NEUROCRINE BIOSCIENCES INC
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April 26, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

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Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Amendment No.)

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Check the appropriate box:

o Preliminary Proxy Statement
o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
x Definitive Proxy Statement
o Definitive Additional Materials
o Soliciting Material Pursuant to Rule §240.14a-12

NEUROCRINE BIOSCIENCES, INC.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

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NEUROCRINE BIOSCIENCES, INC.

Notice of Annual Meeting of Stockholders
To Be Held on May 25, 2005

TO THE STOCKHOLDERS:

NOTICE IS HEREBY GIVEN that the 2005 Annual Meeting of Stockholders of Neurocrine Biosciences, Inc., a Delaware corporation (the Company), will be held on May 25, 2005, at 8:30 a.m. local time, at the Company s corporate headquarters located at 12790 El Camino Real, San Diego, California 92130 for the following purposes as more fully described in the Proxy Statement accompanying this Notice:

1. To elect a Class III Director to the Board of Directors to serve for a term of three years;

2. To ratify the appointment of Ernst & Young LLP as the Company s registered independent public accounting firm for the fiscal year ending December 31, 2005;

3. To approve an amendment to the Company s 2003 Incentive Stock Plan increasing the number of shares of Common Stock reserved for issuance from 2,300,000 to 3,300,000 shares; and

4. To transact such other business as may properly come before the Annual Meeting or any continuation, adjournment or postponement thereof.

Only stockholders of record at the close of business on April 1, 2005 are entitled to receive notice of and to vote at the Annual Meeting.

All stockholders are cordially invited to attend the Annual Meeting in person. However, to assure your representation at the Annual Meeting, you are urged to mark, sign, date and return the enclosed Proxy card as promptly as possible in the postage prepaid envelope, or vote by telephone or internet (instructions have been provided on your proxy card). Stockholders attending the Annual Meeting may vote in person even if they have returned a Proxy.

By Order of the Board of Directors,

Margaret Valeur-Jensen, J.D., Ph.D.
Corporate Secretary

San Diego, California
April 25, 2005

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Neurocrine Biosciences, Inc.

12790 El Camino Real
San Diego, California 92130

PROXY STATEMENT

The enclosed Proxy is solicited on behalf of Neurocrine Biosciences, Inc., a Delaware corporation (the Company), for use at its 2005 Annual Meeting of Stockholders to be held on May 25, 2005 beginning at 8:30 a.m., local time, or at any continuations, postponements or adjournments thereof for the purposes set forth in this Proxy Statement and the accompanying Notice of Annual Meeting of Stockholders. The Annual Meeting will be held at the Company s corporate headquarters, located at 12790 El Camino Real, San Diego, California 92130. The Company s phone number is (858) 617-7600.

This proxy statement is being first mailed on or about April 25, 2005 to all stockholders entitled to vote at the Annual Meeting.

ABOUT THE ANNUAL MEETING

What is the purpose of the Annual Meeting?

At our Annual Meeting, stockholders will act upon the matters outlined in the Notice of Annual Meeting of Stockholders on the cover page of this proxy statement, including the election of a director, ratification of the appointment of Ernst & Young LLP as the Company s independent registered public accounting firm for the year ended December 31, 2005, and approval of an amendment increasing the number of shares of common stock available under the Company s 2003 Incentive Stock Plan from 2,300,000 to 3,300,000. In addition, management will report on the performance of the Company and respond to questions from stockholders.

Who can attend the Annual Meeting?

All stockholders of record at the close of business on April 1, 2005 (the Record Date), or their duly appointed proxies, may attend the Annual Meeting. If you attend, please note that you may be asked to present valid picture identification, such as a driver s license or passport. Cameras, recording devices and other electronic devices will not be permitted at the Annual Meeting.

Please also note that if you hold your shares in Street name (that is, through a broker or other nominee), you will need to bring a copy of a brokerage statement reflecting your stock ownership as of the record date and check in at the registration desk at the Annual Meeting.

Who is entitled to vote at the Annual Meeting?

Stockholders of record at the close of business on the Record Date are entitled to receive notice of and to participate in the Annual Meeting. At the close of business on the Record Date, 36,641,360 shares of the Company s common stock, $0.001 par value per share, were issued and outstanding. As of the Record Date, the Company had approximately 5,969 stockholders, of which 91 are stockholders of record. If you were a stockholder of record on that date, you will be entitled to vote all of the shares that you held on that date at the Annual Meeting, or any postponements or adjournments of the Annual Meeting.

Each outstanding share of the Company s common stock will be entitled to one vote on each proposal considered at the Annual Meeting.

What constitutes a quorum?

The presence at the Annual Meeting, in person or by proxy, of the holders of a majority of the aggregate voting power of the common stock outstanding on the Record Date will constitute a quorum, permitting the Company to conduct its business at the Annual Meeting. As of the Record Date, 36,641,360 shares of common stock, representing the same number of votes, were outstanding. Thus, the presence of the holders of common stock representing at least 18,320,681 shares will be required to establish a quorum. The presence of a quorum will be determined by the Inspector of Elections (the Inspector).

Proxies received but marked as abstentions as well as broker non-votes will be included in the calculation of the number of shares considered to be present at the Annual Meeting.

How do I vote?

If you complete and properly sign the accompanying proxy card and return it to the Company, it will be voted as you direct. If you are a registered stockholder (that is, if you hold your stock in certificate form or are a Neurocrine employee who participates in the Employee Stock Purchase Program) and attend the Annual Meeting, you may deliver your completed proxy card in person. Street name stockholders who wish to vote at the Annual Meeting will need to obtain a proxy form from the institution that holds their shares.

The cost of solicitation of proxies will be borne by the Company. The Company will reimburse expenses incurred by brokerage firms and other persons representing beneficial owners of shares in forwarding solicitation material to beneficial owners. To assist in soliciting proxies (votes), the Company has retained Innisfree, a professional proxy solicitation firm, at an approximate cost of $6,500, plus certain out-of-pocket expenses. Proxies also may be solicited by certain of the Company s directors, officers and regular employees, without additional compensation, personally, by telephone or by other appropriate means.

Can I vote by telephone or electronically?

If you are a registered stockholder you may vote by telephone, or electronically through the Internet, by following the instructions included with your proxy card. If your shares are held in Street name, please check your proxy card or contact your broker or nominee to determine whether you will be able to vote by telephone or electronically. The deadline for voting by telephone or electronically is 11:59 p.m., Eastern Standard Time, on May 24, 2005.

Can I change my vote after I return my proxy card?

Yes. Even after you have submitted your proxy, you may change your vote at any time before the proxy is exercised by filing with the Corporate Secretary of the Company either a notice of revocation or a duly executed proxy bearing a later date. A proxy will also be revoked if the stockholder attends the Annual Meeting and votes in person. Attendance at the Annual Meeting will not by itself revoke a previously granted proxy.

What are the Board s recommendations?

Unless you give other instructions on your proxy card, the persons named as proxy holders on the proxy card will vote in accordance with the recommendations of the Board of Directors. The Board s recommendation is set forth together with the description of each item in this proxy statement. In summary, the Board recommends a vote:

for election of the nominated director (see Proposal One);

for ratification of the appointment of Ernst & Young LLP as the Company s independent registered public accounting firm for fiscal 2005 (see Proposal Two); and

for approval of the amendment to the Company s 2003 Incentive Stock Plan to increase the number of shares of Common Stock reserved for issuance from 2,300,000 to 3,300,000 (see Proposal Three).

With respect to any other matter that properly comes before the meeting, the proxy holders will vote as recommended by the Board of Directors or, if no recommendation is given, in their own discretion.

What vote is required to approve each item?

Election of Director. The affirmative vote of a plurality of the votes cast at the Annual Meeting is required for the election of directors. A properly executed proxy marked WITHHOLD AUTHORITY with respect to the election of one or more directors will not be voted with respect to the director or directors indicated, although it will be counted for purposes of determining whether there is a quorum.

Other Items. For each other item, the affirmative vote of the holders of a majority of the shares represented in person or by proxy and entitled to vote on the item will be required for approval. A properly executed proxy marked ABSTAIN with respect to any such matter will not be voted, although it will be counted for purposes of determining whether there is a quorum. Accordingly, an abstention will have the effect of a negative vote.

If you hold your shares in Street name through a broker or other nominee, your broker or nominee may not be permitted to exercise voting discretion with respect to some of the matters to be acted upon. Thus, if you do not give your broker or nominee specific instructions, your shares may not be voted on and will not be counted in determining the number of shares necessary for approval. Shares represented by such broker non-votes will, however, be counted in determining whether there is a quorum.

Who counts the votes?

Votes cast by proxy or in person at the Annual Meeting will be tabulated by the Inspector.

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STOCK OWNERSHIP

Who are the principal stockholders, and how much stock does management own?

The following table sets forth the beneficial ownership of the Company s common stock as of April 1, 2005 by (i) each of the executive officers named in the table under the heading Compensation of Executive Officers Summary Compensation Table, (ii) each director, (iii) all directors and executive officers as a group and (iv) all persons known to the Company to be the beneficial owners of more than 5% of the Company s common stock. A total of 36,641,360 shares of the Company s common stock were issued and outstanding as of April 1, 2005.

Name and Address of Beneficial Owner (1)	Number of Shares of Common Stock Owned (2)	Number of Shares of Common Stock Subject to Options Exercisable Within 60 Days (3)	Total Number of Shares of Common Stock Beneficially Owned (4)	Percent Ownership
T. Rowe Price Associates (5) 100 E. Pratt Street, Baltimore, MD 21202	4,579,921		4,579,921	12.5%
FMR Corp. 82 Devonshire Street, Boston, MA 02109	4,402,598		4,402,598	12.0%
Janus Capital Management, LLC 100 Fillmore Street, Denver, CO 80206	4,029,736		4,029,736	11.0%
American Century Companies, Inc. 4500 Main St. 9th Floor Kansas City, MO 64111	2,255,578		2,255,578	6.2%
Massachusetts Financial Services Company 500 Boylston St., Boston, MA 02116	1,918,150		1,918,150	5.2%
Paul W. Hawran	284,329	268,187	552,516	1.5%
Robert J. Little	3,000	41,879	44,879	*
Gary A. Lyons	477,852	488,257	966,109	2.6%
Henry Y. Pan, M.B.B.S., Ph.D., F.A.C.C.	12,411	200,834	213,245	*

Name and Address of Beneficial Owner (1)	Number of Shares of Common Stock Owned (2)	Number of Shares of Common Stock Subject to Options Exercisable Within 60 Days (3)	Total Number of Shares of Common Stock Beneficially Owned (4)	Percent Ownership
Wendell Wierenga, Ph.D.	5,492	51,362	56,854	*
Corinne H. Lyle		18,326	18,326	*
W. Thomas Mitchell	1,000	36,666	37,666	*
Joseph A. Mollica, Ph.D.		74,999	74,999	*
Richard F. Pops		75,999	75,999	*
Stephen A. Sherwin, M.D.		73,499	73,499	*
Wylie W. Vale, Ph.D.	281,372	61,554	342,926	*
All executive officers and directors as a group (13 persons)	1,155,118	1,761,297	2,916,415	8.0%

* Represents beneficial ownership of less than one percent (1%) of the outstanding shares of the Company s common stock as of the Record Date.

(1) The address of each individual named is c/o Neurocrine Biosciences, Inc., 12790 El Camino Real, San Diego, CA 92130, unless otherwise indicated.

(2) Represents shares of common stock owned, excluding shares of common stock subject to stock options that are listed under the heading Number of Shares of Common Stock Subject to Options Exercisable Within 60 Days, by the named parties as of the Record Date.

(3) Shares of common stock subject to stock options currently exercisable or exercisable within 60 days of the Record Date are deemed to be outstanding for computing the percentage ownership of the person holding such options and the percentage ownership of any group of which the holder is a member, but are not deemed outstanding for computing the percentage of any other person.

(4) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Except as indicated by footnote, and subject to community property laws where applicable, the persons named in the table have sole voting and investment power with respect to all shares of common stock shown as beneficially owned by them.

(5) These securities are owned by various individual and institutional investors which own 4,579,921 shares representing 12.5% of the shares outstanding, which T. Rowe Price Associates, Inc. (Price Associates) serves as investment adviser with power to direct investments and/or sole power to vote the securities. For purposes of the reporting requirements of the Security Exchange Act of 1934, Price Associates is deemed to be a beneficial owner of such securities; however, Price Associates expressly disclaims that it is, in fact, the beneficial owner of such securities.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act), requires the Company s officers and directors, and persons who own more than ten percent of a registered class of the Company s equity securities, to file reports of ownership on Form 3 and changes in ownership on Form 4 or Form 5 with the SEC. Such officers, directors and 10% stockholders are also required by SEC rules to furnish the Company with copies of all Section 16(a) forms they file. Based solely on its review of the copies of such forms received by it, and written representations from certain reporting persons, the Company believes that its officers, directors and 10% stockholders complied with all Section 16(a) filing requirements applicable to them during the fiscal year ended December 31, 2004.

PROPOSAL ONE: ELECTION OF DIRECTORS

General

The Company s Bylaws provide that the Board of Directors will be comprised of eight directors. The Company s Certificate of Incorporation provides that the Board of Directors is divided into three classes. There are currently three directors in Class I (Joseph A. Mollica, Ph.D., Wylie W. Vale, Ph.D. and W. Thomas Mitchell), three directors in Class II (Corinne H. Lyle, Richard F. Pops, and Stephen A. Sherwin, M.D.), and one director in Class III (Gary A. Lyons). A majority of the members of the Board of Directors meet the definition of independent director under the Nasdaq Stock Market qualification standards.

The directors in Class I hold office until the 2006 Annual Meeting of Stockholders, the directors in Class II hold office until the 2007 Annual Meeting of Stockholders and the director in Class III holds office until the 2005 Annual Meeting of Stockholders (or, in each case, until their earlier resignation, removal from office or death). After each such election, the directors in each such case will then serve in succeeding terms of three years and until a successor is duly elected and qualified. Officers of the Company serve at the discretion of the Board of Directors. There are no family relationships among the Company s directors and executive officers.

The term of office for director Gary A. Lyons, will expire at the 2005 Annual Meeting. At the 2005 Annual Meeting, the stockholders will elect one Class III director for a term of three years.

Vote Required

The nominee receiving the highest number of affirmative votes of the shares present in person or represented by proxy at the 2005 Annual Meeting and entitled to vote on the election of directors will be elected to the Board of Directors.

Votes withheld from any director are counted for purposes of determining the presence or absence of a quorum, but have no other legal effect under Delaware law.

Unless otherwise instructed, the proxy holders will vote the proxies received by them for the Company s nominee named below. If the Company s nominee is unable or declines to serve as a director at the time of the Annual Meeting, the proxies will be voted for any nominee who is designated by the present Board of Directors to fill the vacancy. It is not expected that the Company s nominee will be unable or will decline to serve as a director. **The Board of Directors recommends that stockholders vote FOR the nominee named below.**

Nominee for Election at the Annual Meeting

Gary A. Lyons is presently a Class III director of the Company. Information about the nominee is set forth below:

Name of Director	Age	Position in the Company	Director Since
Gary A. Lyons	54	President, Chief Executive Officer and Director	1993

Gary A. Lyons has served as President, Chief Executive Officer and a director of the Company since joining the Company in February 1993. Prior to joining the Company, Mr. Lyons held a number of senior management positions at Genentech including Vice President of Business Development and Vice President of Sales. Mr. Lyons currently serves on the boards of directors for Intrabiotics Pharmaceuticals, Inc. and Vical, Inc. Mr. Lyons holds a B.S. in marine biology from the University of New Hampshire and an M.B.A. from Northwestern University s J.L. Kellogg Graduate School of Management.

Who are the remaining directors that are not up for election this year?

The Class I and II directors will remain in office after the 2005 Annual Meeting. The Class I directors are Joseph A. Mollica, Ph.D., Wylie W. Vale, Ph.D. and W. Thomas Mitchell. The Class II directors are Corinne H. Lyle, Richard F. Pops and Stephen A. Sherwin, M.D. The names and certain other current information about the directors whose terms of office continue after the Annual Meeting are set forth below:

Name of Director	Age	Position in the Company	Director Since
Joseph A. Mollica, Ph.D. (2) (3)	64	Chairman of the Board	1997
Wylie W. Vale, Ph.D.	63	Director	1992
W. Thomas Mitchell (1) (3)	59	Director	2002
Corinne H. Lyle (1)	45	Director	2004
Richard F. Pops (1) (2)	43	Director	1998
Stephen A. Sherwin, M.D.(2) (3)	56	Director	1999

(1) Member of the Audit Committee.

(2) Member of the Compensation Committee.

(3) Member of the Nominating/Corporate Governance Committee.

Joseph A. Mollica, Ph.D. has served as a director of the Company since June 1997 and became Chairman of the Board in April 1998. Dr. Mollica is currently Chairman of the Board of Pharmacopeia Drug Discovery, Inc., a biopharmaceutical company focusing on combinatorial chemistry, high throughput discovery, molecular modeling and bioinformatics. From 1994 to 2004, Dr. Mollica served as the Chairman of the Board of Directors, President and Chief Executive Officer of Pharmacopeia. From 1987 to December 1993, Dr. Mollica served as Vice President, Medical Products of DuPont Company and then as President and CEO of DuPont Merck Pharmaceutical Company from 1991 to 1993. At Ciba-Geigy, where he was employed from 1966 to 1986, he served in a variety of positions of increasing responsibility, rising to Senior Vice President of Ciba-Geigy s Pharmaceutical Division. He is currently on the boards of directors of Linguagen Corp. and Pharmacopeia. He received his B.S. from the University of Rhode Island and his M.S. and Ph.D. from the University of Wisconsin and Sc.D.,h.c. from the University of Rhode Island.

Wylie W. Vale, Ph.D. is one of the Company s two academic co-founders, Chief Scientific Advisor, Neuroendocrinology; and a member of the Company s Founding Board of Scientific and Medical Advisors. Dr. Vale was elected a director of the Company in September 1992. He is The Helen McLoraine Professor of Molecular Neurobiology at The Salk Institute for Biological Studies and is the Senior Investigator and Head of The Clayton Foundation Laboratories for Peptide Biology at The Salk Institute, where he is a member of the Board of Trustees and former Chairman of the Faculty. He is also an Adjunct Professor of Medicine at the University of California, San Diego. In addition, Dr. Vale is recognized for his work on the molecular, pharmacological and biomedical characterization of neuroendocrine peptides, growth factors and their receptors. In recognition of his discoveries, he has received numerous awards and he is a member of the American Academy of Arts and Sciences and the Institute of Medicine and the National Academy of Sciences. Dr. Vale is a co-founder and member of the Board of Directors of Acceleron Pharma, Inc. He is a past President of both the American Endocrine Society and the International Society of Endocrinology. Dr. Vale received a B.A. in biology from Rice University and a Ph.D. in physiology and biochemistry from the Baylor College of Medicine.

W. Thomas Mitchell was appointed to Neurocrine s Board of Directors in November 2002. He is the former Chairman of the Board and Chief Executive Officer of Genencor International. Under his guidance, Genencor s revenues grew from under $30 million to over $325 million. In addition, he successfully managed the acquisition and integration of three major businesses to build the global enterprise that is now Genencor. An industry leader, Mr. Mitchell has participated in a number of important policy initiatives including the 1999 federal executive order that created the national bioenergy initiative. Mr. Mitchell also served as a member of the Governor s Council on Biotechnology in California, which was responsible for helping to improve the state s competitiveness in the mid-1990 s. Mr. Mitchell currently serves on the Board of Directors of DJ Orthopedics where he is a member of the audit and compensation committees. He also served on the Advisory Boards of the Chemical Engineering School at Cornell University and the University of Iowa s School of Engineering. He received his B.S. in chemical engineering from Drexel University. He also completed the Executive Development Program at the University of Michigan.

Corinne H. Lyle was elected to the Board of Directors in June 2004. She is the Corporate Vice President, Chief Financial Officer and Treasurer of Edwards Lifesciences, a global leader in products and technologies to treat advanced cardiovascular disease and the leading heart valve company in the world. From October 1998 until February 2003, she served as Vice President, Chief Financial Officer of Tularik, Inc., a company involved in the discovery and development of drugs based on gene regulation. Prior to joining Tularik, she was Executive Director Health Care Group at Warburg Dillon Read LLC, an investment bank. From 1994 to 1996, she was Senior Vice President, Investment Banking Health Care Group for PaineWebber, Inc. Ms. Lyle received her undergraduate degree in industrial engineering from Stanford University and her M.B.A. from Harvard Business School.

Richard F. Pops was elected to the Board of Directors in April 1998. Mr. Pops has been Chief Executive Officer of Alkermes, Inc. since February 1991. Under his leadership, Alkermes has grown from a privately held company with 25 employees to a publicly traded pharmaceutical company with more than 500 employees in multiple locations in the United States. He currently serves on the Board of Directors of: Alkermes; Reliant Pharmaceuticals, LLC; CombinatoRx, Inc.; Acceleron Pharma, Inc.; Sitris Phamaceuticals, Inc; Expressive Constructs, Inc; the Biotechnology Industry Organization where he is the current Chairman; the Massachusetts Biotechnology Council; the New England Healthcare Institute and Harvard Medical School Board of Fellows. He received a B.A. in economics from Stanford University in 1983.

Stephen A. Sherwin, M.D. was elected to the Board of Directors in April 1999. Since March 1990, Dr. Sherwin has served as Chief Executive Officer and Director of Cell Genesys, Inc., a biotechnology company. In March 1994, he was elected as Chairman of the Board of Cell Genesys. From 1983 to 1990, Dr. Sherwin held various positions at Genentech, Inc., a biotechnology company, most recently as Vice President of Clinical Research. Prior to 1983, Dr. Sherwin held various positions on the staff of the National Cancer Institute. Dr. Sherwin also serves as Chairman of the Board of Ceregene, Inc., a former subsidiary of Cell Genesys, a company he founded in 2001, and was also a co-founder of Abgenix, also a former subsidiary of Cell Genesys. Dr. Sherwin is a member of the Board of Directors of Rigel Pharmaceuticals, Inc. and the Biotechnology Industry Organization. He holds a B.A. in biology from Yale and an M.D. from Harvard Medical School and is board-certified in internal medicine and medical oncology.

How often did the Board meet during fiscal 2004?

The Board of Directors of the Company held a total of six meetings and took action by written consent on six occasions during 2004. During 2004, the Board of Directors had an Audit Committee, a Compensation Committee and a Nominating/Corporate Governance Committee. Charters for each of these committees have been established and approved by the Board of Directors, and copies of the charters of the Audit and Nominating/Corporate Governance Committees have been posted on the Company s website at *www.neurocrine.com.* No director attended fewer than 75% of the aggregate of the total number of meetings of the Board of Directors and the total number of meetings held by all committees of the Board of Directors on which each director served.

What are the various committees of the Board and which directors are on those committees?

The Compensation Committee consists of directors Joseph A. Mollica, Ph.D., Richard F. Pops and Stephen A. Sherwin, M.D. This committee met two times and took one action by written consent during 2004. The Compensation Committee reviews and recommends to the Board the compensation of executive officers and other employees of the Company. The Compensation Committee is comprised solely of independent directors, as defined by Nasdaq Stock Market Rule 4200(a)(15).

The Company s Audit Committee is also comprised entirely of independent directors, as defined by Nasdaq Stock Market Rule 4200(a)(15). Information regarding the functions performed by the committee, its membership, and the number of meetings held during the fiscal year, is set forth in the Report of the Audit Committee, included in this annual proxy statement. The current members of the audit committee are Corinne H.

Lyle, Richard F. Pops, and W. Thomas Mitchell. The Board of Directors has determined that Corinne H. Lyle and Richard F. Pops are audit committee financial experts within the meaning of item 401(h) of SEC Regulation S-K.

The Company also has a Nominating/Corporate Governance Committee, currently comprised of Joseph A. Mollica, Ph.D., W. Thomas Mitchell and Stephen A. Sherwin, M.D, all independent directors, as defined by Nasdaq Stock Market Rule 4200(a)(15). The Nominating/Corporate Governance Committee is responsible for developing and implementing policies and practices relating to corporate governance, including administration of the Company s *Code of Business Conduct and Ethics*, available on the Company s website at *www.neurocrine.com*. The functions of this committee also include consideration of the composition of the Board and recommendation of individuals for election as directors of the Company. The Nominating/Corporate Governance Committee will consider nominees recommended by stockholders provided such nominations are made pursuant to the Company s Bylaws and applicable law. The committee met twice during 2004 to recommend the slate of directors that was approved at the 2004 Annual Meeting of Stockholders. Additionally, the committee took action by unanimous written consent to recommend that the Board of Directors appoint Corinne H. Lyle to the Board as a Class II director. The committee met in early 2005 to recommend that the Board of Directors nominate Gary A. Lyons for re-election as Class III director for the upcoming three-year term. The Board of Directors subsequently approved this recommendation.

How are directors compensated?

Non-employee directors are reimbursed for expenses incurred in connection with performing their duties as directors of the Company. Directors who are not employees or consultants of the Company receive a $20,000 annual retainer, plus $1,500 for each regular meeting of the Board of Directors and $750 for each special meeting or telephone meeting lasting more than one hour that such directors attend. In addition to the cash compensation set forth above, the Company has agreed to provide Joseph A. Mollica, Ph.D. as Chairman of the Board and Corinne H. Lyle, Chairman of the Audit Committee, each an additional $5,000 annual cash retainer. Each other director who is a member of the Audit Committee, the Compensation Committee or the Nominating/Corporate Governance Committee will receive an annual $2,500 cash retainer for each Committee on which he or she serves. Cash retainers for committee service are subject to a maximum aggregate cash retainer per director of $5,000 ($7,500 for Chairman of the Audit Committee) for committee service in any fiscal year.

Effective March 1, 2000, each non-employee director is eligible to participate in the Company s Deferred Compensation Plan, as amended (the Compensation Plan). In addition to non-employee directors of the Company, the Company s Vice Presidents and higher ranking officers of the Company are also eligible to participate in the Compensation Plan. Under the terms of the Compensation Plan, each eligible participant may elect to defer all or a portion of cash compensation received for services to the Company. Elections must be made by December 1 of each preceding year and are irrevocable once made. Upon receipt of an eligible participant s deferral election, the Company maintains a deferred compensation investment account on behalf

of such participant. Funds so invested are paid to participants based on an elected payout schedule over a period of up to 15 years. Upon death or termination for cause, funds are paid out within 60 days following the event. Funds may also be withdrawn for hardship under some circumstances. For the year 2004, Joseph A. Mollica, Ph.D. elected to defer 100% of his cash compensation from the Company pursuant to the Compensation Plan.

Additionally, each non-employee director receives a grant of nonstatutory options to purchase 12,000 shares of the Company s common stock (Joseph A. Mollica, Ph.D. as Chairman of the Board, will receive 15,000 options) at each Annual Meeting of Stockholders, provided that such non-employee director has been a non-employee director of the Company for at least six months prior to the date of such Annual Meeting. Each new non-employee director is automatically granted nonstatutory stock options to purchase 20,000 shares of the Company s common stock upon the date such person joins the Board of Directors.

All options granted to non-employee directors vest monthly over the one-year period following the date of grant and have exercise prices equal to the fair market value of the Company s common stock on the date of the grant.

What is our director nomination process?

Director qualifications

In selecting non-incumbent candidates and reviewing the qualifications of incumbent candidates for the Board of Directors, the Nominating/Corporate Governance considers the Company s corporate governance principles, which include the following:

Directors should possess the highest ethics, integrity and values, and be committed to representing the long-term interests of the stockholders. They also must have experience they can draw upon to help direct the business strategies of the Company together with sound judgment. They must be actively engaged in the pursuit of information relevant to the Company s business and must constructively engage their fellow Board members and management in dialogue and the decision-making process.

Directors must be willing to devote sufficient time to carrying out their duties and responsibilities effectively, and should be committed to serve on the Board for an extended period of time. Directors should offer their resignation in the event of any significant change in their personal circumstances, including a change in their principal job responsibilities. In evaluating director nominees, the Nominating/Corporate Governance Committee considers the following factors: the appropriate size of the Company s Board of Directors; personal and professional integrity, ethics and values; experience in corporate management, such as serving as an officer or former officer of a publicly held company; and experience as a board member of another publicly held company.

The Nominating/Corporate Governance Committee s goal is to assemble a Board of Directors that brings to the Company a variety of perspectives and skills derived from high quality business and professional experience. In doing so the Nominating/Corporate Governance Committee also considers candidates with appropriate non-business backgrounds.

Other than the foregoing, there are no stated minimum criteria for director nominees, although the Nominating/Corporate Governance Committee may also consider such other facts as it may deem are in the best interests of the Company and its stockholders. The Nominating/Corporate Governance Committee does, however, believe that at least one, and, preferably, several, members of the Board of Directors, meet the criteria for an audit committee financial expert as defined by Securities and Exchange Commission rules. The Nominating/Corporate Governance Committee also believes it appropriate for certain key members of the Company s management to participate as members of the Board of Directors.

Identification and evaluation of nominees for directors

The Nominating/Corporate Governance Committee identifies nominees for director by first evaluating the current members of the Board of Directors willing to continue in service. Current members with qualifications and skills that are consistent with the Nominating/Corporate Governance Committee s criteria for Board of Directors service and who are willing to continue in service are considered for re-nomination, balancing the value of continuity of service by existing members of the Board of Directors with that of obtaining a new perspective. If any member of the Board of Directors does not wish to continue in service or if the Board of Directors decides not to re-nominate a member for re-election, the Nominating/Corporate Governance Committee identifies the desired skills and experience of a new nominee in light of the criteria above. The Nominating/Corporate Governance Committee generally polls the Board of Directors and members of management for their recommendations and may also seek input from third-party search firms. The Nominating/Corporate Governance Committee may also seek input from industry experts or analysts. The Nominating/Corporate Governance Committee reviews the qualifications, experience and background of the candidates. Final candidates are then interviewed by the Company s independent directors and executive management. In making its determinations, the Nominating/Corporate Governance Committee evaluates each individual in the context of the Company s Board of Directors as a whole, with the objective of assembling a group that can best perpetuate the success of the Company and represent stockholder interests through the exercise of sound judgment. After review and deliberation of all feedback and data, the Nominating/Corporate Governance Committee makes its recommendation to the Board of Directors.

We have not received director candidate recommendations from the Company s stockholders and do not have a formal policy regarding consideration of such recommendations. However, any recommendations received from stockholders will be evaluated in the same manner that potential nominees suggested by board members, management or other parties are evaluated.

What is our process for stockholder communications with the Board of Directors?

Although the Company has not established a formal process by which stockholders may communicate directly with directors, the Nominating/Corporate Governance Committee has taken note of recent corporate governance developments relating to stockholder communications and intends to consider development and implementation of specific procedures for stockholders to communicate directly with the Board. Until formal procedures are developed and posted on the Company s website, any communications to the Board of Directors should be sent to the Board in care of Neurocrine Biosciences Investor Relations, 12790 El Camino Real, San Diego, CA 92130.

What is our policy regarding Board-member attendance at the Company s Annual Meeting?

Although the Company does not have a formal policy regarding attendance by members of the Board of Directors at the Annual Meeting, the Company encourages all of its directors to attend. Joseph A. Mollica, Ph.D. and Gary A. Lyons represented the Board of Directors at the 2004 Annual Meeting of Stockholders.

REPORT OF THE AUDIT COMMITTEE

The following Report of the Audit Committee does not constitute soliciting material and should not be deemed filed or incorporated by reference into any other Company filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent the Company specifically incorporates this Report by reference therein.

The Audit Committee is currently comprised of directors Corinne H. Lyle, Richard F. Pops, and W. Thomas Mitchell. All current committee members satisfy the definition of independent director as established in the Nasdaq Stock Market qualification requirements. The Committee met five times during the year ended December 31, 2004.

The Committee oversees the Company s financial reporting process on behalf of the Board of Directors. Management has the primary responsibility for the Company s financial statements and the reporting process, including the systems of internal controls. In fulfilling its oversight responsibilities, the Committee has reviewed and discussed the Company s audited financial statements as of and for the year ended December 31, 2004 with management, including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments and the clarity of disclosures in the financial statements.

The Committee also has reviewed and discussed the Company s audited financial statements as of and for the year ended December 31, 2004 with the independent registered public accounting firm, who are responsible for expressing an opinion on the conformity of those audited financial statements with accounting principles generally accepted in the United States, as well as their judgments as to the quality, not just the acceptability, of the Company s accounting principles and such other matters as are required to be discussed with the Committee under the Statement on Auditing Standards No. 61 (Communications with Audit Committees), as currently in effect. The independent registered public accounting firm also is responsible for performing an independent audit of the Company s internal control over financial reporting in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). In addition, the Committee has discussed with the independent registered public accounting firm, their independence from management and the Company, including the matters in the written disclosures required by the Independence Standards Board No. 1, Independence Discussions with Audit Committees, and considered the compatibility of non-audit services with the auditors independence.

The Committee discussed with the Company s independent registered public accounting firm the overall scope and plans for their audits. The Committee meets with the independent registered public accounting firm, with and without management present, to discuss the results of their examinations, their evaluations of the Company s internal controls, and the overall quality of the Company s financial reporting.

In reliance on the reviews and discussions referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Company s Annual Report on From 10-K for the year ended December 31, 2004, for filing with the Securities and Exchange Commission. The Committee and the Board have also recommended, subject to stockholder approval, the selection of the Company s independent registered public accounting firm.

Respectfully submitted by:
AUDIT COMMITTEE

Corinne H. Lyle
W. Thomas Mitchell
Richard F. Pops

Audit and non-audit fees

The aggregate fees billed to the Company by Ernst & Young LLP, the Company s independent registered public accounting firm, for the indicated services for each of the last two fiscal years were as follows:

	2004	2003
Audit fees (1)	$ 419,571	$ 200,949
Audit related fees (2)		
Tax fees (3)	37,667	83,712
All other fees (4)		
Total	$ 457,238	$ 284,661

(1) Audit fees consist of fees for professional services performed by Ernst & Young LLP for the integrated audit of the Company s annual financial statements and internal control over financial reporting and review of financial statements included in the Company s 10-Q filings, and services that are normally provided in connection with statutory and regulatory filings or engagements.

(2) Audit related fees consist of fees for assurance and related services performed by Ernst & Young LLP that are reasonably related to the performance of the audit or review of the Company s financial statements.

(3) Tax fees consist of fees for professional services performed by Ernst & Young LLP with respect to tax compliance, tax advice and tax planning.

(4) All other fees consist of fees for other permissible work performed by Ernst & Young LLP that does not meet with the above category descriptions.

The Audit Committee has considered whether the provision of non-audit services is compatible with maintaining the independence of Ernst & Young LLP, and has concluded that the provision of such services is compatible with maintaining the independence of the Company s auditors. All of the services rendered by Ernst & Young LLP were pre-approved by the Audit Committee in accordance with the Audit Committee pre-approval policy described below.

Audit Committee policy regarding pre-approval of audit and permissible non-audit services of our independent registered public accounting firm

The Company s Audit Committee has established a policy that all audit and permissible non-audit services provided by the Company s independent registered public accounting firm will be pre-approved by the Audit Committee. These services may include audit services, audit-related services, tax services and other services. The Audit Committee considers whether the provision of each non-audit service is compatible with maintaining the independence of the Company s registered public accounting firm. Pre-approval is detailed as to the particular service or category of services and is generally subject to a specific budget. The Company s independent registered public accounting firm and management are required to periodically (at least quarterly) report to the Audit Committee regarding the extent of services provided by the independent registered public accounting firm in accordance with this pre-approval, and the fees for the services performed to date.

REPORT OF THE COMPENSATION COMMITTEE

The Compensation Committee reviews and recommends to the Board of Directors for approval the Company s executive compensation policies. The Committee is responsible for reviewing the salary and benefits structure of the Company at least annually to insure its competitiveness within the Company s industry. The following is the report of the Committee describing the compensation policies and rationales applicable to the Company s executive officers with respect to the compensation paid to such executive officers for the fiscal year ended December 31, 2004. During 2004, the members of the Committee were Stephen A. Sherwin, M.D., Joseph A. Mollica, Ph.D. and Richard F. Pops.

The Company s philosophy in establishing its compensation policy for executive officers and other employees is to create a structure designed to attract and retain highly skilled individuals by establishing salaries, benefits, and incentive compensation which compare favorably with those for similar positions in other biotechnology companies. Compensation for the Company s executive officers consists of a base salary and potential incentive cash bonuses, as well as potential incentive compensation through stock options and stock ownership.

Base salary

The base salary component of compensation is designed to compensate executive officers competitively at levels necessary to attract and retain qualified executives in the pharmaceutical and biotechnology industry. The base salaries have been targeted at or above the average rates paid by competitors to enable the Company to attract, motivate, reward and retain highly skilled executives. In order to evaluate the Company s competitive position in the industry, the Committee reviewed and analyzed the compensation packages, including base salary levels, offered by other biotechnology and pharmaceutical companies. During 2004, the Company retained the services of an independent consultant to review and recommend improvements to the executive compensation policy. Some of the competitive information was obtained from surveys prepared by consulting companies or industry associations (e.g., the Radford Biotechnology Compensation Survey). As a general matter, the base salary for each executive officer is initially established through negotiation at the time the officer is hired, taking into account such officer s qualifications, experience, prior salary, and competitive salary information. Year-to-year adjustments to each executive officer s base salary are based upon personal performance for the year, changes in the general level of base salaries of persons in comparable positions within the industry, and the average merit salary increase for such year for all employees of the Company established by the Committee, as well as other factors the Committee judges to be pertinent during an assessment period. In making base salary decisions, the Committee exercises its judgment to determine the appropriate weight to be given to each of these factors.

Annual incentive compensation

A portion of the cash compensation paid to the Company s executive officers, including the Chief Executive Officer, is in the form of discretionary bonus payments that are paid on an annual basis as part of the Company s incentive compensation strategy. Bonus payments are linked to the attainment of overall corporate goals established by the Board of Directors and individual goals established for each executive officer. The Board of Directors establishes the maximum potential amount of each officer s bonus payment annually, based upon the recommendation of the Committee. The appropriate weight to be given to each of the various goals used to calculate the amount of each officer s bonus payment is determined by the Committee. The goal of the Company s incentive compensation strategy is to support the achievement of Company goals and objectives by basing compensation on a pay for performance basis.

Long-term incentives

The Committee provides the Company s executive officers with long-term incentive compensation through grants of stock options, restricted stock and/or stock bonuses under the Company s equity compensation plans.

The Board believes that these grant programs provide the Company s executive officers with the opportunity to purchase and maintain an equity interest in the Company and to share in the appreciation of the value of the Company s common stock. The Board believes that these grants directly motivate an executive to maximize long-term stockholder value. The grants also utilize vesting periods (generally four years) that encourage key executives to continue in the employ of the Company. The Board considers each grant subjectively, considering factors such as the individual performance of the executive officer and the anticipated contribution of the executive officer to the attainment of the Company s long-term strategic performance goals. Long-term incentives granted in prior years are also taken into consideration.

The Company has also established an employee stock purchase plan both to encourage employees, including the Company s executive officers, to continue in the employ of the Company and to motivate employees through an ownership interest in the Company. Under the plan, employees, including officers, may have up to 15% of their earnings withheld for purchases of common stock on certain dates specified by the Board. The price of common stock purchased will be equal to 85% of the lower of the fair market value of the common stock on the date of enrollment or exercise date, whichever is lower.

Chief Executive Officer compensation

The compensation of the Chief Executive Officer is reviewed annually on the same basis as discussed above for all executive officers. Gary A. Lyons base salary for 2003 was set at $475,000, and was later increased to $510,000 for 2004. Mr. Lyons joined the Company in February 1993. His initial salary, potential bonus, and stock grants were determined on the basis of negotiation between the Board of Directors and Mr. Lyons with due regard for his qualifications, experience, prior salary, and competitive salary information. Mr. Lyons base salary for 2004 was established in part by comparing the base salaries of chief executive officers at other biotechnology and pharmaceutical companies of similar size. Mr. Lyons has annual and long-term strategic and operational goals established by the Board. In light of the achievement of financial and operational goals and the advancement of drug candidates in the pipeline, Mr. Lyons earned a $200,000 bonus for 2004. As with other executive officers, Mr. Lyons total compensation was based on the Company s accomplishments and the Chief Executive Officer s contribution thereto.

Section 162(m)

The Board has considered the potential future effects of Section 162(m) of the Code on the compensation paid to the Company s executive officers. Section 162(m) disallows a tax deduction for any publicly held corporation for individual compensation exceeding $1.0 million in any taxable year for any of the executive officers named in the proxy statement, unless compensation is performance-based. The Company has adopted a policy that, where reasonably practicable, the Company will seek to qualify the variable compensation paid to its executive officers for an exemption from the deductibility limitations of Section 162(m).

In approving the amount and form of compensation for the Company s executive officers, the Committee will continue to consider all elements of the cost to the Company of providing such compensation, including the potential impact of Section 162(m).

Respectfully submitted by:
COMPENSATION COMMITTEE

Stephen A. Sherwin, M.D.
Richard F. Pops
Joseph A. Mollica, Ph.D.

Compensation Committee interlocks and insider participation

As of December 31, 2004, the Compensation Committee consisted of Stephen A. Sherwin, M.D., Joseph A. Mollica, Ph.D. and Richard F. Pops. No interlocking relationship exists between any member of the Compensation Committee and any member of any other company s Board of Directors or compensation committee.

EXECUTIVE OFFICERS

Who are the executive officers of the Company?

As of the Record Date, the executive officers of the Company were as follows:

Name	Age	Position
Gary A. Lyons	54	President, Chief Executive Officer and Director
Paul W. Hawran	53	Executive Vice President and Chief Financial Officer
Wendell Wierenga Ph.D.	56	Executive Vice President, Research and Development
Henry Y. Pan, M.B.B.S., Ph.D., F.A.C.C.	58	Executive Vice President, Clinical Development and Chief Medical Officer
Margaret E. Valeur-Jensen, J.D., Ph.D.	48	Executive Vice President, General Counsel and Corporate Secretary
Robert J. Little	55	Senior Vice President, Commercial Operations
Kevin C. Gorman, Ph.D.	47	Senior Vice President, Business Development

See above for biographical information concerning Gary A. Lyons.

Paul W. Hawran became Executive Vice President and Chief Financial Officer of the Company in January 2001 after having served as Senior Vice President and Chief Financial Officer of the Company since February 1996 and Vice President and Chief Financial Officer from 1993 to 1996. In this capacity, Mr. Hawran directs accounting, finance, investor relations, information technologies and operations. Mr. Hawran was employed by SmithKline Beecham Corporation from July 1984 to May 1993, most recently as Vice President and Treasurer. Prior to joining SmithKline in 1984, Mr. Hawran held various financial positions at Warner Communications (now Time Warner) where he was involved in corporate finance, financial planning and domestic and international budgeting and forecasting. Mr. Hawran is currently a member of the Board of Directors of Macropore Biosurgery, Inc. Mr. Hawran received a B.S. in finance from St. John s University and an M.S. in taxation from Seton Hall University. He is a Certified Public Accountant and a member of the American Institute of Certified Public Accountants and California and Pennsylvania Institute of Certified Public Accountants.

Wendell Wierenga, Ph.D. became the Company s Executive Vice President, Research and Development in September 2003 and is responsible for all aspects of research and development including discovery research as well as preclinical and clinical development. From August 2000 to August 2003, Dr. Wierenga was Chief Executive Officer of Syrrx, Inc. Prior to joining Syrrx, from March 1997 to July 2000, he was Senior Vice President of Worldwide Pharmaceutical Sciences, Technologies and Development at Parke-Davis/Warner Lambert (now Pfizer), where he was responsible for worldwide drug development, including toxicology, pharmacokinetics/drug metabolism, chemical development, pharmaceutics, clinical supplies, information systems and technology acquisition. From 1990 to 1997, Dr. Wierenga was Senior Vice president for Research at Parke-Davis/Warner Lambert. Prior to Parke-Davis, Dr. Wierenga was at Upjohn Pharmaceuticals for 16 years, most recently as Executive Director of Discovery Research. Dr. Wierenga led/participated in the research and development of more than 50 INDs, over 10 NDAs and over 10 marketed products, including Lipitor® and Neurontin®. He is a member of the Board of Directors of XenoPort, Inc.; Onyx Pharmaceuticals, Inc.; Syrrx,

Inc.; and Ciphergen Biosystems, Inc. Dr. Wierenga earned his B.A. in chemistry from Hope College, his Ph.D. in chemistry from Stanford University and an American Cancer Society Postdoctoral Fellowship at Stanford.

Henry Y. Pan M.B.B.S., Ph.D., F.A.C.C. became Executive Vice President, Clinical Development and Chief Medical Officer of the Company in October 2001. In this capacity, Dr. Pan is responsible for scientific and administrative leadership and management of the Company s clinical research and development initiatives. Prior to joining the Company, Dr. Pan was the Managing Director of VennWorks LLC from 2000 to 2001, an operating company that creates, builds, and operates companies in different technology areas. Prior to joining VennWorks, he was the co-founder, President, CEO and Managing Partner of Pharmacologics LLC from 1999 to 2000. From 1997 to 1999, he was President and CEO of the Pharmaceutical Services division of MDS Inc., an integrated contract research organization. He served as Executive Vice President, Drug Development and Medical Affairs at DuPont Merck Pharmaceutical Company from 1992 to 1997. Dr. Pan was at Bristol-Myers Squibb from 1985 to 1992, most recently as Vice President of Clinical Research and Development. Dr. Pan received his B.S. in genetics from McGill University in 1969, M.S. in toxicology in 1973 and Ph.D. in pharmacology in 1974 from the University of Hawaii, and M.B.B.S. from the University of Hong Kong in 1979. He completed his fellowship training in Clinical Pharmacology in 1985 at Stanford University and is a fellow of the American College of Cardiology, the American College of Clinical Pharmacology, the American Heart Association, the Institute of Biological and Clinical Investigation, and the Academy of Medicine of New Jersey.

Margaret E. Valeur-Jensen, J.D., Ph.D. became Executive Vice President, General Counsel and Corporate Secretary of the Company in February 2005 after having served as Senior Vice President, General Counsel and Corporate Secretary since January 2000. She joined the Company as Vice President, General Counsel and Secretary in October 1998. She is responsible for all corporate and patent law practices at the Company, serves as Corporate Secretary and is a member of the senior management committee. From 1995 to 1998, Dr. Valeur-Jensen served as Associate General Counsel, Licensing and Business Law of Amgen. From 1991 to 1995, she served first as Corporate Counsel and later as Senior Counsel, Licensing for Amgen. Prior to joining Amgen, Dr. Valeur-Jensen practiced law at Davis, Polk & Wardell, a leading corporate law firm. She earned a J.D. degree from Stanford University, a Ph.D. in biochemistry and molecular biology from Syracuse University, and was a Post-Doctoral Fellow at Massachusetts General Hospital and Harvard Medical School.

Robert J. Little joined the Company as Senior Vice President, Commercial Operations in June 2003 and is responsible for building and managing the Company s sales and marketing functions. Before joining the Company, Mr. Little was at Pharmacia, Inc. for 18 years where his most recent position was Group Vice President, Diversified Products. His responsibilities included managing Pharmacia s Diversified Products business, as well as forming a new business group merging pricing, reimbursement and health outcome groups into a global unit focused on current industry issues, pricing and drug values. Mr. Little previously held a number of positions within Pharmacia including Group Vice President Specialty Products, President and Managing Director of Pharmacia in Milan, Italy, President Pharmacia & UpJohn Canada and President Pharmacia Inc. Canada. Prior to joining Pharmacia he held positions at Adria Laboratories and Miles Laboratories/Bayer A.G. in the U.K., Italy and the United States. He received a degree in economics and finance from the West London Business School, Ealing Technical College.

Kevin C. Gorman, Ph.D. has been employed with the Company since 1993. As Senior Vice President of Business Development of Neurocrine Biosciences, he is responsible for the in-licensing and out-licensing of technologies and products, corporate partnering activities and strategic planning. From 1990 until 1993, Dr. Gorman was a principal of Avalon Medical Partners, L.P. where he was responsible for the early stage founding of the Company and several other biotechnology companies such as Onyx Pharmaceuticals, Metra Biosystems, IDUN and ARIAD

Pharmaceuticals. Dr. Gorman received his Ph.D. in immunology and M.B.A. in Finance from the University of California, Los Angeles and did further post-doctoral training at The Rockefeller University.

How are the executive officers compensated?

Compensation of Executive Officers-Summary Compensation Table. The following table sets forth the compensation paid by the Company for each of the three fiscal years in the period ended December 31, 2004 to the Chief Executive Officer and the other four most highly compensated executive officers of the Company as of December 31, 2004 (the Other Named Executive Officers):

		Annual Compensation			Long-term Compensation Awards		
Name and Principal Position	**Year**	**Salary ($) (1)**	**Bonus ($) (1)**	**Other Annual Compensation ($) (8)**	**Stock Bonus Subject to Vesting ($) (2)**	**Securities Underlying Options (#)**	**All Other Compensation ($)**
Gary A. Lyons	2004	510,000	200,000		220,600	100,000	8,232 (3)
President and	2003	475,000	225,000		169,785	110,000	8,082 (3)
Chief Executive Officer	2002	437,000	200,000			125,000	7,582 (3)
Paul W. Hawran	2004	312,000	90,000		55,150	25,000	7,979 (4)
Executive Vice President and	2003	298,000	100,000		48,510	35,000	7,789 (4)
Chief Financial Officer	2002	284,000	100,000			40,000	7,248 (4)
Henry Y. Pan, M.B.B.S., Ph.D., F.A.C.C.	2004	344,000	90,000		82,725	30,000	134,607 (5)
Executive Vice President, Clinical	2003	330,000	100,000		24,255	20,000	137,969 (5)
Development & Chief Medical Officer	2002	315,000	91,000				278,467 (5)
Wendell Wierenga, Ph.D.	2004	309,000	110,000	826		30,000	7,970 (6)
Executive Vice President	2003	100,000	50,000	257	260,737	100,000	3,726 (6)
Research and Development	2002						
Robert J. Little	2004	307,000	75,000			20,000	23,294 (7)
Senior Vice President,	2003	162,500	40,000		172,920	75,000	180,743 (7)
Commercial Operations	2002						

(1) Salary and bonus figures are amounts earned during each respective fiscal year, regardless of whether part or all of such amounts were paid in subsequent fiscal year(s). Effective January 1, 2005, Mr. Lyons annualized salary became $530,000, Mr. Hawran s annualized salary became $325,000, Mr. Pan s annualized salary became $359,000, Mr. Wierenga s annualized salary became $350,000, and Mr. Little s annualized salary became $317,000.

(2) Represents stock bonus awards made during 2004 (number of shares granted were based on achievement of 2003 corporate goals) that vest monthly over a four-year period, and during 2003 (number of shares granted were based on achievement of 2002 corporate goals) that vest monthly over a two-year period. During 2005, no stock bonuses were granted to executives based on results of 2004 corporate goals. All of these awards have been contributed to the Company s deferred compensation plan.

(3) Represents Company insurance premiums for life and disability of $2,082 per year and 401(k) contributions of $6,150 for 2004, $6,000 for 2003 and $5,500 for 2002.

(4)

Represents Company insurance premiums for life and disability of $1,829 for 2004, $1,789 for 2003 and $1,748 for 2002 and 401(k) contributions of $6,150 for 2004, $6,000 for 2003 and $5,500 for 2002.

(5) Represents payments made by the Company in 2004 for loan forgiveness ($126,536), the Company 401(k) contribution ($6,150) and life and disability insurance premiums ($1,921); in 2003 for loan forgiveness ($130,088), the Company 401(k) contribution ($6,000) and life and disability insurance premiums ($1,881); in 2002 for moving ($183,478), personal travel ($3,461), forgiveness of a loan ($84,190), the Company 401(k) contribution ($5,500) and life and disability insurance premiums ($1,838).

(6) Dr. Wierenga joined the Company on September 2, 2003. All Other Compensation represents Company premiums for life and disability insurance of $1,820 for 2004, $726 for 2003 and 401(k) contributions of $6,150 for 2004, $3,000 for 2003.

(7) Mr. Little joined the Company on June 16, 2003. All Other Compensation represents Company insurance premiums for life and disability of $1,815 for 2004 and $1,165 for 2003, tax preparation fees of $3,055 for 2004, mortgage equalization payments of $15,000 for 2004, moving expenses of $3,424 for 2004 and $129,578 for 2003 and a sign-on bonus of $50,000 for 2003.

(8) Other annual compensation represents a long-term care policy for Dr. Wierenga and his spouse.

Option Grants in Last Fiscal Year. The following table sets forth certain information concerning grants of options made during the year ended December 31, 2004 by the Company to each of the Named Executive Officers:

					Potential Realizable Value at Assumed Annual Rate of Stock Appreciation for Option Term (2)	
Name	**Number of Shares Underlying Options Granted # (1)**	**% of Total Options Granted to Employees in Fiscal Year**	**Exercise Price per Share**	**Expiration Date**	**5%**	**10%**
Gary A. Lyons	100,000	8.7%	$57.51	05/26/14	$3,616,773	$9,165,613
Paul W. Hawran	25,000	2.2	57.51	05/26/14	904,193	2,291,403
Wendell Wierenga, Ph.D.	30,000	2.6	57.51	05/26/14	1,085,032	2,749,684
Henry Y. Pan, M.B.B.S., Ph.D., F.A.C.C.	30,000	2.6	57.51	05/26/14	1,085,032	2,749,684
Robert J. Little.	20,000	1.7	57.51	05/26/14	723,355	1,833,123

(1) The options granted in 2004 to the officers listed above become exercisable as to -1/48th of the option shares each month following the vesting start date, with full vesting occurring on the fourth anniversary of the vesting start date. All options listed above were granted at an exercise price equal to the fair market value of the Company s common stock as determined by the Board of Directors on the date of grant.

(2)	2,191	1,106	202	883			
Commercial paper	2,112	0	0	2,112	909	1,203	0
Corporate securities	46,261	568	(8)	46,821	10	7,455	39,356
Municipal securities	5,645	74	0	5,719	0	618	5,101
	11,948	66	(6)	12,008	0	0	12,008

Mortgage- and asset-backed securities													
Subtotal		113,266		972		(18)		114,220		6,177		15,921	92,122
Total	$	120,220	$	1,051	$	(20)	$	121,251	$	10,746	$	18,383	$ 92,122

(a) The fair value of Level 1 securities is estimated based on quoted prices in active markets for identical assets or liabilities.

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

The net unrealized losses as of June 29, 2013 and net unrealized gains as of September 29, 2012 are related primarily to long-term marketable securities. The Company may sell certain of its marketable securities prior to their stated maturities for strategic reasons including, but not limited to, anticipation of credit deterioration and duration management. The net realized gains or losses recognized by the Company related to such sales were not significant during the three- and nine-month periods ended June 29, 2013 and June 30, 2012. The maturities of the Company s long-term marketable securities generally range from one to five years.

As of June 29, 2013 and September 29, 2012, gross unrealized losses related to individual securities that had been in a continuous loss position for 12 months or longer were not significant.

As of June 29, 2013, the Company considered the declines in market value of its marketable securities investment portfolio to be temporary in nature and did not consider any of its investments other-than-temporarily impaired. The Company typically invests in highly-rated securities, and its investment policy generally limits the amount of credit exposure to any one issuer. The policy requires investments generally to be investment grade, with the primary objective of minimizing the potential risk of principal loss. Fair values were determined for each individual security in the investment portfolio. When evaluating an investment for other-than-temporary impairment, the Company reviews factors such as the length of time and extent to which fair value has been below its cost basis, the financial condition of the issuer and any changes thereto, changes in market interest rates, and the Company s intent to sell, or whether it is more likely than not it will be required to sell, the investment before recovery of the investment s cost basis. During the three- and nine-month periods ended June 29, 2013 and June 30, 2012, the Company did not recognize any significant impairment charges.

Derivative Financial Instruments

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

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

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

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

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

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

The Company had a net deferred gain of $348 million and a net deferred loss of $240 million associated with cash flow hedges, net of taxes, recorded in AOCI as of June 29, 2013 and September 29, 2012, respectively. Deferred gains and losses associated with cash flow hedges of foreign currency revenue are recognized as a component of net sales in the same period as the related revenue is recognized, and deferred gains and losses related to cash flow hedges of inventory purchases are recognized as a component of cost of sales in the same period as the related costs are recognized. Deferred gains and losses associated with cash flow hedges of interest income or expense are recognized as a component of other income/(expense), net in the same period as the related income or expense is recognized. The majority of the Company s hedged foreign currency transactions and hedged interest rate transactions as of June 29, 2013 are expected to occur within six months and five years, respectively.

Derivative instruments designated as cash flow hedges must be de-designated as hedges when it is probable the forecasted hedged transaction will not occur in the initially identified time period or within a subsequent two-month time period. Deferred gains and losses in AOCI associated with such derivative instruments are reclassified immediately into other income and expense. Any subsequent changes in fair value of such derivative instruments are reflected in other income and expense unless they are re-designated as hedges of other transactions. The Company did not recognize any significant net gains or losses related to the loss of hedge designation on discontinued cash flow hedges during the three- and nine-month periods ended June 29, 2013 and June 30, 2012.

The Company s unrealized net gains and losses on net investment hedges, included in the cumulative translation adjustment account of AOCI, were not significant as of June 29, 2013 and September 29, 2012. The ineffective portions of and amounts excluded from the effectiveness test of net investment hedges are recorded in other income and expense.

The gain/loss recognized in other income and expense for foreign currency forward and option contracts not designated as hedging instruments was not significant during the three- and nine-month periods ended June 29, 2013 and June 30, 2012, respectively. These amounts represent the net gain or loss on the derivative contracts and do not include changes in the related exposures, which generally offset a portion of the gain or loss on the derivative contracts.

The following table shows the notional principal amounts of the Company s outstanding derivative instruments and credit risk amounts associated with outstanding or unsettled derivative instruments as of June 29, 2013 and September 29, 2012 (in millions):

	June 29, 2013		September 29, 2012	
	Notional Principal	**Credit Risk Amounts**	**Notional Principal**	**Credit Risk Amounts**
Instruments designated as accounting hedges:				
Foreign exchange contracts	$ 29,489	$ 585	$ 41,970	$ 140
Interest rate contracts	$ 3,000	$ 69	$ 0	$ 0
Instruments not designated as accounting hedges:				
Foreign exchange contracts	$ 11,635	$ 84	$ 13,403	$ 12

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

The Company generally enters into master netting arrangements, which are designed to reduce credit risk by permitting net settlement of transactions with the same counterparty. To further limit credit risk, the Company generally enters into collateral security arrangements that provide for collateral to be received or posted when the net fair value of certain financial instruments fluctuates from contractually established thresholds. The Company presents its derivative assets and derivative liabilities at their gross fair values. As of June 29, 2013, the Company received $642 million of cash collateral related to the derivative instruments under its collateral security arrangements, which were recorded as accrued expenses in the Condensed Consolidated Balance Sheet. As of September 29, 2012, the Company posted cash collateral related to the derivative instruments under its collateral security arrangements of $278 million, which it recorded as other current assets in the Condensed Consolidated Balance Sheet. The Company did not have any derivative instruments with credit-risk related contingent features that would require it to post additional collateral as of June 29, 2013 or September 29, 2012.

The following tables show the Company s derivative instruments at gross fair value as reflected in the Condensed Consolidated Balance Sheets as of June 29, 2013 and September 29, 2012 (in millions):

	June 29, 2013		
	Fair Value of Derivatives Designated as Hedge Instruments	Fair Value of Derivatives Not Designated as Hedge Instruments	Total Fair Value
Derivative assets (a):			
Foreign exchange contracts	$ 526	$ 84	$ 610
Interest rate contracts	$ 69	$ 0	$ 69
Derivative liabilities (b):			
Foreign exchange contracts	$ 256	$ 28	$ 284

	September 29, 2012		
	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	$ 138	$ 12	$ 150
Derivative liabilities (b):			
Foreign exchange contracts	$ 516	$ 41	$ 557

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

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

The following table shows the pre-tax effect of the Company s derivative instruments designated as cash flow and net investment hedges in the Condensed Consolidated Statements of Operations for the three- and nine-month periods ended June 29, 2013 and June 30, 2012 (in millions):

	Three Months Ended						
	Gains/(Losses) Recognized in OCI - Effective Portion		Gains/(Losses) Reclassified from AOCI into Net Income - Effective Portion		Gains/(Losses) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing		
	June 29, 2013	June 30, 2012	June 29, 2013 (a)	June 30, 2012 (b)	Location	June 29, 2013	June 30, 2012
Cash flow hedges:							
Foreign exchange contracts	$ 272	$ 234	$ 492	$ 84	Other income/(expense), net	$ (63)	$ (39)
Interest rate contracts	33	0	(2)	0	Other income/(expense), net	0	0
Net investment hedges:							
Foreign exchange contracts	26	3	0	0	Other income/(expense), net	0	1
Total	$ 331	$ 237	$ 490	$ 84		$ (63)	$ (38)

	Nine Months Ended						
	Gains/(Losses) Recognized in OCI - Effective Portion		Gains/(Losses) Reclassified from AOCI into Net Income - Effective Portion		Gains/(Losses) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing		
	June 29, 2013	June 30, 2012	June 29, 2013 (c)	June 30, 2012 (d)	Location	June 29, 2013	June 30, 2012
Cash flow hedges:							
Foreign exchange contracts	$ 1,218	$ 337	$ 304	$ 468	Other income/(expense), net	$ (115)	$ (248)
Interest rate contracts	33	0	(2)	0	Other income/(expense), net	0	0
Net investment hedges:							
Foreign exchange contracts	132	10	0	0	Other income/(expense), net	1	2
Total	$ 1,383	$ 347	$ 302	$ 468		$ (114)	$ (246)

(a) Includes gains/(losses) reclassified from AOCI into net income for the effective portion of cash flow hedges, of which $96 million, $396 million and $(2) million were recognized within net sales, cost of sales and other income/(expense), net, respectively, within the Condensed Consolidated Statement of Operations for the three months ended June 29, 2013.

(b) Includes gains/(losses) reclassified from AOCI into net income for the effective portion of cash flow hedges, of which $63 million and $21 million were recognized within net sales and cost of sales, respectively, within the Condensed Consolidated Statement of Operations for the three months ended June 30, 2012.

(c) Includes gains/(losses) reclassified from AOCI into net income for the effective portion of cash flow hedges, of which $(68) million, $372 million and $(2) million were recognized within net sales, cost of sales and other income/(expense), net, respectively, within the

Condensed Consolidated Statement of Operations for the nine months ended June 29, 2013.

(d) Includes gains/(losses) reclassified from AOCI into net income for the effective portion of cash flow hedges, of which $404 million and $64 million were recognized within net sales and cost of sales, respectively, within the Condensed Consolidated Statement of Operations for the nine months ended June 30, 2012.

Accounts Receivable

The Company has considerable trade receivables outstanding with its third-party cellular network carriers, wholesalers, retailers, value-added resellers, small and mid-sized businesses, and education, enterprise and government customers that are not covered by collateral, third-party financing arrangements or credit insurance. There was one customer that accounted for 13% of the Company s trade receivables as of June 29, 2013. As of September 29, 2012, the Company had two customers that represented 10% or more of total trade receivables, one of which accounted for 14% and the other 10%. The Company s cellular network carriers accounted for 59% and 66% of trade receivables as of June 29, 2013 and September 29, 2012, respectively.

Additionally, the Company has non-trade receivables from certain of its manufacturing vendors. Vendor non-trade receivables from two of the Company s vendors accounted for 54% and 26% of total non-trade receivables as of June 29, 2013 and three of the Company s vendors accounted for 45%, 21% and 12% of total non-trade receivables as of September 29, 2012.

Note 3 Condensed Consolidated Financial Statement Details

The following tables show the Company s condensed consolidated financial statement details as of June 29, 2013 and September 29, 2012 (in millions):

Property, Plant and Equipment

	June 29, 2013	September 29, 2012
Land and buildings	$ 3,055	$ 2,439
Machinery, equipment and internal-use software	20,024	15,984
Leasehold improvements	3,810	3,464
Gross property, plant and equipment	26,889	21,887
Accumulated depreciation and amortization	(10,562)	(6,435)
Net property, plant and equipment	$ 16,327	$ 15,452

Accrued Expenses

	June 29, 2013	September 29, 2012
Accrued warranty and related costs	$ 2,717	$ 1,638
Accrued taxes	1,290	1,535
Deferred margin on component sales	1,255	1,492
Accrued marketing and selling expenses	1,152	910
Accrued compensation and employee benefits	1,006	735
Other current liabilities	6,050	5,104
Total accrued expenses	$ 13,470	$ 11,414

Non-Current Liabilities

	June 29, 2013	September 29, 2012
Deferred tax liabilities	$ 16,070	$ 13,847
Other non-current liabilities	4,483	2,817

Total other non-current liabilities	$	20,553	$	16,664

Note 4 Income Taxes

As of June 29, 2013, the Company recorded gross unrecognized tax benefits of $3.4 billion, of which $1.2 billion, if recognized, would affect the Company s effective tax rate. As of September 29, 2012, the total amount of gross unrecognized tax benefits was $2.1 billion, of which $889 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 $501 million and $401 million of gross interest and penalties accrued as of June 29, 2013 and September 29, 2012, 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 $125 million and $225 million in the next 12 months.

Note 5 Long-Term Debt

In May 2013, the Company issued floating- and fixed-rate notes with varying maturities for an aggregate principal amount of $17 billion (collectively the Notes). The Notes are senior unsecured obligations, and interest is payable in arrears, quarterly for the floating-rate notes and semi-annually for the fixed-rate notes.

The principal amounts and associated interest rates of the Notes as of June 29, 2013, are as follows:

	June 29, 2013		
	Amount (in millions)		Effective Rate
Floating-rate notes, due 2016	$	1,000	0.51%
Floating-rate notes, due 2018		2,000	1.10%
Fixed-rate 0.45% notes due 2016		1,500	0.51%
Fixed-rate 1.00% notes due 2018		4,000	1.08%
Fixed-rate 2.40% notes due 2023		5,500	2.44%
Fixed-rate 3.85% notes due 2043		3,000	3.91%
Total	$	17,000	

The floating-rate notes due 2016 and 2018 bear interest at the three-month London InterBank Offered Rate (LIBOR) plus 0.05% and 0.25%, respectively. To manage the risk associated with the floating-rate notes, the Company entered into interest rate swaps with an aggregate notional amount of $3 billion designated as cash flow hedges of its floating-rate notes. These hedges effectively convert the floating interest rate on the floating-rate notes to a fixed interest rate. The gains and losses related to changes in the fair value of the interest rate swaps are recorded in OCI with a portion reclassified to interest expense each period to offset changes in interest rates on the floating-rate notes. The effective rates for the Notes include the interest on the Notes, amortization of the discount and, if applicable, adjustments related to hedging. The Company recognized $53 million of interest expense for the three- and nine-month periods ended June 29, 2013. As of June 29, 2013, the aggregate unamortized discount for the Company s Notes was $42 million.

Future principal payments for the Company s Notes as of June 29, 2013, are as follows (in millions):

	June 29, 2013	
2013 (remaining three months)	$	0
2014		0
2015		0
2016		2,500
2017		0
Thereafter		14,500
Total	$	17,000

As of June 29, 2013, the fair value of the Company s Notes, based on Level 2 inputs, was $16.1 billion.

Note 6 Shareholders Equity and Share-Based Compensation

Preferred Stock

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

Dividend and Share Repurchase Program

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

	2013	
	Dividend Per Share	**Amount** (in millions)
Third quarter	$ 3.05	$ 2,789
Second quarter	$ 2.65	$ 2,490
First quarter	$ 2.65	$ 2,486

No dividends were paid by the Company during the first three quarters of 2012. Future dividends are subject to declaration by the Board of Directors.

In 2012, the Company s Board of Directors authorized a program to repurchase up to $10 billion of the Company s common stock beginning in 2013. In April 2013, the Company s Board of Directors increased the share repurchase program authorization from $10 billion to $60 billion, of which $18 billion had been utilized as of June 29, 2013. The Company s share repurchase program does not obligate it to acquire any specific number of shares. Under the program, shares may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 of the Securities Exchange Act of 1934, as amended (the Exchange Act).

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

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

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

During the third quarter of 2013, the Company also repurchased 9.0 million shares of its common stock in the open market at an average price of $446.74 per share for a total of $4.0 billion. These shares were retired upon repurchase.

Accumulated Other Comprehensive Income

The following table shows the components of AOCI, net of taxes, as of June 29, 2013 and September 29, 2012 (in millions):

	June 29, 2013	September 29, 2012
Net unrealized gains/losses on marketable securities	$ (413)	$ 731
Net unrecognized gains/losses on derivative instruments	348	(240)
Cumulative foreign currency translation	(169)	8
Accumulated other comprehensive income	$ (234)	$ 499

Equity Awards

A summary of the Company s RSU activity and related information for the nine months ended June 29, 2013, is as follows:

	Number of RSUs (in thousands)	Weighted-Average Grant Date Fair Value	Aggregate Intrinsic Value (in millions)
Balance at September 29, 2012	15,005	$ 344.87	
RSUs granted	5,124	$ 556.98	
RSUs vested	(5,574)	$ 315.62	
RSUs cancelled	(901)	$ 405.36	
Balance at June 29, 2013	13,654	$ 432.42	$ 5,414

RSUs that vested during the three- and nine-month periods ended June 29, 2013 had fair values of $1.2 billion and $2.9 billion, respectively, as of the vesting date. RSUs that vested during the three- and nine-month periods ended June 30, 2012 had fair values of $1.5 billion and $3.1 billion, respectively, as of the vesting date.

A summary of the Company s stock option activity and related information for the nine months ended June 29, 2013, is as follows:

	Outstanding Options			
	Number of Options (in thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
Balance at September 29, 2012	6,545	$ 127.56		
Options granted	8	$ 30.36		
Options assumed	29	$ 210.08		
Options cancelled	(6)	$ 113.46		
Options exercised	(1,887)	$ 107.50		
Balance at June 29, 2013	4,689	$ 136.01	1.3	$ 1,221

Exercisable at June 29, 2013	4,662	$	136.44	1.3	$	1,212
Expected to vest after June 29, 2013	27	$	60.03	7.8	$	9

Aggregate intrinsic value represents the value of the Company s closing stock price on the last trading day of the period in excess of the weighted-average exercise price multiplied by the number of options outstanding or exercisable. The total intrinsic value of options at the time of exercise was $180 million and $738 million for the three- and nine-month periods ended June 29, 2013, respectively, and $332 million and $1.5 billion for the three- and nine-month periods ended June 30, 2012, respectively.

The Company had approximately 28.8 million shares reserved for future issuance under the Company s stock plans as of June 29, 2013. RSUs granted are deducted from the shares available for grant under the Company s stock plans utilizing a factor of two times the number of RSUs granted. Similarly, RSUs cancelled are added back to the shares available for grant under the Company s stock plans utilizing a factor of two times the number of RSUs cancelled.

Share-Based Compensation

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

The Company granted 8,000 stock options, which had a weighted-average grant date fair value of $294.84 per share, during the three- and nine-month periods ended June 29, 2013. The Company did not grant any stock options during the three- and nine-month periods ended June 30, 2012. The weighted-average fair value of stock purchase rights per share was $107.98 and $118.96 during the three- and nine-month periods ended June 29, 2013, respectively, and was $114.01 and $102.41 during the three- and nine-months ended June 30, 2012, respectively.

In conjunction with certain business combinations, the Company assumed 29,000 stock options with a weighted-average fair value per share of $407.80 during the nine-month period ended June 29, 2013 and 41,000 stock options with a weighted-average fair value per share of $400.79 during the nine-month period ended June 30, 2012.

The following table shows a summary of the share-based compensation expense included in the Condensed Consolidated Statements of Operations for the three- and nine-month periods ended June 29, 2013 and June 30, 2012 (in millions):

	Three Months Ended		Nine Months Ended	
	June 29, 2013	**June 30, 2012**	**June 29, 2013**	**June 30, 2012**
Cost of sales	$ 90	$ 70	$ 262	$ 196
Research and development	245	172	708	500
Selling, general and administrative	243	206	728	596
Total share-based compensation expense	$ 578	$ 448	$ 1,698	$ 1,292

The income tax benefit related to share-based compensation expense was $197 million and $606 million for the three- and nine-month periods ended June 29, 2013, respectively, and $131 million and $432 million for the three- and nine-month periods ended June 30, 2012, respectively. As of June 29, 2013, the total unrecognized compensation cost related to outstanding stock options and RSUs expected to vest was $5.1 billion, which the Company expects to recognize over a weighted-average period of 3.1 years.

Employee Benefit Plans

Rule 10b5-1 Trading Plans

During the three-month period ended June 29, 2013, executive officers Timothy D. Cook, Peter Oppenheimer, D. Bruce Sewell, Philip W. Schiller, and Jeffrey E. Williams and director William V. Campbell had equity trading plans in place in accordance with Rule 10b5-1(c)(1) under the Exchange Act. An equity trading plan is a written document that pre-establishes the amounts, prices and dates (or formula for determining the amounts, prices and dates) of future purchases or sales of the Company s stock, including shares acquired pursuant to the Company s employee and director equity plans.

Note 7 Commitments and Contingencies

Accrued Warranty and Indemnification

The following table shows changes in the Company s accrued warranties and related costs for the three- and nine-month periods ended June 29, 2013 and June 30, 2012 (in millions):

	Three Months Ended		Nine Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Beginning accrued warranty and related costs	$ 3,014	$ 1,678	$ 1,638	$ 1,240
Cost of warranty claims	(1,033)	(436)	(2,566)	(1,301)
Accruals for product warranty	736	323	3,645	1,626
Ending accrued warranty and related costs	$ 2,717	$ 1,565	$ 2,717	$ 1,565

The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against it or an indemnified third-party and, in the opinion of management, does not have a potential liability related to unresolved infringement claims subject to indemnification that would materially adversely affect its financial condition or operating results. Therefore, the Company did not record a liability for infringement costs related to indemnification as of either June 29, 2013 or September 29, 2012.

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

Concentrations in the Available Sources of Supply of Materials and Product

Although most components essential to the Company s business are generally available from multiple sources, a number of components are currently obtained from single or limited sources, which subjects the Company to significant supply and pricing risks. Many components, including those that are available from multiple sources, are at times subject to industry-wide shortages and significant commodity pricing fluctuations. In addition, the Company has entered into various agreements for the supply of components; however, there can be no guarantee that the Company will be able to extend or renew these agreements on similar terms, or at all. Therefore, the Company remains subject to significant risks of supply shortages and price increases that can materially adversely affect its financial condition and operating results.

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

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

Long-Term Supply Agreements

The Company has entered into long-term agreements to secure the supply of certain inventory components. Under certain of these agreements, which expire between 2013 and 2022, the Company has made prepayments for the future purchase of inventory components and has acquired capital equipment to use in the manufacturing of such components.

As of June 29, 2013, the Company had a total of $3.3 billion of inventory component prepayments outstanding, of which $1.1 billion are classified as other current assets and $2.2 billion are classified as other assets in the Condensed Consolidated Balance Sheets. The Company had a total of $4.2 billion of inventory component prepayments outstanding as of September 29, 2012. The Company s outstanding prepayments will be applied to certain inventory component purchases made during the term of each respective agreement. During the three- and nine-month periods ended June 29, 2013, the Company utilized $269 million and $946 million of inventory component prepayments, respectively.

Other Off-Balance Sheet Commitments

The Company leases various equipment and facilities, including retail space, under noncancelable operating lease arrangements. The Company does not currently utilize any other off-balance sheet financing arrangements. The major facility leases are typically for terms not exceeding 10 years and generally provide renewal options for terms not exceeding five additional years. Leases for retail space are for terms ranging from five to 20 years, the majority of which are for 10 years, and often contain multi-year renewal options. As of June 29, 2013, the Company s total future minimum lease payments under noncancelable operating leases were $4.6 billion, of which $3.3 billion related to leases for retail space.

The Company utilizes several outsourcing partners to manufacture sub-assemblies for the Company s products and to perform final assembly and testing of finished products. These outsourcing partners acquire components and build product based on demand information supplied by the Company, which typically covers periods up to 150 days. The Company also obtains individual components for its products from a wide variety of individual suppliers. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders in each case based on projected demand. Where appropriate, the purchases are applied to inventory component prepayments that are outstanding with the respective supplier. As of June 29, 2013, the Company had outstanding off-balance sheet third-party manufacturing commitments and component purchase commitments of $13.0 billion.

In addition to the commitments mentioned above, the Company had additional off-balance sheet obligations of $1.4 billion as of June 29, 2013, which were comprised mainly of commitments to acquire capital assets, including product tooling and manufacturing process equipment, and commitments related to advertising, research and development, Internet and telecommunications services and other obligations.

Contingencies

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

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

On August 24, 2012, a jury returned a verdict awarding the Company $1.05 billion in its lawsuit against Samsung Electronics Co., Ltd and affiliated parties in the United States District Court, Northern District of California, San Jose Division. On March 1, 2013, the District Court upheld $599 million of the jury s award and ordered a new trial as to the remainder. Because the award is subject to entry of final judgment, partial re-trial and appeal, the Company has not recognized the award in its results of operations.

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

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

Note 8 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. Prior to 2013, the Company s reportable operating segments consisted of the Americas, Europe, Japan, Asia-Pacific and Retail. In 2013, the Company established a new reportable operating segment, Greater China, which was previously included in the Asia-Pacific segment. Segment data for prior periods has been reclassified to reflect establishment of the Greater China 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 Greater China segment includes China, Hong Kong and Taiwan. The Rest of Asia Pacific segment includes Australia and Asian countries, other than Japan and those countries included in the Greater China segment. The Retail segment operates Apple retail stores in 13 countries, including the U.S. The results of the Americas, Europe, Greater China, Japan and Rest of Asia Pacific segments do not include results of the Retail segment. Each operating segment provides similar hardware and software products and similar services. The accounting policies of the various segments are the same as those described in Note 1, Summary of Significant Accounting Policies of the Notes to Consolidated Financial Statements in Part II, Item 8 of the Company s 2012 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 research and development, corporate marketing expenses, share-based compensation expense, income taxes, various nonrecurring charges, and other separately managed general and administrative costs and certain manufacturing period expenses. Prior to 2013, the Company did not allocate certain manufacturing costs and variances, including costs related to product tooling and manufacturing process equipment, to its operating segments and instead included these costs and variances in other corporate expenses. In 2013, the Company began allocating these costs and variances to its operating segments and as a result reclassified costs of $146 million and a net credit of $48 million from corporate expenses to its operating segments for the three- and nine-month periods ended June 30, 2012, respectively. The Company does not include intercompany transfers between segments for management reporting purposes.

The following table shows information by operating segment for the three- and nine-month periods ended June 29, 2013 and June 30, 2012 (in millions):

	Three Months Ended		Nine Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Americas:				
Net sales	$ 14,405	$ 12,806	$ 48,798	$ 43,702
Operating income	$ 5,140	$ 5,161	$ 17,637	$ 18,082
Europe:				
Net sales	$ 7,614	$ 8,237	$ 29,878	$ 28,300
Operating income	$ 2,450	$ 3,229	$ 10,308	$ 11,834
Greater China:				
Net sales	$ 4,641	$ 5,389	$ 19,684	$ 17,106
Operating income	$ 1,440	$ 2,468	$ 6,771	$ 7,955
Japan:				
Net sales	$ 2,543	$ 2,009	$ 10,121	$ 8,204
Operating income	$ 1,343	$ 1,068	$ 5,158	$ 4,600
Rest of Asia Pacific:				
Net sales	$ 2,046	$ 2,498	$ 9,201	$ 8,631
Operating income	$ 729	$ 878	$ 3,098	$ 3,549
Retail:				
Net sales	$ 4,074	$ 4,084	$ 15,756	$ 14,599
Operating income	$ 667	$ 828	$ 3,316	$ 3,833

A reconciliation of the Company s segment operating income to the condensed consolidated financial statements for the three- and nine-month periods ended June 29, 2013 and June 30, 2012 is as follows (in millions):

	Three Months Ended		Nine Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Segment operating income	$ 11,769	$ 13,632	$ 46,288	$ 49,853
Share-based compensation expense	(578)	(448)	(1,698)	(1,292)
Other corporate expenses, net	(1,990)	(1,611)	(5,621)	(4,264)
Total operating income	$ 9,201	$ 11,573	$ 38,969	$ 44,297

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

This section and other parts of this Form 10-Q contain forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, that involve risks and uncertainties. Forward-looking statements provide current expectations of future events based on certain assumptions and include any statement that does not directly relate to any historical or current fact. Forward-looking statements also can be identified by words such as anticipates, expects, believes, will, would, could, can, future, and similar terms. Forward-looking statements are not guarantees of future performance and the Company s actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in Part II, Item 1A of this Form 10-Q under the heading Risk Factors, which are incorporated herein by reference. The following discussion should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended September 29, 2012 (the 2012 Form 10-K) filed with the U.S. Securities and Exchange Commission (the SEC) and the condensed consolidated financial statements and notes thereto included elsewhere in this Form 10-Q. All information presented herein is based on the Company s fiscal calendar. Unless otherwise stated, references in this report to particular years, quarters, months or periods refer to the Company s fiscal years ended in September and the associated quarters, months, or periods of those fiscal years. Each of the terms the Company and Apple as used herein refers collectively to Apple Inc. and its wholly-owned subsidiaries, unless otherwise stated. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Available Information

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

Executive Overview

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

The Company is committed to bringing the best user experience to its customers through its innovative hardware, software, peripherals, and services. The Company s business strategy leverages its unique ability to design and develop its own operating systems, hardware, application software, and services to provide its customers new products and solutions with superior ease-of-use, seamless integration, and innovative design. As part of its strategy, the Company continues to expand its platform for the discovery and delivery of third-party digital content and applications through the iTunes Store. As part of the iTunes Store, the Company s App Store and iBookstore allow customers to discover and download applications and books through either a Mac or Windows-based computer or through iOS devices, namely iPhone, iPad and iPod touch. The Company s Mac App Store allows customers to easily discover, download and install Mac applications. The Company also supports a community for the development of third-party software and hardware products and digital content that complement the Company s offerings. The Company s strategy also includes expanding its distribution network to effectively reach more customers and provide them with a high-quality sales and post-sales support experience.

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

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

Products

In June 2013, the Company announced new versions of its operating systems, iOS 7 and OS X Mavericks, both of which are expected to be available in the fall of 2013. The Company also released updated versions of MacBook Air.

A detailed discussion of the Company s products may be found in Part I, Item 1, Business, of the Company s 2012 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 Part II, Item 8 of the Company s 2012 Form 10-K describes the significant accounting policies and methods used in the preparation of the Company s condensed consolidated financial statements. Management bases its estimates on historical experience and on various other assumptions it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates and such differences may be material.

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

Revenue Recognition

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

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

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

The Company s process for determining ESPs involves management s judgment and considers multiple factors that may vary over time depending upon the unique facts and circumstances related to each deliverable. If the facts and circumstances underlying the factors considered change, including the estimated or actual costs incurred to provide non-software services or the estimated period the software upgrades and non-software services are expected to be provided, or should future facts and circumstances lead the Company to consider additional factors, the Company s ESPs and the future rate of related amortization for software upgrades and non-software services related to future sales of these devices could change.

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

Valuation and Impairment of Marketable Securities

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

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

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

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

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

Warranty Costs

The Company provides for the estimated cost of warranties at the time the related revenue is recognized based on historical and projected warranty claim rates, historical and projected cost-per-claim, and knowledge of specific product failures that are outside of the Company s typical experience. Each quarter, the Company reevaluates 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 liabilities would be required and could materially affect the Company s results of operations.

Income Taxes

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

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

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

Legal and Other Contingencies

As discussed in Part II, Item 1 of this Form 10-Q under the heading Legal Proceedings and in Note 7, Commitments and Contingencies in the Notes to Condensed Consolidated Financial Statements of this Form 10-Q, the Company is subject to various legal proceedings and claims that arise in the ordinary course of business. The Company records a liability when it is probable that a loss has been incurred and the amount is reasonably estimable. There is significant judgment required in both the probability determination and as to whether an exposure can be reasonably estimated. In the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies for legal and other contingencies. However, the outcome of legal proceedings and claims brought against the Company is subject to significant uncertainty. Therefore, although management considers the likelihood of such an outcome to be remote, if one or more of these legal matters were resolved against the Company in a reporting period for amounts in excess of management s expectations, the Company s consolidated financial statements for that reporting period could be materially adversely affected.

Net Sales

The following table shows net sales by operating segment and net sales and unit sales by product during the three- and nine-month periods ended June 29, 2013 and June 30, 2012 (in millions, except unit sales in thousands):

	Three Months Ended			Nine Months Ended		
	June 29, 2013	June 30, 2012	Change	June 29, 2013	June 30, 2012	Change
Net Sales by Operating Segment:						
Americas	$ 14,405	$ 12,806	12%	$ 48,798	$ 43,702	12%
Europe	7,614	8,237	(8)%	29,878	28,300	6%
Greater China (a)	4,641	5,389	(14)%	19,684	17,106	15%
Japan	2,543	2,009	27%	10,121	8,204	23%
Rest of Asia Pacific	2,046	2,498	(18)%	9,201	8,631	7%
Retail	4,074	4,084		15,756	14,599	8%
Total net sales	$ 35,323	$ 35,023	1%	$ 133,438	$ 120,542	11%
Net Sales by Product:						
iPhone (b)	$ 18,154	$ 15,821	15%	$ 71,769	$ 62,047	16%
iPad (b)	6,374	8,779	(27)%	25,794	23,812	8%
Mac (b)	4,893	4,933	(1)%	15,859	16,604	(4)%
iPod (b)	733	1,060	(31)%	3,838	4,795	(20)%
iTunes, Software and Services (c)	3,990	3,203	25%	11,791	9,394	26%
Accessories (d)	1,179	1,227	(4)%	4,387	3,890	13%
Total net sales	$ 35,323	$ 35,023	1%	$ 133,438	$ 120,542	11%
Unit Sales by Product:						
iPhone	31,241	26,028	20%	116,460	98,136	19%
iPad	14,617	17,042	(14)%	56,954	44,274	29%
Mac	3,754	4,020	(7)%	11,767	13,235	(11)%
iPod	4,569	6,751	(32)%	22,881	29,821	(23)%

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

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

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

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

The Company s fiscal year is the 52 or 53-week period that ends on the last Saturday of September. An extra week is added to the Company s first quarter approximately every six years to realign the Company s fiscal quarters more closely to calendar quarters. A 14th week was added to the first quarter of 2012, while the first quarter of 2013 spanned only 13 weeks. Inclusion of the 14th week increased the Company s overall net sales and operating expenses for the first nine months of 2012 compared to 2013.

Product Performance

iPhone

Net sales of iPhone were $18.2 billion and $71.8 billion in the third quarter and first nine months of 2013, respectively, increases of $2.3 billion or 15% and $9.7 billion or 16% compared to the same periods in 2012. iPhone unit sales totaled 31.2 million and 116.5 million in the third quarter and first nine months of 2013, respectively, increases of 20% and 19% compared to the same periods in 2012. For the first nine months of 2013, iPhone year-over-year growth resulted from strong demand for iPhone in all of the Company s operating segments primarily due to the launch of iPhone 5 beginning in September 2012 and strong ongoing demand for iPhone 4 and 4S. All of the Company s operating segments except Greater China experienced increases in net sales and unit sales of iPhone during the third quarter of 2013 compared to the same period in 2012. The year-over-year impact of higher iPhone unit sales was partially offset during the third quarter and first nine months of 2013 by reductions in iPhone average selling prices in almost all of the Company s operating segments primarily as a result of a shift in product mix towards lower-priced iPhone models, particularly iPhone 4. Net sales of iPhone accounted for 51% and 45% of the Company s total net sales for the third quarters of 2013 and 2012, respectively, and were 54% and 51% of the Company s total net sales during the first nine months of 2013 and 2012, respectively.

iPad

Net sales of iPad were $6.4 billion and $25.8 billion in the third quarter and first nine months of 2013, respectively. While iPad net sales during the third quarter of 2013 decreased $2.4 billion or 27% compared to the third quarter of 2012, iPad net sales increased by $2.0 billion or 8% during the first nine months of 2013 compared to the same period in 2012. Unit sales of iPad were 14.6 million and 57.0 million during the third quarter and first nine months of 2013, respectively, a decrease of 14% compared to the third quarter of 2012 and an increase of 29% compared to the first nine months of 2012. The increase in net sales and unit sales of iPad during the first nine months of 2013 resulted from strong growth in unit sales in all of the Company s operating segments. This growth was driven by the launch of iPad mini and the fourth generation iPad beginning in the first quarter of 2013. The year-over-year growth rate of total iPad unit sales was higher than the growth rate of total iPad net sales during the first nine months of 2013 due to a reduction in average selling prices in all of the Company s operating segments primarily as a result of the introduction of iPad mini and a price reduction on iPad 2. The year-over-year decrease in net sales of iPad during the third quarter of 2013 compared to the same period in 2012 reflects the reduction in average selling price in all of the Company s operating segments and lower iPad unit sales in all of the Company s operating segments except Japan. The launch of the third-generation iPad in many countries around the world beginning March 2012 without a comparable new iPad product introduction in the same period in 2013 contributed to the decline in third quarter iPad unit sales. Net sales of iPad accounted for 18% and 25% of the Company s total net sales for the third quarters of 2013 and 2012, respectively, and were 19% and 20% of the Company s total net sales during the first nine months of 2013 and 2012, respectively.

Mac

Net sales of Mac were $4.9 billion and $15.9 billion in the third quarter and first nine months of 2013, respectively, decreases of $40 million or 1% and $745 million or 4% compared to the same periods in 2012. Mac unit sales decreased by 266 thousand or 7% and 1.5 million or 11% in the third quarter and first nine months of 2013 compared to the same periods in 2012. Mac net sales and unit sales for the first nine months of 2013 were relatively flat or somewhat down in all of the Company s operating segments. The decline in Mac net sales reflects the overall weakness in the market for personal computers. Net sales of Mac accounted for 14% of the Company s total net sales in the third quarters of 2013 and 2012, respectively, and were 12% and 14% of the Company s total net sales during the first nine months of 2013 and 2012, respectively.

iTunes, Software and Services

Net sales of iTunes, software and services were $4.0 billion and $11.8 billion in the third quarter and first nine months of 2013, respectively, increases of $787 million or 25% and $2.4 billion or 26% compared to the same periods in 2012. These increases were primarily due to growth in net sales from iTunes, AppleCare and licensing. iTunes generated total net sales of $2.4 billion and $6.9 billion for the third quarter and first nine months of 2013 compared to net sales of $1.8 billion and $5.5 billion during the same periods in 2012. iTunes growth reflects continued growth in the installed base of iOS devices and expanded offerings of iTunes digital content and applications around the world, resulting in higher net sales on the App Store and higher net sales of digital content. Net sales of iTunes, software and services accounted for 11% and 9% of the Company s total net sales for the third quarters of 2013 and 2012, respectively, and were 9% and 8% of the Company s total net sales during the first nine months of 2013 and 2012, respectively.

Segment Operating Performance

The Company manages its business primarily on a geographic basis. Prior to 2013, the Company s reportable operating segments consisted of the Americas, Europe, Japan, Asia-Pacific and Retail. In 2013, the Company established a new reportable operating segment, Greater China, which was previously included in the Asia-Pacific segment. Segment data for prior periods has been reclassified to reflect establishment of the Greater China 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 Greater China segment includes China, Hong Kong and Taiwan. The Rest of Asia Pacific segment includes Australia and Asian countries, other than Japan and those countries included in the Greater China segment. The Retail segment operates Apple retail stores in 13 countries, including the U.S. The results of the Americas, Europe, Greater China, Japan and Rest of Asia Pacific segments do not include results of the Retail segment. Each operating segment provides similar hardware and software products and similar services. Further information regarding the Company s operating segments may be found in Note 8, Segment Information and Geographic Data in Notes to Condensed Consolidated Financial Statements of this Form 10-Q.

Americas

Net sales in the Americas segment increased $1.6 billion or 12% during the third quarter of 2013 compared to the third quarter of 2012, and increased $5.1 billion or 12% during the first nine months of 2013 compared to the same period in 2012. The growth in net sales during the first nine months of 2013 was driven by increased sales of iPhone, increased sales of iPad, particularly iPad mini, and higher sales from iTunes. These increases were partially offset by a decrease in net sales of iPod and, to a lesser extent, Mac. The growth in net sales during the third quarter of 2013 compared to the same period in 2012 primarily reflects growth in net sales of iPhone and higher sales from iTunes, partially offset by declines in net sales of iPad, Mac and iPod. The Americas segment s net sales were 41% and 37% of the Company s total net sales in the third quarters of 2013 and 2012, respectively, and 36% of total net sales for both the first nine months of 2013 and 2012.

Europe

Net sales in the Europe segment decreased $623 million or 8% during the third quarter of 2013 compared to the third quarter of 2012, and increased $1.6 billion or 6% during the first nine months of 2013 compared to the same period in 2012. Net sales during the third quarter of 2013 were negatively impacted by reductions of both iPhone and iPad channel inventory, and reflect decreases in net sales of iPad, iPod and, to a lesser extent, Mac. These factors were partially offset by increases in net sales of iPhone and higher sales from iTunes. The growth in net sales during the first nine months of 2013 was primarily driven by increased sales of iPhone, iPad and higher sales from iTunes. These increases were partially offset by decreases in net sales of Mac and iPod. Net sales in the Europe segment continue to be negatively impacted by the region s uncertain economic conditions. The Europe segment s net sales were 21% and 23% of the Company s total net sales in the third quarters of 2013 and 2012, respectively, and 22% and 24% of total net sales for the first nine months of 2013 and 2012, respectively.

Greater China

Net sales in the Greater China segment decreased $748 million or 14% during the third quarter of 2013 compared to the third quarter of 2012, and increased $2.6 billion or 15% during the first nine months of 2013 compared to the same period in 2012. The growth in net sales during the first nine months of 2013 was primarily driven by the launch of iPhone 5 in China during the first quarter of 2013 and by the impact of launching the fourth generation iPad and iPad mini during the second quarter of 2013. The decrease in net sales during the third quarter of 2013 was driven primarily by reduction of both iPhone and iPad channel inventory and a small decrease in demand for iPhone, partially offset by a small increase in demand for iPad. Furthermore, iPad sales in Hong Kong in the third quarter of 2012 were favorably impacted by the launch of the third-generation iPad without a comparable new iPad product introduction in the same period in 2013. The Greater China segment s net sales were 13% and 15% of the Company s total net sales for the third quarters of 2013 and 2012, respectively, and 15% and 14% of total net sales for the first nine months of 2013 and 2012, respectively.

Japan

Net sales in the Japan segment increased $534 million or 27% during the third quarter of 2013 compared to the third quarter of 2012, and increased $1.9 billion or 23% during the first nine months of 2013 compared to the same period in 2012. The growth in net sales during the third quarter and first nine months of 2013 resulted primarily from increased unit sales of iPhone and iPad, higher sales from iTunes, and an increase in iPhone channel inventory during the third quarter of 2013. These factors were partially offset by the impact of the increased strength of the U.S. dollar relative to the Japanese Yen. The Japan segment s net sales were 7% and 6% of the Company s total net sales for the third quarters of 2013 and 2012, respectively, and 8% and 7% of total net sales for the first nine months of 2013 and 2012, respectively.

Rest of Asia Pacific

Net sales in the Rest of Asia Pacific segment decreased $452 million or 18% during the third quarter of 2013 compared to the third quarter of 2012, and increased $570 million or 7% during the first nine months of 2013 compared to the same period in 2012. The decrease in net sales during the third quarter of 2013 was primarily driven by decreased net sales of iPad and iPod, partially offset by increased net sales of iPhone and higher sales from iTunes. The growth in net sales during the first nine months of 2013 was primarily driven by the launch of iPhone 5 and higher sales from iTunes, partially offset by a decrease in net sales of iPad and Mac. The Rest of Asia Pacific segment s net sales were 6% and 7% of the Company s total net sales for the third quarters of 2013 and 2012, respectively, and 7% of total net sales for the first nine months of 2013 and 2012.

Retail

Net sales in the Retail segment decreased $10 million during the third quarter of 2013 compared to the third quarter of 2012, and increased $1.2 billion or 8% during the first nine months of 2013 compared to the same period in 2012. The decrease in net sales during the third quarter of 2013 compared to the same period in 2012 was primarily driven by decreased net sales of iPad and iPod, partially offset by increased net sales of iPhone, Mac, software and services, and accessories. The growth in net sales during the first nine months of 2013 was primarily driven by increased unit sales of iPhone and iPad and increased sales of software and services, and accessories. The Company opened six new retail stores during the third quarter of 2013, five of which were outside the United States, ending the quarter with 408 stores compared to 372 stores at the end of the third quarter of 2012. With an average of 405 and 367 open stores during the third quarter of 2013 and 2012, respectively, average revenue per store decreased to $10.1 million in the third quarter of 2013, compared to $11.1 million in the third quarter of 2012. Average revenue per store was $39.3 million and $40.3 million for the first nine months of 2013 and 2012, respectively. The Retail segment s net sales were 12% of the Company s total net sales in both the third quarters of 2013 and 2012 and both the first nine months of 2013 and 2012.

The Retail segment reported operating income of $667 million during the third quarter of 2013 as compared to $828 million during the third quarter of 2012, and reported operating income of $3.3 billion during the first nine months of 2013 compared to $3.8 billion during the first nine months of 2012. The year-over-year decrease in Retail operating income during the third quarter and first nine months of 2013 was primarily attributable to an overall decline in the Retail segment s gross margin percentage similar to that experienced by the Company overall. As of June 29, 2013, the Retail segment had approximately 41,700 full-time equivalent employees.

Gross Margin

Gross margin for the three- and nine-month periods ended June 29, 2013 and June 30, 2012 was as follows (in millions, except gross margin percentages):

	Three Months Ended		Nine Months Ended	
	June 29, 2013	**June 30, 2012**	**June 29, 2013**	**June 30, 2012**
Net sales	$ 35,323	$ 35,023	$ 133,438	$ 120,542
Cost of sales	22,299	20,029	83,005	66,281
Gross margin	$ 13,024	$ 14,994	$ 50,433	$ 54,261
Gross margin percentage	36.9%	42.8%	37.8%	45.0%

The gross margin percentage in the third quarter of 2013 was 36.9% compared to 42.8% in the third quarter of 2012, and the gross margin percentage for the first nine months of 2013 was 37.8% compared to 45.0% in the first nine months of 2012. The year-over-year decrease in gross margin during the third quarter and first nine months of 2013 was driven by multiple factors including introduction of new versions of existing products with higher cost structures and flat or reduced pricing, introduction of iPad mini with gross margin significantly below the Company s average product margins, higher expenses associated with changes to certain of the Company s service policies and other warranty costs, and price reductions on certain products, including iPad 2 and iPhone 4.

The Company expects its gross margin percentage to be lower in 2013 than experienced in 2012, and the Company anticipates gross margin to be between 36% and 37% during the fourth quarter of 2013. The lower gross margin expected in 2013 is largely due to anticipation of a higher mix of new and innovative products with flat or reduced pricing that have higher cost structures and deliver greater value to customers and anticipated component cost and other cost increases. Future strengthening of the U.S. dollar could further negatively impact gross margin.

The foregoing statements regarding the Company s expected gross margin percentage in 2013 and the fourth quarter of 2013 are forward-looking and could differ from actual results because of several factors including, but not limited to, those discussed below in Part II, Item 1A, Risk Factors of this Form 10-Q and those described in this paragraph. 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, potential increases in the cost of components, and potential strengthening of the U.S. dollar, as well as potential increases in the costs of outside manufacturing services and a potential shift in the Company s sales mix towards products with lower gross margins. In response to competitive pressures, the Company expects it will continue to take product pricing actions, which would adversely affect gross margins. Gross margins could also be affected by the Company s ability to manage product quality and warranty costs effectively and to stimulate demand for certain of its products. Due to the Company s significant international operations, financial results can be significantly affected in the short-term by fluctuations in exchange rates.

Operating Expenses

Operating expenses for the three- and nine-month periods ended June 29, 2013 and June 30, 2012, were as follows (in millions, except for percentages):

	Three Months Ended		Nine Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Research and development expense	$ 1,178	$ 876	$ 3,307	$ 2,475
Percentage of net sales	3%	3%	3%	2%
Selling, general and administrative expense	$ 2,645	$ 2,545	$ 8,157	$ 7,489
Percentage of net sales	8%	7%	6%	6%
Total operating expenses	$ 3,823	$ 3,421	$ 11,464	$ 9,964
Percentage of net sales	11%	10%	9%	8%

Research and Development (R&D) Expense

R&D expense increased $302 million or 34% during the third quarter of 2013 compared to the third quarter of 2012 and increased $832 million or 34% during the first nine months of 2013 compared to the same period in 2012. These increases were primarily due to an increase in headcount and related expenses to support expanded R&D activities. The Company continues to believe that focused investments in R&D are critical to its future growth and competitive position in the marketplace and are directly related to timely development of new and enhanced products that are central to the Company s core business strategy. As such, the Company expects to make further investments in R&D to remain competitive.

Selling, General and Administrative (SG&A) Expense

SG&A expense increased $100 million or 4% during the third quarter of 2013 compared to the third quarter of 2012, and increased $668 million or 9% during the first nine months of 2013 compared to the same period in 2012. These increases were primarily due to the Company s continued expansion of its Retail segment and increased headcount and related expenses, partially offset by lower spending on professional services.

Other Income and Expense

Other income and expense for the three- and nine-month periods ended June 29, 2013 and June 30, 2012, was as follows (in millions):

	Three Months Ended		Nine Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Interest and dividend income	$ 385	$ 292	$ 1,226	$ 774
Interest expense	(53)	0	(53)	0
Other income/(expense), net	(98)	(4)	(130)	(201)
Total other income/(expense), net	$ 234	$ 288	$ 1,043	$ 573

Total other income and expense decreased by $54 million during the third quarter of 2013 compared to the third quarter of 2012, and increased by $470 million during the first nine months of 2013 compared to the same period in 2012. The overall decrease in other income and expense during the third quarter of 2013 was due primarily to interest expense on debt and remeasurement losses from foreign exchange rate movements, partially offset by higher interest and dividend income resulting from the Company s higher cash, cash equivalents and marketable securities balances. The overall increase in other income and expense over the first nine months of 2013 compared to the same period in 2012 was due primarily to higher interest and dividend income on the Company s higher cash, cash equivalents and marketable securities balances and lower premium expenses on foreign exchange contracts, partially offset by interest expense on debt. The weighted-average interest rate earned by the Company on its cash, cash equivalents and marketable securities was 1.00% and 1.06% in the third quarters of 2013 and 2012, respectively, and 1.04% and 1.03% in the first nine months of 2013 and 2012, respectively.

Provision for Income Taxes

The Company s effective tax rates for the three- and nine-month periods ended June 29, 2013 were 26.9% and 26.2%, respectively, compared to 25.6% and 25.3% for the three- and nine-month periods ended June 30, 2012, respectively. The Company s effective rates for both periods differ from the statutory federal income tax rate of 35% due primarily to certain undistributed foreign earnings, a substantial portion of which was generated by subsidiaries organized in Ireland, for which no U.S. taxes are provided because such earnings are intended to be indefinitely reinvested outside the U.S. The higher effective tax rate during the third quarter and first nine months of 2013 as compared to the same periods of 2012 is due primarily to a lower proportion of foreign earnings in 2013.

The Internal Revenue Service (the IRS) has completed its field audit of the Company s federal income tax returns for the years 2004 through 2006 and proposed certain adjustments. The Company has contested certain of these adjustments through the IRS Appeals Office. The IRS is currently examining the years 2007 through 2009. All IRS audit issues for years prior to 2004 have been resolved. In addition, the Company is subject to audits by state, local, and foreign tax authorities. Management believes that adequate provisions have been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company s tax audits are resolved in a manner not consistent with management s expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs.

Liquidity and Capital Resources

The following table presents selected financial information and statistics as of June 29, 2013 and September 29, 2012 (in millions):

	June 29, 2013	September 29, 2012
Cash, cash equivalents and marketable securities	$ 146,620	$ 121,251
Accounts receivable, net	$ 8,839	$ 10,930
Inventories	$ 1,697	$ 791
Working capital	$ 31,900	$ 19,111

As of June 29, 2013, the Company had $146.6 billion in cash, cash equivalents and marketable securities, an increase of $25.4 billion from September 29, 2012. The principal components of this net increase were the cash generated by operating activities of $43.8 billion and the net proceeds from the issuance of long-term debt of $16.9 billion, which was partially offset by cash used to repurchase common stock of $18 billion, cash used to pay dividends and dividend equivalent rights of $7.8 billion and payments made for acquisition of property, plant and equipment and intangible assets of $6.8 billion.

The Company s marketable securities investment portfolio is invested primarily in highly-rated securities and its investment policy generally limits the amount of credit exposure to any one issuer. The policy requires investments generally to be investment grade with the objective of minimizing the potential risk of principal loss. As of June 29, 2013 and September 29, 2012, $106.0 billion and $82.6 billion, respectively, of the Company s cash, cash equivalents and marketable securities were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S. The Company believes its existing balances of cash, cash equivalents and marketable securities will be sufficient to satisfy its working capital needs, capital asset purchases, outstanding commitments, and other liquidity requirements associated with its existing operations over the next 12 months. The Company anticipates the cash used for future dividends and the share repurchase program will come from its current domestic cash, cash generated from on-going U.S. operating activities and from borrowings.

Long-Term Debt

In May 2013, the Company issued floating- and fixed-rate notes with varying maturities for an aggregate principal amount of $17 billion, of which $2.5 billion is due in 2016 and $14.5 billion is due between 2018 and 2043.

Capital Assets

The Company s capital expenditures were $5.2 billion during the first nine months of 2013 consisting of $309 million for retail store facilities and $4.9 billion for other capital expenditures, including product tooling and manufacturing process equipment, and other corporate facilities and infrastructure. The Company s actual cash payments for capital expenditures during the first nine months of 2013 were $6.2 billion.

The Company anticipates utilizing approximately $8.5 billion for capital expenditures during 2013, including approximately $600 million for retail store facilities and approximately $7.9 billion for other capital expenditures, including for product tooling and manufacturing process equipment, and corporate facilities and infrastructure, including information systems hardware, software and enhancements.

During 2013, the Company expects to open approximately 27 new retail stores, with more than three-quarters located outside of the U.S.

Dividend and Share Repurchase Program

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

In 2012, the Company s Board of Directors authorized a program to repurchase up to $10 billion of the Company s common stock. In April 2013, the Company s Board of Directors increased the share repurchase program authorization from $10 billion to $60 billion, of which $18 billion had been utilized as of June 29, 2013. The share repurchase program is expected to be completed by December 2015. The Company s share repurchase program does not obligate it to acquire any specific number of shares. Under the program, shares may be repurchased in privately negotiated or open market transactions, including under plans complying with Rule 10b5-1 of the Exchange Act.

Beginning in August 2012 through December 2015, the Company anticipates it will utilize approximately $100 billion to pay dividends, repurchase shares, and to remit withheld taxes related to net share settlement of restricted stock units, of which $29 billion had been utilized through June 29, 2013.

Off-Balance Sheet Arrangements and Contractual Obligations

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

Lease Commitments

The Company s major facility leases are typically for terms not exceeding 10 years and generally provide renewal options for terms not exceeding five additional years. Leases for retail space are for terms ranging from five to 20 years, the majority of which are for 10 years, and often contain multi-year renewal options. As of June 29, 2013, the Company s total future minimum lease payments under noncancelable operating leases were $4.6 billion, of which $3.3 billion related to leases for retail space.

Purchase Commitments with Outsourcing Partners and Component Suppliers

The Company utilizes several outsourcing partners to manufacture sub-assemblies for the Company s products and to perform final assembly and testing of finished products. These outsourcing partners acquire components and build product based on demand information supplied by the Company, which typically covers periods up to 150 days. The Company also obtains individual components for its products from a wide variety of individual suppliers. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders in each case based on projected demand. Where appropriate, the purchases are applied to inventory component prepayments that are outstanding with the respective supplier. As of June 29, 2013, the Company had outstanding off-balance sheet third-party manufacturing commitments and component purchase commitments of $13.0 billion.

Other Obligations

In addition to the commitments mentioned above, the Company had additional off-balance sheet obligations of $1.4 billion as of June 29, 2013, that were comprised mainly of commitments to acquire capital assets, including product tooling and manufacturing process equipment, and commitments related to advertising, research and development, Internet and telecommunications services and other obligations.

The Company s other non-current liabilities in the Condensed Consolidated Balance Sheets consist primarily of deferred tax liabilities, gross unrecognized tax benefits and the related gross interest and penalties. As of June 29, 2013, the Company had non-current deferred tax liabilities of $16.1 billion. Additionally, as of June 29, 2013, the Company had gross unrecognized tax benefits of $3.4 billion and an additional $501 million for gross interest and penalties classified as non-current liabilities. At this time, the Company is unable to make a reasonably reliable estimate of the timing of payments due to uncertainties in the timing of tax audit outcomes.

Indemnification

The Company generally does not indemnify end-users of its operating system and application software against legal claims that the software infringes third-party intellectual property rights. Other agreements entered into by the Company sometimes include indemnification provisions under which the Company could be subject to costs and/or damages in the event of an infringement claim against the Company or an indemnified third-party. However, the Company has not been required to make any significant payments resulting from such an infringement claim asserted against it or an indemnified third-party. In the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss with respect to indemnification of end-users of its operating system or application software for infringement of third-party intellectual property rights. The Company did not record a liability for infringement costs related to indemnification as of June 29, 2013 or September 29, 2012.

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

In the third quarter of 2013, the Company issued $17 billion of long-term debt, which included $3 billion of floating-rate notes. To manage the risk associated with the floating-rate notes, the Company entered into interest rate swaps with an aggregate notional amount of $3 billion, which, in effect, fixed the interest rate of the floating-rate notes. The Company s market risk disclosures set forth in Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk of its 2012 Form 10-K have not changed materially for the nine months ended June 29, 2013.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on an evaluation under the supervision and with the participation of the Company s management, the Company s principal executive officer and principal financial officer have concluded that the Company s disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act were effective as of June 29, 2013 to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the 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 third quarter of 2013, which were identified in connection with management s evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company is subject to the various legal proceedings and claims discussed below as well as certain other legal proceedings and claims that have not been fully resolved and that have arisen in the ordinary course of business. In the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies. However, the outcome of legal proceedings and claims brought against the Company is subject to significant uncertainty. Therefore, although management considers the likelihood of such an outcome to be remote, if one or more of these legal matters were resolved against the Company in a reporting period for amounts in excess of management s expectations, the Company s consolidated financial statements for that reporting period could be materially adversely affected. See the risk factors *The Company is frequently involved in intellectual property litigation, and could be found to have infringed on intellectual property rights* and *The Company could be impacted by unfavorable results of legal proceedings* in Part II, Item 1A of this Form 10-Q under the heading Risk Factors. The Company settled certain matters during the third quarter of 2013 that did not individually or in the aggregate have a material impact on the Company s financial condition and results of operations.

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

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

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

On April 11, 2012, the U.S. Department of Justice (the DOJ) filed a civil antitrust action against the Company and five major book publishers in the U.S. District Court for the Southern District of New York, alleging an unreasonable restraint of interstate trade and commerce in violation of §1 of the Sherman Act and seeking, among other things, injunctive relief, the District Court s declaration that the Company s agency agreements with the publishers are null and void and/or the District Court s reformation of such agreements. The DOJ s complaint asserted, among other things, that the decision by the five publishers to shift to an agency model to sell eBooks and their agreements with the Company were an attempt to raise, fix and stabilize retail e-book prices, to end price competition among e-book retailers, and to limit retail price competition. The Company filed a response to the DOJ complaint in late May 2012, denying the DOJ s allegations. All five publishers reached a settlement with the DOJ, which required the publishers to terminate their agreements with the Company and renegotiate new agreements pursuant to the terms of their settlement with the DOJ. On July 10, 2013, the District Court found, following a bench trial, that the Company conspired to restrain trade in violation of §1 of the Sherman Act and relevant state statutes to the extent those laws are congruent with §1 of the Sherman Act. The District Court also stated that the plaintiffs in the case were entitled to injunctive relief and that a trial on damages would follow. The Company intends to appeal the District Court s decision.

Item 1A. Risk Factors

The following description of risk factors includes any material changes to, and supersedes the description of, risk factors associated with the Company s business previously disclosed in Part I, Item 1A of the Company s 2012 Form 10-K and in Part II, Item 1A of the Form 10-Q for the quarters ended December 29, 2012 and March 30, 2013, in each case under the heading Risk Factors. The business, financial condition and operating results of the Company can be affected by a number of factors, whether currently known or unknown, including but not limited to those described below, any one or more of which could, directly or indirectly, cause the Company s actual results of operations and financial condition to vary materially from past, or from anticipated future, results of operations and financial condition. Any of these factors, in whole or in part, could materially and adversely affect the Company s business, financial condition, results of operations and common stock price.

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

Global economic conditions could materially adversely affect the Company.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Because the Company currently obtains components from single or limited sources, the Company is subject to significant supply and pricing risks. Many components, including those that are available from multiple sources, are at times subject to industry-wide shortages and significant commodity pricing fluctuations. While the Company has entered into various agreements for the supply of components, there can be no assurance that the Company will be able to extend or renew these agreements on similar terms, or at all. The follow-on effects from global economic conditions on the Company s suppliers, described in *Global economic conditions could materially adversely affect the Company* above, also could affect the Company s ability to obtain components. Therefore, the Company remains subject to significant risks of supply shortages and price increases. The Company expects its gross margin percentage to be lower in 2013 than experienced in 2012. The lower gross margin expected in 2013 is largely due to anticipation of a higher mix of new and innovative products with flat or reduced pricing that have higher cost structures and deliver greater value to customers and anticipated component cost and other cost increases. Future strengthening of the U.S. dollar could further negatively impact gross margin.

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

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

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

The supply and manufacture of many critical components is performed by sole-sourced outsourcing partners in the U.S., Asia and Europe. Outsourcing partners in Asia perform final assembly of substantially all of the Company s hardware products. Manufacturing or logistics in these locations or transit to final destinations may be disrupted for a variety of reasons including, but not limited to, natural and man-made disasters, information technology system failures, military actions or economic, business, labor, environmental, public health, or political issues.

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

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

Many of the Company s products include third-party intellectual property, which requires licenses from those third parties. Based on past experience and industry practice, the Company believes such licenses generally can be obtained on reasonable terms. There is, however, no assurance that the necessary licenses can be obtained on acceptable terms or at all.

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

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

The Company is frequently involved in intellectual property litigation, and could be found to have infringed on intellectual property rights.

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

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

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

In management s opinion, there is not at least a reasonable possibility the Company may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies, including matters related to infringement of intellectual property rights. However, the outcome of litigation is inherently uncertain. Therefore, although management considers the likelihood of such an outcome to be remote, if one or more of these legal matters were resolved against the Company in a reporting period for amounts in excess of management s expectations, the Company s consolidated financial statements for that reporting period could be materially adversely affected.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The Company may be subject to breaches of its information technology systems, which could damage business partner and customer relationships, could curtail or otherwise adversely impact access to online stores and services, and could subject the Company to significant reputational, financial, legal, and operational consequences.

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

The Company requires user names and passwords in order to access its information technology systems. The Company also uses encryption and authentication technologies to secure the transmission and storage of data. These security measures may be compromised as a result of third-party security breaches, employee error, malfeasance, faulty password management, or other irregularity, and result in persons obtaining unauthorized access to Company data or accounts. Third parties may attempt to fraudulently induce employees or customers into disclosing user names, passwords or other sensitive information, which may in turn be used to access the Company s information technology systems. To help protect customers and the Company, the Company monitors accounts and systems for unusual activity and may freeze accounts under suspicious circumstances, which may result in the delay or loss of customer orders.

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

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

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

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

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

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

The Company s profit margins vary among its products and its distribution channels. The Company s software, accessories, and service and support contracts generally have higher gross margins than certain of the Company s other products. Gross margins on the Company s hardware products vary across product lines and can change over time as a result of product transitions, pricing and configuration changes, and component, warranty, and other cost fluctuations. The Company s direct sales generally have higher associated gross margins than its indirect sales through its channel partners. In addition, the Company s gross margin and operating margin percentages, as well as overall profitability, may be materially adversely impacted as a result of a shift in product, geographic or channel mix, new products, component cost increases, the strengthening U.S. dollar, or price competition. The Company has typically experienced higher net sales in the first fiscal quarter compared to other fiscal quarters due in part to holiday seasonal demand. Actual and anticipated timing of new product introductions by the Company can also significantly impact the level of net sales experienced by the Company in any particular quarter. The Company could be subject to unexpected developments late in a quarter, such as lower-than-anticipated demand for the Company s products, issues with new product introductions, an internal systems failure, or failure of one of the Company s logistics, components supply, or manufacturing partners.

The Company s stock price is subject to volatility.

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

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

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

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

The Company s primary exposure to movements in foreign currency exchange rates relates to non-U.S. dollar denominated sales and operating expenses worldwide. For example, the uncertainty regarding the ability of certain European countries to continue to service their sovereign debt obligations and the related financial restructuring efforts by European governments may cause the value of several European currencies, including the euro, to fluctuate, which could adversely affect the Company s non-U.S. dollar sales and operating expenses in the impacted jurisdictions. Weakening of foreign currencies relative to the U.S. dollar adversely affects the U.S. dollar value of the Company s foreign currency-denominated sales and earnings, and generally leads the Company to raise international pricing, potentially reducing demand for the Company s products. In some circumstances, for competitive or other reasons, the Company may decide not to raise local prices to fully offset the dollar s strengthening, or at all, which would adversely affect the U.S. dollar value of the Company s foreign currency denominated sales and earnings. Conversely, a strengthening of foreign currencies relative to the U.S. dollar, while generally beneficial to the Company s foreign currency-denominated sales and earnings, could cause the Company to reduce international pricing and incur losses on its foreign currency derivative instruments, thereby limiting the benefit. Additionally, strengthening of foreign currencies may also increase the Company s cost of product components denominated in those currencies, thus adversely affecting gross margins.

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

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

The Company has not recognized any significant losses on its cash, cash equivalents and marketable securities, but could experience significant declines in the market value of its investment portfolio. Given the global nature of its business, the Company has both domestic and international investments. Credit ratings and pricing of these investments can be negatively affected by liquidity, credit deterioration, financial results, economic risk, political risk, sovereign risk or other factors. As a result, the value and liquidity of the Company s cash, cash equivalents and marketable securities could decline and result in a significant impairment.

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

The Company distributes its products through third-party cellular network carriers, wholesalers, retailers and value-added resellers. A substantial majority of the Company s outstanding trade receivables are not covered by collateral or credit insurance. The Company s exposure to credit and collectability risk on its trade receivables is higher in certain international markets and its ability to mitigate such risks may be limited. The Company also has unsecured vendor non-trade receivables resulting from purchases of components by outsourcing partners and other vendors that manufacture sub-assemblies or assemble final products for the Company. In addition, the Company has made prepayments associated with long-term supply agreements to secure supply of inventory components. As of June 29, 2013, a significant portion of the Company s trade receivables were concentrated within cellular network carriers, and its non-trade receivables and long-term supply agreements were concentrated among a few individual vendors located primarily in Asia. While the Company has procedures to monitor and limit exposure to credit risk on its trade and vendor non-trade receivables as well as long-term prepayments, there can be no assurance such procedures will effectively limit its credit risk and avoid losses.

The Company could be impacted by unfavorable results of legal proceedings.

The Company is subject to various legal proceedings and claims that have not yet been fully resolved and that have arisen in the ordinary course of business, and additional claims may arise in the future. Results of legal proceedings are subject to significant uncertainty and, regardless of the merit of the claims, litigation may be expensive, time-consuming, disruptive to the Company s operations, and distracting to management. In recognition of these considerations, the Company may enter into arrangements to settle litigation.

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

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

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

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

Share repurchase activity during the three months ended June 29, 2013 was as follows:

Q3 Fiscal Periods	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs (in millions) (a)
March 31, 2013 to May 4, 2013:				
August 2012 ASR	1,494,992 (b)	(b)	1,494,992 (b)	
April 2013 ASR	23,507,518 (c)	(c)	23,507,518 (c)	
Open Market Purchases	1,123,668	$ 444.94	1,123,668	
May 5, 2013 to June 1, 2013:				
Open Market Purchases	7,830,044	$ 447.00	7,830,044	
June 2, 2013 to June 29, 2013	0	$ 0	0	
Total	33,956,222		33,956,222	$ 42,050

(a) In 2012, the Company s Board of Directors authorized a program to repurchase up to $10 billion of the Company s common stock beginning in 2013. In April 2013, the Company s Board of Directors increased the share repurchase program authorization from $10 billion to $60 billion. The Company s share repurchase program does not obligate it to acquire any specific number of shares. Under the program, shares may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 of the Exchange Act. The $42.1 billion represents the remaining amount available to repurchase shares under the authorized repurchase program.

(b) In August 2012, the Company entered into an accelerated share repurchase arrangement (ASR) with a financial institution to purchase up to $1.95 billion of the Company s common stock. In April 2013, the purchase period for the ASR ended and an additional 1,494,992 shares were delivered and retired during the third quarter of 2013. In total, 4,077,774 shares were delivered under the ASR at an average repurchase price of $478.20 per share.

(c) In April 2013, the Company entered into a new ASR program with two financial institutions to purchase up to $12 billion of the Company s common stock. In exchange for up-front payments totaling $12 billion, the financial institutions committed to deliver shares during the ASR s purchase periods, which will end during 2014. The total number of shares ultimately delivered, and therefore the average price paid per share, will be determined at the end of the applicable purchase period based on the volume weighted average price of the Company s stock during that period. During the third quarter of 2013, 23,507,518 shares were initially delivered to the Company and retired. This does not represent the final number of shares to be delivered under the ASR. The up-front payments of $12 billion were accounted for as a reduction to shareholders equity in the Company s Condensed Consolidated Balance Sheet.

Item 3. Defaults Upon Senior Securities

None.

Item 5. Other Information

None.

Item 6. Exhibits
Index to Exhibits

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

* Indicates management contract or compensatory plan or arrangement.

** Filed herewith.

*** Furnished herewith.

SIGNATURE

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

July 24, 2013	APPLE INC.
	By: /s/ Peter Oppenheimer Peter Oppenheimer Senior Vice President, Chief Financial Officer