the Company and each of its then-current executive officers and members of its Board of Directors on May 19, 2005, in Santa Clara County Superior Court asserting claims for breach of fiduciary duty, material misstatements and omissions and violations of California Business & Professions Code §17200 (unfair competition). Plaintiff alleged that the Company s March 14, 2005 proxy statement was false and misleading for failure to disclose certain information relating to the Apple Computer, Inc. Performance Bonus Plan, which was approved by shareholders at the annual meeting held on April 21, 2005. The complaint sought injunctive and other relief for purported injury to the Company. Through several amended complaints, the plaintiff added a claim that the Company violated the terms of the Performance Bonus Plan and a claim for waste related to restricted stock unit grants to certain officers in 2003 and 2004 and an option grant to the Company s CEO in January 2000. On October 25, 2007, the Court entered a final judgment against plaintiff and ordered the case dismissed with prejudice. On November 23, 2009, the Court of Appeal affirmed the Superior Court s dismissal of the case with prejudice.

Birdsong v. Apple Computer, Inc.

Plaintiff filed this action on January 30, 2006, in the United States District Court for the Western District of Louisiana asserting Louisiana causes of action on behalf of a purported Louisiana class of iPod purchasers. The plaintiff alleged that the Company s iPod music players, and the ear bud headphones sold with them, are inherently defective in design and are sold without adequate warnings concerning the risk of noise-induced hearing loss by iPod users. After the case was transferred to the Northern District of California, plaintiffs amended their claims to allege California law-based claims for breaches of implied and express warranties, violations of California Business & Professions Code §17200 (unfair competition), California Business & Professions Code §17500 (false advertising), the Consumer Legal Remedies Act and negligent misrepresentation on behalf of a putative nationwide class and a Louisiana law-based claim for redhibition for a Louisiana sub-class. Plaintiffs sought restitution, injunctive relief, unspecified damages and attorneys fees. On June 16, 2008, the Court granted the Company s motion to dismiss the third amended complaint with prejudice. On December 30, 2009, the Court of Appeals for the Ninth Circuit affirmed the District Court s dismissal of the case with prejudice.

A similar complaint, *Royer-Brennan v. Apple Computer, Inc. and Apple Canada, Inc.*, was filed in Montreal, Quebec, Canada, on February 1, 2006, seeking authorization to institute a class action on behalf of iPod purchasers in Quebec. This case is currently pending.

Branning et al. v. Apple Computer, Inc.

Plaintiffs originally filed this purported class action in San Francisco County Superior Court on February 17, 2005 on behalf of putative classes of consumers and resellers. The case was transferred to Santa Clara Superior Court in May 2005. The initial complaint alleged violations of California Business & Professions Code §17200 (unfair competition) and the Consumer Legal Remedies Act and causes of action for misappropriation of trade secrets, breach of contract and violation of the Song-Beverly Consumer Warranty Act. Plaintiffs requested unspecified damages and other relief. Plaintiffs subsequently filed multiple amended complaints adding new plaintiffs and new causes of action including claims for false advertising, fraud, conversion, breach of the implied covenant of good faith and fair dealing and for violation of California Business & Professions Code §16700 et seq. (the Cartwright Act). In general, the consumer plaintiffs allege that the Company shorted the coverage provided under its warranties and AppleCare Protection Plan extended service contracts and sold plaintiffs used products that were represented to be new. In general, the reseller plaintiffs allege that the Company damaged their businesses by opening the Apple retail stores and making misrepresentations in connection with doing so. On October 28, 2009, the Court granted the consumer plaintiffs motion to certify a class relating to their shorting claims, but denied class certification as to their used as new claims. This case is currently pending.

Harvey v. Apple Inc.

Plaintiff filed this action on August 6, 2007, in the United States District Court for the Eastern District of Texas alleging infringement by the Company of U.S. Patent Nos. 6,753,671 and 6,762,584. The complaint seeks unspecified damages and other relief. On October 8, 2009, the case was transferred to the Northern District of California, where it is currently pending.

Honeywell International, Inc., et al. v. Apple Computer, Inc., et al.

Plaintiffs Honeywell International, Inc. and Honeywell Intellectual Properties, Inc. filed this action on October 6, 2004, in the United States District Court in Delaware alleging infringement by the Company and other defendants of U.S. Patent No. 5,280,371. Plaintiffs sought unspecified damages and other relief. Plaintiffs agreed to dismiss the Company without prejudice from this action, and the Court entered the dismissal. The case is now concluded.

In re Apple iPod Nano Products Liability Litigation (formerly Wimmer v. Apple Computer, Inc.; Moschella, et al., v. Apple Computer, Inc.; *Calado, et al. v. Apple Computer, Inc.*; *Kahan, et al., v. Apple Computer, Inc.*; *Jennings, et al., v. Apple Computer, Inc.*; *Rappel v. Apple Computer, Inc.*; *Mayo v. Apple Computer, Inc.*; *Valencia v. Apple Computer, Inc.*; *Williamson v. Apple Computer, Inc.*; *Sioson v. Apple Computer, Inc.*

Beginning on October 19, 2005, eight complaints were filed in various United States District Courts and two complaints were filed in California State Court alleging that the Company s iPod nano was defectively designed so that it scratches excessively during normal use, rendering the screen unreadable. The federal actions were consolidated in the United States District Court for the Northern District of California pursuant to an April 17, 2006 order of the Judicial Panel on Multidistrict Litigation. Plaintiffs filed a First Consolidated and Amended Master Complaint on September 21, 2006, alleging violations of California and other states consumer protection and warranty laws and claiming unjust enrichment. The Master Complaint alleged two putative plaintiff classes: (1) all U.S. residents (excluding California residents) who purchased an iPod nano that was not manufactured or designed using processes necessary to ensure normal resistance to scratching of the screen; and (2) all iPod nano purchasers other than U.S. residents who purchased an iPod nano that was not manufactured or designed using processes necessary to ensure normal resistance to scratching of the screen. On May 4, 2006, the two California State Court actions were consolidated in Los Angeles County Superior Court. Plaintiffs filed a Consolidated Amended Class Action Complaint on June 8, 2006, alleging violations of California state consumer protection, unfair competition, false advertising and warranty laws and claiming unjust enrichment. The Consolidated Complaint alleged a putative plaintiff class of all California residents who own an iPod nano containing a manufacturing defect that results in the nano being susceptible to excessive scratching. The parties reached a settlement and on April 28, 2009, the Court granted final approval of the settlement. On May 21, 2009, an objector appealed the Court s approved of the settlement. The appeal has been dismissed and the actions are now concluded.

Individual Network LLC v. Apple, Inc.

Plaintiff filed this action against the Company on April 24, 2007, in the United States District Court for the Eastern District of Texas alleging infringement of U.S. Patent No. 7,117,516. Plaintiff alleged certain features of the iTunes store infringe the patent. The complaint sought unspecified damages and other relief. The Company counterclaimed against Individual Networks LLC for infringement of U.S. Patent No. 5,724,567. The parties reached a settlement and the case was dismissed on November 30, 2009.

Mediostream, Inc. v. Acer America Corp. et al.

Plaintiff filed this action against the Company, Acer America Corp., Dell, Inc. and Gateway, Inc. on August 28, 2007, in the United States District Court for the Eastern District of Texas alleging infringement of U.S. Patent No. 7,009,655. Plaintiff seeks unspecified damages and other relief. This case is currently pending.

Nokia Corporation v. Apple Inc.; Apple Inc. v. Nokia Corporation

On October 22, 2009, Nokia Corporation (Nokia) filed a complaint against the Company in the United States District Court for the District of Delaware, alleging infringement of U.S. Patent Nos. 5,802,465; 5,862,178; 5,946,651; 6,359,904; 6,694,135; 6,755,548; 6,882,727; 7,009,940; 7,092,672; and 7,403,621. The complaint alleges that these patents are essential to one or more of the GSM, UMTS and 802.11 wireless communications standards, and that the Company has the right to license these patents from plaintiff on fair, reasonable, and non-discriminatory (FRAND) terms and conditions. Nokia seeks unspecified FRAND compensation and other relief. On December 11, 2009, the Company filed an answer denying all material allegations, asserting numerous

affirmative defenses, and asserting counterclaims for declaratory judgment of non-infringement and invalidity as well as claims against Nokia for infringement of U.S. Patent Nos. 5,634,074; 6,343,263; 5,915,131; 5,555,369; 6,239,795; 5,315,703; 6,189,034; 7,469,381; RE 39,486; 5,455,854; 7,383,453; 5,848,105; and 5,379,431.

On December 29, 2009, Nokia filed a complaint in the United States International Trade Commission (ITC) (the Nokia ITC Action) requesting that the ITC conduct an investigation into whether certain iPhones, iPods and Apple computers infringe U.S. Patent Nos. 6,714,091; 6,834,181; 6,895,256; 6,518,957; 6,073,036; 6,262,735; and 6,924,789.

On December 29, 2009, Nokia filed a complaint against the Company in the United States District Court for the District of Delaware alleging infringement of the same patents that are the subject of the Nokia ITC action.

On January 15, 2010, the Company filed a complaint in the ITC (the Apple ITC Action) requesting that the ITC conduct an investigation into whether certain Nokia mobile communication devices and components thereof infringe certain claims of U.S. Patent Nos. 5,379,431; 5,455,599; 5,519,867; 5,915,131; 5,920,726; 5,969,705; 6,343,263; 6,424,354; and RE 39,486.

All of these cases are currently pending.

OPTi Inc. v. Apple Inc.

Plaintiff filed this action against the Company on January 16, 2007, in the United States District Court for the Eastern District of Texas alleging infringement of U.S. Patent Nos. 5,710,906, 5,813,036, and 6,405,291. The complaint seeks unspecified damages and other relief. On April 3, 2009, the Court ruled that the accused computers sold between 2005 and 2007 infringed the 291 patent. On April 23, 2009, the jury returned a verdict that the patent was valid and willfully infringed, and awarded $19 million in damages. On December 3, 2009, the Court granted the Company s judgment as a matter of law on willfulness, denied plaintiff s motion for enhanced damages and entered judgment against the Company for $21.7 million. The case is on appeal.

Saito Shigeru Kenchiku Kenkyusho (Shigeru Saito Architecture Institute) v. iPod; Apple Japan Inc. v. Shigeru Saito Architecture Institute

Plaintiff Saito filed a petition in the Japan Customs Office in Tokyo on January 23, 2007, alleging infringement by the Company of Japanese Patent No. 3,852,854. The petition sought an order barring the importation into Japan of fifth generation iPods and second generation iPod nanos. The Customs Office rejected the petition to bar importation and dismissed plaintiff s case.

Apple Japan, Inc. filed a Declaratory Judgment action against Saito on February 6, 2007, in the Tokyo District Court, seeking a declaration that the 854 patent is invalid and not infringed. Saito filed a Counter Complaint for infringement seeking damages. These cases are currently pending.

St-Germain v. Apple Canada, Inc.

Plaintiff filed this case in Montreal, Quebec, Canada, on August 5, 2005, as a putative class action for the refund by the Company of the Canadian Private Copying Levy that was applied to the iPod purchase price in Quebec between December 12, 2003, and December 14, 2004, but later declared invalid by the Canadian Court. The Company has completed a refund program for this levy. On January 11, 2008, the Court issued a ruling in plaintiff s favor. The Court ruled that despite the Company s good faith efforts with the levy refund program, the Company must pay the amount claimed, and that the class is comprised of 20,000 persons who purchased an iPod in Quebec between December 12, 2003 and December 14, 2004. The Court ordered the Company to submit a statement of account showing the amount received by the Canadian Private Copying Collective, and the amount that has already been paid to class members in Quebec under the Company s levy refund program. The Court also ordered the parties to submit further briefing regarding the collective recovery award by February 23, 2008. This case is currently on appeal.

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

The first-listed action is a consolidated case filed in the United States District Court for the Northern District of California combining two cases previously pending under the names *Charoensak v. Apple Computer Inc. (formerly Slattery v. Apple Computer Inc*., filed on January 3, 2005*)* and *Tucker v. Apple Computer, Inc*. (filed on July 21, 2006). A Consolidated Complaint was filed on April 17, 2007 on behalf of a purported class of direct purchasers of iPods and iTunes Store content, alleging various claims including alleged unlawful tying of music and video purchased on the iTunes Store with the purchase of iPods and unlawful acquisition or maintenance of monopoly market power. The Consolidated Complaint alleges violations of §§1 and 2 of the Sherman Act (15 U.S.C. §§1 and 2), California Business & Professions Code §16700 et seq. (the Cartwright Act), California Business & Professions Code §17200 (unfair competition), the California Consumer Legal

Remedies Act and California monopolization law. Plaintiffs seek unspecified damages and other relief. On December 22, 2008, the Court granted certification of plaintiffs monopolization claims and denied without prejudice certification of their tying claims. On October 30, 2009, the Court dismissed plaintiffs claims for violation of §1 of the Sherman Act and California Business & Professions Code §16700 et seq. On December 21, 2009, the Court decertified the injunctive relief class and Rule 23(b)(3) damages class. This case is currently pending.

A related complaint, *Somers v. Apple Inc.*, was filed on December 31, 2007, in the United States District Court for the Northern District of California on behalf of a purported class of indirect purchasers, alleging various claims including alleged unlawful tying of music and videos purchased on the iTunes Store with the purchase of iPods and vice versa and unlawful acquisition or maintenance of monopoly market power. The complaint alleges violations of §§1 and 2 of the Sherman Act (15 U.S.C. §§1 and 2), California Business & Professions Code §16700 et seq. (the Cartwright Act), California Business & Professions Code §17200 (unfair competition), the California Consumer Legal Remedies Act and California monopolization law. Plaintiff seeks unspecified damages and other relief. This case is currently pending.

Tse v. Apple Computer, Inc. et al.

Plaintiff Ho Keung Tse filed this action against the Company and other defendants on August 5, 2005, in the United States District Court for the District of Maryland alleging infringement of U.S. Patent No. 6,665,797. The complaint seeks unspecified damages and other relief. The action was subsequently transferred to the Northern District of California. The case is currently stayed pending the outcome of the U.S. Patent and Trademark Office reexamination of the asserted patent.

Vitt v. Apple Computer, Inc.

Plaintiff filed this purported class action on November 7, 2006, in the United States District Court for the Central District of California on behalf of a purported nationwide class of all purchasers of the iBook G4 alleging that the computer s logic board fails at an abnormally high rate. The complaint alleges violations of California Business & Professions Code §17200 (unfair competition) and California Business & Professions Code §17500 (false advertising). Plaintiff seeks unspecified damages and other relief. This case is currently pending.

Vogel v. Jobs et al. (2006 Action)

Plaintiffs filed this purported class action on August 24, 2006, in the United States District Court for the Northern District of California against the Company and certain of the Company s current and former officers and directors alleging improper backdating of stock option grants to maximize certain defendants profits, failing to properly account for those grants and issuing false financial statements. Plaintiffs Consolidated Complaint, filed March 23, 2007, purports to be brought on behalf of several classes of holders of the Company s stock and asserts claims under Section 14(a) and 20(a) of the Exchange Act as well as state law. The Consolidated Complaint seeks rescission of amendments to various stock option and other incentive compensation plans, an accounting and damages in an unspecified amount. The court entered judgment in the defendants favor and dismissed the case on June 12, 2008. Plaintiffs appeal of the judgment is pending.

Vogel v. Apple Inc., et al. (2008 Action)

Plaintiff filed this purported class action on June 27, 2008, in the United States District Court for the Northern District of California against the Company and certain of the Company s current and former officers and directors. The allegations, which arise out of the Company s past stock option practices, are similar to those in the 2006 *Vogel v. Jobs et al.* action that was dismissed on June 12, 2008, as described above. The complaint purports to be brought on behalf of several classes of holders of the Company s stock and asserts claims under Sections 10(b) and 20(a) of the Exchange Act. The complaint seeks rescission of amendments to various stock option and other incentive compensation plans, an accounting and damages in an unspecified amount. On July 22, 2008, the Court stayed this case pending the appeal in the 2006 Action.

Item 1A. Risk Factors

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

Economic conditions could materially adversely affect the Company.

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

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

Uncertainty about current global economic conditions could also continue to increase the volatility of the Company s stock price.

Global markets for personal computers, mobile communication devices, digital music and video devices, and related peripherals and services are highly competitive and subject to rapid technological change. If the Company is unable to compete effectively in these markets, its financial condition and operating results could be materially adversely affected.

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

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

In the market for personal computers and peripherals, the Company faces a significant number of competitors, many of which have broader product lines, lower priced products, and larger installed customer bases. Consolidation in this market has resulted in larger and potentially stronger competitors. Price competition has been particularly intense as competitors selling Windows-based personal computers have aggressively cut prices and lowered product margins. The Company also faces increased competition in key market segments, including consumer, SMB, education, enterprise, government and creative markets. An increasing number of Internet devices that include software applications and are smaller and simpler than traditional personal computers compete for market share with the Company s existing products.

The Company is currently the only authorized maker of hardware using the Mac OS. The Mac OS has a minority market share in the personal computer market, which is dominated by computer makers using competing operating systems, most notably Windows. The Company s financial condition and operating results depend substantially on the Company s ability to continually improve the Mac platform to maintain functional and design advantages. Use of unauthorized copies of the Mac OS on other companies hardware products may result in decreased demand for the Company s hardware products, and could materially adversely affect the Company s financial condition and operating results.

The Company is currently focused on certain mobile communication devices, such as iPhone, consumer electronic devices, including the iPod family of digital music and video players and third-party digital content and applications distribution. The Company faces substantial competition from companies that have significant technical, marketing, distribution and other resources, as well as established hardware, software and digital content supplier relationships. The Company also competes with illegitimate ways to obtain third-party digital content and applications. The Company has only recently entered the mobile communications market, and many of its competitors in the mobile communications market have significantly greater experience, product breadth and distribution channels than the Company. Because some current and potential competitors have substantial resources and experience and a lower cost structure, they may be able to provide such products and services at little or no profit or even at a loss. The Company also expects competition to intensify as competitors attempt to imitate the Company s approach to providing these components seamlessly within their individual offerings or work collaboratively to offer integrated solutions.

The Company currently receives subsidies from its exclusive and non-exclusive carriers providing cellular network service for iPhone. 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.

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 personal computer, mobile communication and consumer electronics industries, the Company must continually introduce new products, services and technologies, enhance existing products and services, and effectively stimulate customer demand for new and upgraded products. The success of new product introductions depends on a number of factors including but not limited to timely and successful product development, market acceptance, the Company s ability to manage the risks associated with new products and production ramp issues, the availability of application software for new products, the effective management of purchase commitments and inventory levels in line with anticipated product demand, the availability of products in appropriate quantities and costs to meet anticipated demand, and the risk that new products may have quality or other defects in the early stages of introduction. Accordingly, the Company cannot determine in advance the ultimate effect of new product introductions and transitions on its financial condition and operating results.

The Company faces substantial inventory and other asset risk.

The Company records a write-down for product and component inventories that have become obsolete or exceed anticipated demand or net realizable value and accrues necessary cancellation fee reserves for orders of excess products and components. The Company also reviews its long-lived assets for impairment whenever events or changed circumstances indicate the carrying amount of an asset may not be recoverable. If the Company determines that impairment has occurred, it records a write-down equal to the amount by which the carrying value of the assets exceeds its fair market value. Although the Company believes its inventory and other asset related provisions are currently adequate, no assurance can be given that, given the rapid and unpredictable pace of product obsolescence in the global personal computer, mobile communication, and consumer electronics industries, the Company will not incur additional inventory or asset related charges. Such charges have, and could, materially adversely affect the Company s financial condition and operating results.

The Company must order components for its products and build inventory in advance of product announcements and shipments. Consistent with industry practice, components are normally acquired through a combination of purchase orders, supplier contracts, open orders and, where appropriate, prepayments, in each case based on projected demand. Such purchase commitments typically cover forecasted component and manufacturing requirements for 30 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 inventories of components or products. The Company s financial condition and operating results have been in the past and could be in the future materially adversely affected by the Company s ability to manage its inventory levels and respond to short-term shifts in customer demand patterns.

Future operating results depend upon the Company s ability to obtain key components including but not limited to microprocessors, NAND flash memory, DRAM and LCDs at favorable prices and in sufficient quantities.

Because the Company currently obtains certain key components including but not limited to microprocessors, enclosures, certain LCDs, certain optical drives, and ASICs, from single or limited sources, the Company is subject to significant supply and pricing risks. Many of these and other key components that are available from multiple sources including but not limited to NAND flash memory, DRAM and certain LCDs, are subject at times to industry-wide shortages and significant commodity pricing fluctuations. The Company has entered into certain agreements for the supply of key components including but not limited to microprocessors, NAND flash memory, DRAM and LCDs at favorable pricing, but there is no guarantee that the Company will be able to extend or renew these agreements on similar favorable terms, or at all, upon expiration or otherwise obtain favorable pricing in the future. The follow-on effects from the credit crisis on the Company s key suppliers, referred to in *Economic conditions could materially adversely affect the Company* above, which is incorporated herein by reference, also could affect the Company s ability to obtain key components. Therefore, the Company remains subject to significant risks of supply shortages and/or price increases that could materially adversely affect the Company s financial condition and operating results. The Company expects to experience decreases in its gross margin percentage in future periods, as compared to levels achieved during 2009 and the first quarter of 2010, due largely to flat or reduced average selling prices on new and innovative products that have higher cost structures that deliver greater value to customers and both expected and potential future cost increases for key components. For additional information refer to Part I, Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations, under the subheading Gross Margin, which is incorporated herein by reference.

The Company and other participants in the personal computer, mobile communication and consumer electronics industries compete for various components with other industries that have experienced increased demand for their products. The Company uses some custom components that are not common to the rest of the personal computer, mobile communication and consumer electronics industries. The Company s new products often utilize custom components available from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. When a component or product uses new technologies, initial capacity constraints may exist until the suppliers yields have matured or manufacturing capacity has increased. Continued availability of these components at acceptable prices, or at all, may be affected if those suppliers decided to concentrate on the production of common components instead of components customized to meet the Company s requirements. If the supply of a key single-sourced component for a new or existing product were delayed or constrained, if such components were available only at significantly higher prices, or if a key manufacturing vendor delayed shipments of completed products to the Company, the Company s financial condition and operating results could be materially adversely affected.

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

Most of the Company s components and products are manufactured in whole or in part by a few third-party manufacturers. Many of these manufacturers are located outside of the U.S., and are concentrated in several general locations. 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. In addition, the Company relies on third-party manufacturers to adhere to the Company s supplier code of conduct. Although arrangements with such manufacturers may contain provisions for warranty expense reimbursement, the Company may remain responsible to the consumer for warranty service in the event of product defects. Any unanticipated product defect or warranty liability, whether pursuant to arrangements with contract manufacturers or otherwise, could materially adversely affect the Company s reputation, financial condition and operating results.

Final assembly of the Company s products is currently performed in the Company s manufacturing facility in Ireland, and by external vendors in California, Texas, China, the Czech Republic and Korea. Currently, the supply and manufacture of many critical components is performed by sole-sourced third-party vendors in the U.S., China, Germany, Ireland, Israel, Japan, Korea, Malaysia, the Netherlands, the Philippines, Taiwan, Thailand and Singapore. Sole-sourced third-party vendors in China perform final assembly of substantially all of the Company s portable Mac products, iPhones, iPods and most of the Company s desktop products. If manufacturing or logistics in these locations is disrupted for any reason, including natural disasters, information technology system failures, military actions or economic, business, labor, environmental, public health, or political issues, the Company s financial condition and operating results could be materially adversely affected.

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

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

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

The Company relies on access to third-party patents and intellectual property, and the Company s future results could be materially adversely affected if it is alleged or found to have infringed intellectual property rights.

Many of the Company s products are designed to include third-party intellectual property, and in the future the Company may need to seek or renew licenses relating to various aspects of its products and business methods. Although the Company believes that, based on past experience and industry practice, such licenses generally could be obtained on reasonable terms, there is no assurance that the necessary licenses would be available on acceptable terms or at all.

Because of technological changes in the global personal computer, mobile communication and consumer electronics industries, current extensive patent coverage, and the rapid issuance of new patents, it is possible that certain components of the Company s products and business methods may unknowingly infringe the patents or other intellectual property rights of third parties. From time to time, the Company has been notified that it may be infringing such rights. Regardless of merit, responding to such claims can consume significant time and expense. At present, the Company is vigorously defending a number of patent infringement cases, and several pending claims are in various stages of evaluation. In certain cases, the Company may consider the desirability of entering into licensing agreements, although no assurance can be given that such licenses can be obtained on acceptable terms or that litigation will not occur. If the Company is found to be infringing such rights, it may be required to pay substantial damages. If there is a temporary or permanent injunction prohibiting the Company from marketing or selling certain products or a successful claim of infringement against the Company requires it to pay royalties to a third party, the Company s financial condition and operating results could be materially adversely affected, regardless of whether it can develop non-infringing technology. While in management s opinion the Company does not have a potential liability for damages or royalties from any known current legal proceedings or claims related to the infringement of patent or other intellectual property rights that would individually or in the aggregate materially adversely affect its financial condition and operating results, the results of such legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of the matters related to infringement of patent or other intellectual property rights of others or should several of these matters be resolved against the Company in the same reporting period, the Company s financial condition and operating results could be materially adversely affected.

With the June 2007 introduction of iPhone, the Company has begun to compete with mobile communication device companies that hold significant patent portfolios. Regardless of the scope or validity of such patents or the merits of any potential patent claims by competitors, the Company may have to engage in protracted litigation, enter into expensive agreements or settlements and/or modify its products. Any of these events could have a material adverse impact on the Company s financial condition and operating results.

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

The Company believes decisions by customers to purchase its hardware products, including its Macs, iPhones and iPods, are often based to a certain extent on the availability of third-party software applications and services. There is no assurance that third-party developers will continue to develop and maintain applications and services for the Company s products on a timely basis or at all, and discontinuance or delay of these applications and services could materially adversely affect the Company s financial condition and operating results.

With respect to its Mac products, the Company believes the availability of third-party software applications and services depends in part on the developers perception and analysis of the relative benefits of developing, maintaining, and upgrading such software for the Company s products compared to Windows-based products. This analysis may be based on factors such as the perceived strength of the Company and its products, the anticipated revenue that may be generated, continued acceptance by customers of Mac OS X, and the costs of developing such applications and services. If the Company s minority share of the global personal computer market causes developers to question the Company s prospects, developers could be less inclined to develop or upgrade software for the Company s products and more inclined to devote their resources to developing and upgrading software for the larger Windows market. The Company s development of its own software applications and services may also negatively affect the decisions of third-party developers, such as Microsoft, Adobe and Google, to develop, maintain, and upgrade similar or competitive software and services for the Company s products. Mac OS X Version 10.5 Leopard (Mac OS X Leopard), which became available in October 2007, includes a new feature that enables Intel-based Mac systems to run Microsoft Windows XP and Windows Vista operating systems. This feature may deter developers from creating software applications for Mac OS X if such applications are already available for the Windows platform.

With respect to iPhone and iPod touch, the Company relies on the continued availability and development of compelling and innovative software applications. Unlike third-party software applications for Mac products, the software applications for the iPhone and iPod touch platforms are distributed through a single distribution channel, the App Store. The absence of multiple distribution channels, which are available for competing platforms, may limit the availability and acceptance of third-party applications by the Company s customers, thereby causing developers to curtail significantly, or stop, development for the Company s platforms. In addition, iPhone and iPod touch are subject to rapid technological change, and, if third-party developers are unable to keep up with this pace of change, third-party applications might not successfully operate and may result in dissatisfied customers. Further, if the Company develops its own software applications and services, such development may negatively affect the decisions of third-party developers to develop, maintain, and upgrade similar or competitive applications for the iPhone and iPod touch platforms. As with applications for the Company s Mac products, the availability and development of these applications also depend on developers perceptions and analysis of the relative benefits of developing software for the Company s products rather than its competitors products, including devices that use competing platforms. If developers focus their efforts on these competing platforms, the availability and quality of applications for the Company s devices may suffer.

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

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

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

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

Through December 26, 2009, the Company had opened 283 retail stores. The Company s retail stores have required substantial fixed investment in equipment and leasehold improvements, information systems, inventory and personnel. The Company also has entered into substantial operating lease commitments for retail space with terms ranging from five to 20 years, the majority of which are for ten years. Certain stores have been designed and built to serve as high-profile venues to promote brand awareness and serve as vehicles for corporate sales and marketing activities. Because of their unique design elements, locations and size, these stores require substantially more investment than the Company s more typical retail stores. Due to the high fixed cost structure associated with the Retail segment, a decline in sales or the closure or poor performance of individual or multiple stores could result in significant lease termination costs, write-offs of equipment and leasehold improvements, and severance costs that could materially adversely affect the Company s financial condition and operating results.

Many factors unique to retail operations, some of which are beyond the Company s control, pose risks and uncertainties that could materially adversely affect the Company s financial condition and operating results. These risks and uncertainties include, among other things, macro-economic factors that could have a negative effect on general retail activity, as well as the Company s inability to manage costs associated with store construction and operation, inability to sell third-party products at adequate margins, failure to manage relationships with existing retail channel partners, more challenging environment in managing retail operations outside the U.S., costs associated with unanticipated fluctuations in the value of retail inventory, and inability to obtain and renew leases in quality retail locations at a reasonable cost.

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

The Company has invested, and in the future may invest, in new business strategies or acquisitions. Such endeavors may involve significant risks and uncertainties, including distraction of management from current operations, insufficient revenue to offset liabilities assumed and expenses associated with the strategy, inadequate return of capital, and unidentified issues not discovered in the Company s due diligence. Because these new ventures are inherently risky, no assurance can be given that such strategies and initiatives will be successful and will not materially adversely affect the Company s financial condition and operating results.

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

The Company sells highly complex hardware and software products and services that can contain defects in design and manufacture. Sophisticated operating system software and applications, such as those sold by the Company, often contain bugs that can unexpectedly interfere with the software s intended operation. Defects may also occur in components and products the Company purchases from third parties. There can be no assurance the Company will be able to detect and fix all defects in the hardware, software and services it sells. Failure to do so could result in lost revenue, harm to reputation, and significant warranty and other expenses, and could have a material adverse impact on the Company s financial condition and operating results.

In certain countries, including the U.S., the Company relies on a single cellular network carrier to provide service for iPhone.

In the U.S., Germany, Spain and certain other countries, the Company has contracted with a single carrier to provide cellular network services for iPhone on an exclusive basis. If these exclusive carriers cannot successfully compete with other carriers in their markets on any basis, including but not limited to the quality and coverage of wireless voice and data services, performance and timely build-out of advanced wireless networks, and pricing and other terms of conditions of end-user contracts, or if these exclusive carriers fail to promote iPhone aggressively or favor other handsets in their promotion and sales activities or service plans, sales may be materially adversely affected.

The Company is subject to risks associated with laws, regulations and industry-imposed standards related to mobile communications devices.

Laws and regulations related to mobile communications devices in the many jurisdictions in which the Company operates are extensive and subject to change. Such changes, which could include but are not limited to restrictions on production, manufacture, distribution, and use of the device, locking the device to a carrier s network, or mandating the use of the device on more than one carrier s network, could materially adversely affect the Company s financial condition and operating results.

Mobile communication devices, such as iPhone, are 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, which could materially adversely affect the Company s financial condition and operating results.

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

Much of the Company s future success depends on the continued availability and service of key personnel, including its CEO, its executive team and highly skilled employees in technical, marketing and staff positions. Experienced personnel in the technology industry are in high demand and competition for their talents is intense, especially in the Silicon Valley, where most of the Company s key personnel are located. There can be no assurance that the Company will continue to attract and retain key personnel.

In addition, the Company has relied on equity awards in the form of stock options and restricted stock units as one means for recruiting and retaining highly skilled talent. Significant adverse volatility in the Company s stock price could result in a stock option s exercise price exceeding the underlying stock s market value or a significant deterioration in the value of restricted stock units granted, thus lessening the effectiveness of stock-based awards for retaining employees.

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

War, terrorism, geopolitical uncertainties, public health issues, and other business interruptions have caused and could cause damage or disruption to international commerce and the global economy, and thus could have a strong negative effect on the Company, its suppliers, logistics providers, manufacturing vendors and customers, including channel partners. The Company s business operations are subject to interruption by natural disasters, fire, power shortages, terrorist attacks, and other hostile acts, labor disputes, public health issues, and other events beyond its control. Such events could decrease demand for the Company s products, make it difficult or impossible for the Company to make and deliver products to its customers, including channel partners, or to receive components from its suppliers, and create delays and inefficiencies in the Company s supply chain. Should major public health issues, including pandemics, arise, the Company could be negatively affected by more stringent employee travel restrictions, additional limitations in freight services, governmental actions limiting the movement of products between regions, delays in production ramps of new products, and disruptions in the operations of the Company s manufacturing vendors and component suppliers. The majority of the Company s research and development activities, its corporate headquarters, information technology systems, and other critical business operations, including certain component suppliers and manufacturing vendors, are located near major seismic faults. Because the Company does not carry earthquake insurance for direct quake-related losses and significant recovery time could be required to resume operations, the Company s financial condition and operating results could be materially adversely affected in the event of a major earthquake.

The Company may be subject to information technology system failures, network disruptions and breaches in data security.

Information technology system failures, network disruptions and breaches of data security caused by such factors including without limitation earthquakes, fire, theft, or other causes could disrupt the Company s operations by causing delays or cancellation of customer, including channel partner, orders, negatively affecting the Company s online, iTunes, MobileMe and retail offerings and services, impeding the manufacture or shipment of products, processing transactions and reporting financial results, resulting in the unintentional disclosure of customer or Company information, or damage to the Company s reputation. While management has taken steps to address these concerns by implementing sophisticated network security and internal control measures, there can be no assurance that a system failure or loss or data security breach will not materially adversely affect the Company s financial condition and operating results.

The Company expects its quarterly revenue and operating results to fluctuate for a variety of reasons.

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

The Company s stock price continues to be volatile.

The Company s stock has at times experienced substantial price volatility due to a number of factors, including but not limited to variations between its actual and anticipated financial results, announcements by the Company and its competitors, and uncertainty about current global economic conditions. The stock market as a whole also has experienced extreme price and volume fluctuations that have affected the market price of many technology companies in ways that may have been unrelated to these companies operating performance. Furthermore, the Company believes its stock price reflects high future growth and profitability expectations. If the Company fails to meet these expectations its stock price may significantly decline.

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

The Company derives a large and growing portion of its revenue and earnings from its international operations. Compliance with U.S. and foreign laws and regulations that apply to the Company s international operations, including without limitation import and export requirements, the Foreign Corrupt Practices Act, tax laws (including U.S. taxes on foreign subsidiaries), foreign exchange controls and cash repatriation restrictions, data privacy requirements, labor laws, and anti-competition regulations, increases the costs of doing business in foreign jurisdictions, and such costs may rise in the future as a result of changes in these laws and regulations or in their interpretation. Furthermore, the Company has implemented policies and procedures designed to facilitate compliance with these laws and regulations, but there can be no assurance that the Company s employees, contractors, or agents will not violate such laws and regulations or the Company s policies. Any such violations could individually or in the aggregate materially adversely affect the Company s financial condition or operating results.

The Company s financial condition and operating results also could be significantly affected by other risks associated with international activities, including but not limited to, economic and labor conditions, political instability, and changes in the value of the U.S. dollar versus local currencies. Margins on sales of the Company s products in foreign countries, and on sales of products that include components obtained from foreign suppliers, could be materially adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including duties, tariffs and antidumping penalties.

The Company s primary exposure to movements in foreign currency exchange rates relate to non-U.S. dollar denominated sales in Europe, Japan, Australia, Canada and certain parts of Asia, as well as non-U.S. dollar denominated operating expenses incurred throughout the world. Weakening of foreign currencies relative to the U.S. dollar will adversely affect the U.S. dollar value of the Company s foreign currency-denominated sales and earnings, and generally will lead the Company to raise international pricing, potentially reducing demand for the Company s products. In some circumstances, due to competition or other reasons, the Company may decide not to raise local prices to the full extent of the dollar s strengthening, or at all, which would adversely affect the U.S. dollar value of the Company s foreign currency denominated sales and earnings. Conversely, a strengthening of foreign currencies, while generally beneficial to the Company s foreign currency-denominated sales and earnings, could cause the Company to reduce international pricing, thereby limiting the benefit. Additionally, strengthening of foreign currencies may also increase the Company s cost of product components denominated in those currencies, thus adversely affecting gross margins.

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

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

Although the Company has not recognized any material losses on its cash, cash equivalents and marketable securities, any significant future declines in their market values could materially adversely affect the Company s financial condition and operating results. Given the global nature of its business, the Company has investments both domestically and internationally. Additionally, the Company s overall investment portfolio has concentrations in the financial sector, which has been negatively impacted by adverse market liquidity conditions in the recent past. Credit ratings and pricing of these investments can be negatively impacted by liquidity, credit deterioration or losses, financial results, or other factors. As a result, the value or liquidity of the Company s cash, cash equivalents and marketable securities could decline and result in a material impairment, which could materially adversely affect the Company s financial condition and operating results.

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

A substantial majority of the Company s outstanding trade receivables are not covered by collateral or credit insurance. The Company also has unsecured non-trade receivables resulting from purchases of components by contract manufacturers 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 certain inventory components. While the Company has procedures to monitor and limit exposure to credit risk on its trade and non-trade receivables as well as long-term prepayments, there can be no assurance such procedures will effectively limit its credit risk and avoid losses, which could materially adversely affect the Company s financial condition and operating results.

The matters relating to the Company s past stock option practices and its restatement of consolidated financial statements may result in additional litigation.

The Company s investigation into its past stock option practices and its restatement of prior financial statements in the Annual Report on Form 10-K for the year ended September 30, 2006 gave rise to litigation and government investigations. As described in Part II, Item 1, Legal Proceedings, several derivative and class action complaints regarding stock options were filed against the Company and current and former officers and directors. These actions have been dismissed following a comprehensive settlement. Two former officers of the Company were also named as defendants in an SEC enforcement action, which has been settled.

No assurance can be given that additional actions will not be filed against the Company and current and former officers and directors as a result of past stock option practices. If such actions are filed and result in adverse findings, the remedies could materially adversely affect the Company s financial condition and operating results.

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

The Company is subject to various legal proceedings and claims that have arisen out of the ordinary conduct of its business and are not yet resolved and additional claims may arise in the future. Results of legal proceedings cannot be predicted with certainty. Regardless of merit, litigation may be both time-consuming and disruptive to the Company s operations and cause significant expense and diversion of management attention. In recognition of these considerations, the Company may enter into material settlements. Should the Company fail to prevail in certain matters, or should several of these matters be resolved against the Company in the same reporting period, the Company may be faced with significant monetary damages or injunctive relief against it that would materially adversely affect a portion of its business and might materially affect the Company s financial condition and operating results.

The Company is subject to risks associated with laws and regulations related to health, safety and environmental protection.

The Company s products and services, and the production and distribution of those goods and services, are subject to a variety of laws and regulations. These may require the Company to offer customers the ability to return a product at the end of its useful life and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have been passed in several jurisdictions in which the Company operates, including various countries within Europe and Asia and certain states and provinces within North America. Although the Company does not anticipate any material adverse effects based on the nature of its operations and the focus of such laws, there is no assurance such existing laws or future laws will not materially adversely affect the Company s financial condition and operating results.

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

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

The Company is subject to risks associated with the availability and coverage of insurance.

For certain risks, the Company does not maintain insurance coverage because of cost and/or availability. Because the Company retains some portion of its insurable risks, and in some cases self-insures completely, unforeseen or catastrophic losses in excess of insured limits could materially adversely affect the Company s financial condition and operating results.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

(a) **Index to Exhibits**

Exhibit Number	Exhibit Description	Incorporated by Reference Form	Filing Date/ Period End Date
3.1	Restated Articles of Incorporation, filed with the Secretary of State of the State of California on July 10, 2009.	10-Q	6/27/09
3.2	By-Laws of the Registrant, as amended through May 27, 2009.	8-K	6/2/09
4.1	Form of Stock Certificate of the Registrant.	10-Q	12/30/06
10.1**	Employee Stock Purchase Plan, as amended through November 10, 2009.		
10.2*	Form of Indemnification Agreement between the Registrant and each director and executive officer of the Registrant.	10-Q	6/27/09
10.3*	1997 Employee Stock Option Plan, as amended through October 19, 2001.	10-K	9/28/02
10.4*	1997 Director Stock Option Plan, as amended through May 10, 2007.	8-K	5/16/07
10.5*	2003 Employee Stock Plan, as amended through May 10, 2007.	8-K	5/16/07
10.6*	Reimbursement Agreement dated as of May 25, 2001 by and between the Registrant and Steven P. Jobs.	10-Q	6/29/02
10.7*	Form of Option Agreements.	10-K	9/24/05
10.8*	Form of Restricted Stock Unit Award Agreement effective as of August 28, 2007.	10-K	9/29/07
10.9*	Form of Restricted Stock Unit Award Agreement effective as of November 11, 2008.	10-Q	12/27/08
10.10*	Transition Agreement and Settlement Agreement and Release dated as of November 3, 2008 by and between the Registrant and Anthony Fadell.	10-Q	12/27/08
14.1	Business Conduct Policy of the Registrant dated February 2009.	10-Q	3/28/09
31.1**	Rule 13a-14(a) / 15d-14(a) Certification of Chief Executive Officer.		
31.2**	Rule 13a-14(a) / 15d-14(a) Certification of Chief Financial Officer.		
32.1***	Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer.		
101.INS****	XBRL Instance Document		
101.SCH****	XBRL Taxonomy Extension Schema Document		
101.CAL****	XBRL Taxonomy Extension Calculation Linkbase Document		
101.LAB****	XBRL Taxonomy Extension Label Linkbase Document		
101.PRE****	XBRL Taxonomy Extension Presentation Linkbase Document		

* Indicates management contract or compensatory plan or arrangement.

** Filed herewith.

*** Furnished herewith.

**** Pursuant to applicable securities laws and regulations, the Company is deemed to have complied with the reporting obligation relating to the submission of interactive data files in such exhibits and is not subject to liability under any anti-fraud provisions of the federal securities laws as long as the Company has made a good faith attempt to comply with the submission requirements and promptly amends the interactive data files after becoming aware that the interactive data files fails to comply with the submission requirements. Users of this data are advised that, pursuant to Rule 406T, these interactive data files are deemed not filed and otherwise are not subject to liability.

SIGNATURE

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

January 25, 2010	APPLE INC.
	By: /s/ Peter Oppenheimer Peter Oppenheimer Senior Vice President, Chief Financial Officer