

APPLE INC

FORM 10-Q (Quarterly Report)

Filed 05/04/05 for the Period Ending 03/26/05

Address	ONE INFINITE LOOP CUPERTINO, CA 95014
Telephone	(408) 996-1010
CIK	0000320193
Symbol	AAPL
SIC Code	3571 - Electronic Computers
Industry	Computer Hardware
Sector	Technology
Fiscal Year	09/27

APPLE COMPUTER INC

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended March 26, 2005 OR

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

For the transition period from to .

Commission file number 0-10030

APPLE COMPUTER, INC.

(Exact name of Registrant as specified in its charter)

CALIFORNIA

(State or other jurisdiction
of incorporation or organization)

942404110

(I.R.S. Employer Identification No.)

1 Infinite Loop

Cupertino, California
(Address of principal executive offices)

95014

(Zip Code)

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

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

Yes No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

823,933,916 shares of common stock issued and outstanding as of April 22, 2005

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

APPLE COMPUTER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
(in millions, except share and per share amounts)

	Three Months Ended		Six Months Ended	
	March 26, 2005	March 27, 2004	March 26, 2005	March 27, 2004
Net sales	\$ 3,243	\$ 1,909	\$ 6,733	\$ 3,915
Cost of sales	2,275	1,379	4,769	2,849
Gross margin	968	530	1,964	1,066
Operating expenses:				
Research and development	119	123	242	242
Selling, general, and administrative	447	345	917	688
Restructuring costs	—	10	—	10
Total operating expenses	566	478	1,159	940
Operating income	402	52	805	126
Other income and expense:				
Gains on non-current investments	—	—	—	4
Interest and other income, net	33	12	59	21
Total other income and expense	33	12	59	25
Income before provision for income taxes	435	64	864	151
Provision for income taxes	145	18	279	42
Net income	\$ 290	\$ 46	\$ 585	\$ 109
Earnings per common share:				
Basic	\$ 0.36	\$ 0.06	\$ 0.73	\$ 0.15
Diluted	\$ 0.34	\$ 0.06	\$ 0.69	\$ 0.15
Shares used in computing earnings per share (in thousands):				
Basic	808,172	730,694	798,602	727,796
Diluted	857,011	756,460	848,553	750,336

See accompanying notes to condensed consolidated financial statements.

APPLE COMPUTER, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)
(in millions, except share amounts)

	<u>March 26, 2005</u>	<u>September 25, 2004</u>
ASSETS:		
Current assets:		
Cash and cash equivalents	\$ 2,254	\$ 2,969
Short-term investments	4,803	2,495
Accounts receivable, less allowances of \$51 and \$47, respectively	888	774
Inventories	164	101
Deferred tax assets	297	231
Other current assets	601	485
Total current assets	<u>9,007</u>	<u>7,055</u>
Property, plant and equipment, net	742	707
Goodwill	80	80
Acquired intangible assets	33	17
Other assets	249	191
Total assets	<u>\$ 10,111</u>	<u>\$ 8,050</u>
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	\$ 1,773	\$ 1,451
Accrued expenses	1,579	1,200
Total current liabilities	<u>3,352</u>	<u>2,651</u>
Non-current liabilities	373	323
Total liabilities	<u>3,725</u>	<u>2,974</u>
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value; 1,800,000,000 shares authorized; 823,136,748 and 782,887,234 shares issued and outstanding, respectively	3,195	2,514
Deferred stock compensation	(70)	(93)
Retained earnings	3,255	2,670
Accumulated other comprehensive income (loss)	6	(15)
Total shareholders' equity	<u>6,386</u>	<u>5,076</u>
Total liabilities and shareholders' equity	<u>\$ 10,111</u>	<u>\$ 8,050</u>

See accompanying notes to condensed consolidated financial statements.

APPLE COMPUTER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(in millions)

	Six Months Ended	
	March 26, 2005	March 27, 2004
Cash and cash equivalents, beginning of the period	\$ 2,969	\$ 3,396
Operating Activities:		
Net income	585	109
Adjustments to reconcile net income to cash generated by operating activities:		
Depreciation, amortization, and accretion	82	69
Stock based compensation expense	20	13
Provision for (benefit from) deferred income taxes	13	(4)
Tax benefit from stock options	275	12
Loss on disposition of property, plant, and equipment	4	—
Gains on non-current investments	—	(4)
Changes in operating assets and liabilities:		
Accounts receivable, net	(114)	181
Inventories	(63)	(7)
Other current assets	(116)	(17)
Other assets	(56)	(25)
Accounts payable	322	(163)
Other liabilities	359	116
Cash generated by operating activities	<u>1,311</u>	<u>280</u>
Investing Activities:		
Purchases of short-term investments	(5,304)	(976)
Proceeds from maturities of short-term investments	2,750	660
Proceeds from sales of short-term investments	242	52
Proceeds from sales of non-current investments	—	5
Purchases of property, plant, and equipment	(101)	(79)
Other	(19)	12
Cash used for investing activities	<u>(2,432)</u>	<u>(326)</u>
Financing Activities:		
Payment of long-term debt	—	(300)
Proceeds from issuance of common stock	406	108
Cash generated by (used for) financing activities	<u>406</u>	<u>(192)</u>
Decrease in cash and cash equivalents	(715)	(238)
Cash and cash equivalents, end of the period	<u>\$ 2,254</u>	<u>\$ 3,158</u>
Supplemental cash flow disclosures:		
Cash paid for interest	\$ —	\$ 10
Cash paid for income taxes, net	\$ 47	\$ 15

See accompanying notes to condensed consolidated financial statements.

APPLE COMPUTER, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 1 — Summary of Significant Accounting Policies

Apple Computer, Inc. and its subsidiaries (the Company) designs, manufactures and markets personal computers and related software, services, peripherals and networking solutions. The Company also designs, develops and markets a line of portable digital music players along with related accessories and services including the online distribution of third-party music and audio books. The Company sells its products worldwide through its online stores, its own retail stores, its direct sales force and third-party wholesalers, resellers and value added resellers. In addition to its own hardware, software and peripheral products, the Company sells a variety of third-party hardware and software products through its online and retail stores. The Company sells to education, consumer, creative professional, business and government customers.

Basis of Presentation and Preparation

The accompanying condensed consolidated financial statements include the accounts of the Company. Intercompany accounts and transactions have been eliminated. The preparation of these condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in these condensed consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates. Interim information is unaudited; however, in the opinion of the Company's management, all adjustments of a normal recurring nature necessary for a fair statement of interim periods presented have been included. The results for interim periods are not necessarily indicative of results to be expected for the entire year. Certain prior year amounts in these condensed consolidated financial statements and notes thereto have been reclassified to conform to the current period's presentation.

These condensed consolidated financial statements and accompanying notes should be read in conjunction with the Company's annual consolidated financial statements and the notes thereto for the fiscal year ended September 25, 2004, included in its Annual Report on Form 10-K for the year ended September 25, 2004 (the 2004 Form 10-K). Unless otherwise stated, references to particular years or quarters refer to the Company's fiscal years ended in September and the associated quarters of those fiscal years.

Common Stock Split

On February 28, 2005, the Company effected a two-for-one stock split to shareholders of record as of February 18, 2005. All share and per share information have been retroactively adjusted to reflect the stock split.

Research and Development

Research and development costs are expensed as incurred. Development costs of computer software to be sold, leased or otherwise marketed are subject to capitalization beginning when a product's technological feasibility has been established and ending when a product is available for general release to customers pursuant to Statement of Financial Accounting Standards (SFAS) No. 86, *Computer Software to be Sold, Leased, or Otherwise Marketed*. In most instances, the Company's products are released soon after technological feasibility has been established; therefore, costs incurred subsequent to achievement of technological feasibility are usually not significant, and generally all software development costs have been expensed.

In the fourth quarter of 2004, the Company began incurring substantial development costs associated with the latest version of Mac OS X (code-named "Tiger") subsequent to achievement of technological feasibility as evidenced by public demonstration in August 2004 and the subsequent release of a developer beta version of the product. Therefore, during the second quarter and first quarter of 2005 and the fourth quarter of 2004, the Company capitalized approximately \$14.7 million, \$14.8 million and \$4.5 million, respectively, of costs associated with the development of Tiger. Amortization of this asset to cost of sales will commence when Tiger begins shipping and will be recognized on a straight-line basis over a 3 year estimated useful life. The final version of the product was released in April 2005.

During the second quarter of 2004, the Company incurred substantial development costs associated with FileMaker Pro 7 subsequent to achievement of technological feasibility as evidenced by public demonstration and release of a developer beta version, and prior to the release of the final version of the product in March 2004. Therefore, during

the second quarter of 2004, the Company capitalized approximately \$2.3 million of costs associated with the development of FileMaker Pro 7. In accordance with SFAS No. 86, amortization of this asset to cost of sales began in March 2004 when FileMaker Pro 7 was shipped and is being recognized on a straight-line basis over a 3 year estimated useful life.

Stock-Based Compensation

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004) (SFAS 123R), *Share-Based Payment*, that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. SFAS 123R eliminates the ability to account for share-based compensation transactions using the intrinsic value method under Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and generally would require instead that such transactions be accounted for using a fair-value-based method. The Company is currently evaluating SFAS 123R to determine which fair-value-based model and transitional provision it will follow upon adoption. The options for transition methods as prescribed in SFAS 123R include either the modified prospective or the modified retrospective methods. The modified prospective method requires that compensation expense be recorded for all unvested stock options and restricted stock as the requisite service is rendered beginning with the first quarter of adoption, while the modified retrospective method would record compensation expense for stock options and restricted stock beginning with the first period restated. Under the modified retrospective method, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. SFAS 123R will be effective for the Company beginning in its first quarter of fiscal 2006. Although the Company will continue to evaluate the application of SFAS 123R, management expects adoption to have a material impact on its results of operations.

The Company currently measures compensation expense for its employee stock-based compensation plans using the intrinsic value method prescribed by APB Opinion No. 25. The Company applies the disclosure provisions of SFAS No. 123, *Accounting for Stock-based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-based Compensation – Transition and Disclosure* as if the fair-value-based method had been applied in measuring compensation expense. Under APB Opinion No. 25, when the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of the grant, no compensation expense is recognized.

As required under SFAS No. 123, the pro forma effects of stock-based compensation on net income and earnings per common share for employee stock options granted and employee stock purchase plan share purchases have been estimated at the date of grant and beginning of the period, respectively, using a Black-Scholes option pricing model. For purposes of pro forma disclosures, the estimated fair value of the options and shares is amortized to pro forma net income over the options' vesting period and the shares' plan period.

The Company's pro forma information for the three and six month periods ended March 26, 2005 and March 27, 2004 follows (in millions, except per share amounts):

	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>3/26/05</u>	<u>3/27/04</u>	<u>3/26/05</u>	<u>3/27/04</u>
Net income - as reported	\$ 290	\$ 46	\$ 585	\$ 109
Add: Stock-based employee compensation expense included in reported net income, net of tax	9	6	18	13
Deduct: Stock-based employee compensation expense determined under the fair-value-based method for all awards, net of tax	<u>(27)</u>	<u>(34)</u>	<u>(56)</u>	<u>(70)</u>
Net income - pro forma	<u>\$ 272</u>	<u>\$ 18</u>	<u>\$ 547</u>	<u>\$ 52</u>
Net income per common share - as reported				
Basic	\$ 0.36	\$ 0.06	\$ 0.73	\$ 0.15
Diluted	\$ 0.34	\$ 0.06	\$ 0.69	\$ 0.15
Net income per common share - pro forma				
Basic	\$ 0.34	\$ 0.02	\$ 0.68	\$ 0.07
Diluted	\$ 0.32	\$ 0.02	\$ 0.64	\$ 0.07

Earnings Per Share

Basic earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the dilutive potential shares of common stock had been issued. The dilutive effect of outstanding options, restricted stock and restricted stock units is reflected in diluted earnings per share by application of the treasury stock method. Under the treasury stock method, an increase in the fair market value of the Company's common stock can result in a greater dilutive effect from outstanding options, restricted stock and restricted stock units. Additionally, the exercise of employee stock options and the vesting of restricted stock and restricted stock units can result in a greater dilutive effect on earnings per share.

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except net income and per share amounts):

	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>3/26/05</u>	<u>3/27/04</u>	<u>3/26/05</u>	<u>3/27/04</u>
Numerator (in millions):				
Net income	<u>\$ 290</u>	<u>\$ 46</u>	<u>\$ 585</u>	<u>\$ 109</u>
Denominator:				
Weighted average-shares outstanding, excluding unvested restricted stock	808,172	730,694	798,602	727,796
Effect of dilutive options, restricted stock units and restricted stock	<u>48,839</u>	<u>25,766</u>	<u>49,951</u>	<u>22,540</u>
Denominator for diluted earnings per share	<u>857,011</u>	<u>756,460</u>	<u>848,553</u>	<u>750,336</u>
Basic earnings per share	<u>\$ 0.36</u>	<u>\$ 0.06</u>	<u>\$ 0.73</u>	<u>\$ 0.15</u>
Diluted earnings per share	<u>\$ 0.34</u>	<u>\$ 0.06</u>	<u>\$ 0.69</u>	<u>\$ 0.15</u>

Potentially dilutive securities, including stock options, restricted stock units, and restricted stock, to acquire approximately 0.9 million and 13.7 million shares of common stock for the three months ended March 26, 2005 and March 27, 2004, respectively, and 1.1 million and 18.6 million shares of common stock for the six months ended March 26, 2005 and March 27, 2004, respectively were excluded from the computation of diluted earnings per share for these periods because their effect would have been antidilutive.

Note 2 – Financial Instruments

Cash, Cash Equivalents and Short-Term Investments

The following table summarizes the fair value of the Company's cash and available-for-sale securities held in its short-term investment portfolio, recorded as cash and cash equivalents or short-term investments as of March 26, 2005 and September 25, 2004 (in millions):

	<u>3/26/05</u>	<u>9/25/04</u>
Cash	\$ 165	\$ 200
U.S. Treasury and Agency securities	3	87
U.S. corporate securities	1,255	1,795
Foreign securities	831	887
Total cash equivalents	<u>2,089</u>	<u>2,769</u>
U.S. Treasury and Agency securities	870	1,080
U.S. corporate securities	3,272	1,352
Foreign securities	661	63
Total short-term investments	<u>4,803</u>	<u>2,495</u>
Total cash, cash equivalents, and short-term investments	<u>\$ 7,057</u>	<u>\$ 5,464</u>

The Company's short-term investment portfolio consists of investments in U.S. Treasury and Agency securities, U.S. corporate securities, and foreign securities. The Company's U.S. corporate securities consist primarily of commercial paper, certificates of deposit, time deposits and corporate debt securities. Foreign securities consist primarily of foreign commercial paper, certificates of deposit and time deposits with foreign institutions, most of which are denominated in U.S. dollars. The Company had net unrealized losses, net of taxes, of \$5.8 million on its investment portfolio, approximately half of which related to investments with stated maturities of less than one year, as of March 26, 2005. As of September 25, 2004, the Company had net unrealized losses, net of taxes, of \$4 million on its investment portfolio, primarily related to investments with stated maturities of less than one year. The Company occasionally sells short-term investments prior to their stated maturities. No material gains or losses were recognized on any such sales during the three and six month periods ending March 26, 2005 or March 27, 2004.

As of March 26, 2005 and September 25, 2004, \$327 million and \$180 million, respectively, of the Company's investment portfolio that was classified as short-term investments had maturities ranging from 1 to 5 years. The remainder of the Company's short-term investments had underlying maturities between 3 and 12 months.

Derivative Financial Instruments

The Company uses derivatives to partially offset its business exposure to foreign exchange and interest rate risk. Foreign currency forward and option contracts are used to offset the foreign exchange risk on certain existing assets and liabilities and to hedge the foreign exchange risk on expected future cash flows on certain forecasted revenue and cost of sales. From time to time, the Company enters into interest rate derivative agreements to modify the interest rate profile of certain investments and debt. The Company's accounting policies for these instruments are based on whether the instruments are designated as hedge or non-hedge instruments. As of the end of the first six months of 2005, the general nature of the Company's risk management activities and the general nature and mix of the Company's derivative financial instruments have not changed materially from the end of fiscal 2004.

Foreign Exchange Risk Management

The Company may enter into foreign currency forward and option contracts with financial institutions to protect against foreign exchange risk associated with existing assets and liabilities, certain firmly committed transactions and

forecasted future cash flows. Generally, the Company's practice is to hedge a majority of its existing material foreign exchange transaction exposures. However, the Company may not hedge certain foreign exchange transaction exposures due to immateriality, prohibitive economic cost of hedging particular exposures, or limited availability of appropriate hedging instruments.

Accounting for Derivative Financial Instruments

The Company accounts for all derivatives at fair value. Derivatives that are not hedges are adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in fair value will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings. As of March 26, 2005, the Company had a net deferred gain associated with cash flow hedges of approximately \$3.8 million net of taxes, substantially all of which is expected to be reclassified to earnings by the end of the fourth quarter of fiscal 2005.

Note 3 – Condensed Consolidated Financial Statement Details (in millions)

Inventories

	<u>3/26/05</u>	<u>9/25/04</u>
Purchased parts	\$ 1	\$ 1
Finished goods	163	100
Total inventories	<u>\$ 164</u>	<u>\$ 101</u>

Other Current Assets

	<u>3/26/05</u>	<u>9/25/04</u>
Vendor non-trade receivables	\$ 354	\$ 276
Other current assets	247	209
Total other current assets	<u>\$ 601</u>	<u>\$ 485</u>

Property, Plant, and Equipment, Net

	<u>3/26/05</u>	<u>9/25/04</u>
Land and buildings	\$ 354	\$ 351
Machinery, equipment, and internal-use software	460	422
Office furniture and equipment	82	79
Leasehold improvements	474	446
	<u>1,370</u>	<u>1,298</u>
Accumulated depreciation and amortization	<u>(628)</u>	<u>(591)</u>
Total property, plant, and equipment, net	<u>\$ 742</u>	<u>\$ 707</u>

Other Assets

	<u>3/26/05</u>	<u>9/25/04</u>
Non-current deferred tax assets	\$ 88	\$ 86
Capitalized software development costs, net	48	25
Other assets	113	80
Total other assets	<u>\$ 249</u>	<u>\$ 191</u>

Accrued Expenses

	<u>3/26/05</u>	<u>9/25/04</u>
Deferred revenue - current	\$ 427	\$ 342
Accrued marketing and distribution	186	147
Accrued compensation and employee benefits	164	134
Accrued warranty and related costs	154	105
Other current liabilities	648	472
Total accrued expenses	<u>\$ 1,579</u>	<u>\$ 1,200</u>

Non-current Liabilities

	3/26/05	9/25/04
Deferred revenue - non-current	\$ 231	\$ 202
Deferred tax liabilities	132	113
Other non-current liabilities	10	8
Total non-current liabilities	<u>\$ 373</u>	<u>\$ 323</u>

Interest and Other Income, Net

	Three Months Ended		Six Months Ended	
	3/26/05	3/27/04	3/26/05	3/27/04
Interest income	\$ 39	\$ 15	\$ 67	\$ 29
Interest expense	—	(1)	—	(3)
Other income (expense), net	(6)	(2)	(8)	(5)
Interest and other income, net	<u>\$ 33</u>	<u>\$ 12</u>	<u>\$ 59</u>	<u>\$ 21</u>

Note 4 – Restructuring Actions

2004 Restructuring Actions

The Company recorded total restructuring charges of approximately \$23 million during the year ended September 25, 2004, including approximately \$14 million in severance costs, \$5.5 million in asset impairments, and a \$3.5 million charge for lease cancellations. Of the \$23 million charge, \$18.4 million had been utilized by the end of the second quarter of 2005, with the remaining \$4.6 million consisting of \$1.5 million for employee severance benefits and \$3.1 million for lease cancellations. These actions will result in the termination of 485 positions, 441 of which had been terminated prior to the end of the second quarter of 2005.

The following table summarizes activity associated with restructuring actions initiated during fiscal 2004 (in millions):

	Employee Severance Benefits	Asset Impairments	Lease Cancellations	Totals
Total charge	\$ 14.0	\$ 5.5	\$ 3.5	\$ 23.0
Total spending through March 26, 2005	(12.0)	—	(0.4)	(12.4)
Total non-cash items	—	(5.2)	—	(5.2)
Adjustments	(0.5)	(0.3)	—	(0.8)
Accrual at March 26, 2005	<u>\$ 1.5</u>	<u>\$ —</u>	<u>\$ 3.1</u>	<u>\$ 4.6</u>

2003 Restructuring Actions

The Company recorded total restructuring charges of approximately \$26.8 million during the year ended September 27, 2003, including approximately \$7.4 million in severance costs, a \$5.0 million charge to write-off deferred compensation, \$7.1 million in asset impairments and a \$7.3 million charge for lease cancellations. Of the \$26.8 million charge, all had been utilized by the end of the second quarter of 2005, except for approximately \$2.3 million related to operating lease costs on abandoned facilities.

The following table summarizes activity associated with restructuring actions initiated during fiscal 2003 (in millions):

	<u>Employee Severance Benefits</u>	<u>Deferred Compensation Write-off</u>	<u>Asset Impairments</u>	<u>Lease Cancellations</u>	<u>Totals</u>
Total charge	\$ 7.4	\$ 5.0	\$ 7.1	\$ 7.3	\$ 26.8
Total spending through March 26, 2005	(7.9)	—	—	(4.5)	(12.4)
Total non-cash items	—	(5.0)	(7.1)	—	(12.1)
Adjustments	0.5	—	—	(0.5)	—
Accrual at March 26, 2005	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 2.3</u>	<u>\$ 2.3</u>

Note 5 – Shareholders' Equity

Preferred Stock

The Company has 5 million shares of authorized preferred stock, none of which is 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.

Stock Repurchase Plan

In July 1999, the Company's Board of Directors authorized a plan for the Company to repurchase up to \$500 million of its common stock. This repurchase plan does not obligate the Company to acquire any specific number of shares or acquire shares over any specified period of time. The Company has not engaged in any transactions to repurchase its common stock since fiscal 2003. Since inception of the stock repurchase plan, the Company had repurchased a total of 13.2 million shares at a cost of \$217 million. The Company was authorized to repurchase up to an additional \$283 million of its common stock as of March 26, 2005.

Comprehensive Income

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

The following table summarizes components of total comprehensive income, net of taxes, during the three and six-month periods ended March 26, 2005, and March 27, 2004 (in millions):

	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>3/26/05</u>	<u>3/27/04</u>	<u>3/26/05</u>	<u>3/27/04</u>
Net income	\$ 290	\$ 46	\$ 585	\$ 109
Other comprehensive income:				
Net change in unrealized derivative gains/losses	17	22	8	14
Change in foreign currency translation	(7)	(2)	15	12
Net change in unrealized investment gains/losses	(1)	1	(2)	2
Reclassification adjustment for investment gains included in net income	—	—	—	(3)
Total comprehensive income	<u>\$ 299</u>	<u>\$ 67</u>	<u>\$ 606</u>	<u>\$ 134</u>

The following table summarizes activity in other comprehensive income related to derivatives, net of taxes, held by the Company during the three and six-month periods ended March 26, 2005, and March 27, 2004 (in millions):

	Three Months Ended		Six Months Ended	
	3/26/05	3/27/04	3/26/05	3/27/04
Change in fair value of derivatives	\$ 4	\$ 1	\$ (8)	\$ (17)
Adjustment for net losses realized and included in net income	13	21	16	31
Change in unrealized derivative gains/losses	<u>\$ 17</u>	<u>\$ 22</u>	<u>\$ 8</u>	<u>\$ 14</u>

The following table summarizes the components of accumulated other comprehensive income (loss), net of taxes (in millions):

	As of 3/26/05	As of 9/25/04
Unrealized losses on available-for-sale securities	\$ (6)	\$ (4)
Unrealized gains (losses) on derivative investments	4	(4)
Cumulative foreign currency translation	8	(7)
Accumulated other comprehensive income (loss)	<u>\$ 6</u>	<u>\$ (15)</u>

Note 6 – Employee Benefit Plans

2003 Employee Stock Option Plan

The 2003 Employee Stock Option Plan (the 2003 Plan), formerly the 1998 Executive Officer Plan, is a shareholder approved plan that provides for broad-based grants to all employees in addition to executive officers and other key employees. Based on the terms of individual option grants, options granted under the 2003 Plan generally expire 7 to 10 years after the grant date and generally become exercisable over a period of 4 years, based on continued employment, with either annual or quarterly vesting. The 2003 Plan permits the granting of incentive stock options, nonstatutory stock options, restricted stock units, stock appreciation rights, and stock purchase rights.

1997 Employee Stock Option Plan

In August 1997, the Company's Board of Directors approved the 1997 Employee Stock Option Plan (the 1997 Plan), a non-shareholder approved plan for grants of stock options to employees who are not officers of the Company. Based on the terms of individual option grants, options granted under the 1997 Plan generally expire 7 to 10 years after the grant date and generally become exercisable over a period of 4 years, based on continued employment, with either annual or quarterly vesting. In October 2003, the Company terminated the 1997 Employee Stock Option Plan and cancelled all remaining unissued shares totaling 28,590,702. No new options can be granted from the 1997 Plan.

1997 Director Stock Option Plan

In August 1997, the Company's Board of Directors adopted a shareholder approved Director Stock Option Plan (DSOP) for non-employee directors of the Company. Initial grants of 30,000 options under the DSOP vest in three equal installments on each of the first through third anniversaries of the date of grant, and subsequent annual grants of 10,000 options are fully vested at grant.

Rule 10b5-1 Trading Plans

Certain of the Company's executive officers, including Mr. Timothy D. Cook, Mr. Peter Oppenheimer, Mr. Jonathan Rubinstein, Dr. Bertrand Serlet, and Dr. Avadis Tevanian, Jr., have entered into trading plans pursuant to Rule 10b5-1(c)(1) of the Securities Exchange Act of 1934, as amended. A trading plan is a written document that pre-establishes the amounts, prices and dates (or formula for determining the amounts, prices and dates) of future purchases or sales of the Company's stock including the exercise and sale of employee stock options and shares acquired pursuant to the Company's employee stock purchase plan and upon vesting of restricted stock units.

Employee Stock Purchase Plan

The Company has a shareholder approved employee stock purchase plan (the Purchase Plan), under which substantially all employees may purchase common stock through payroll deductions at a price equal to 85% of the lower of the fair market values as of the beginning and end of six month offering periods. Stock purchases under the Purchase Plan are limited to 10% of an employee's compensation, up to a maximum of \$25,000 in any calendar year. The number of shares authorized for issuance is limited to a total of 1 million shares per offering period. As of March 26, 2005, approximately 2.7 million shares were reserved for future issuance under the Purchase Plan.

Subsequent Event – Employee Stock and Bonus Plans

At the Annual Meeting of Shareholders held on April 21, 2005, the Company's shareholders approved the Performance Bonus Plan, a performance-based annual cash incentive plan for the Company's executive officers. The shareholders also approved amendments to the 2003 Employee Stock Option Plan, including an increase in the number of shares reserved for issuance under the plan by 49 million shares. In addition, the shareholders approved an amendment to the Company's Employee Stock Purchase Plan to increase the number of shares reserved for issuance thereunder by 2 million shares.

Stock Option Plan Activity

A summary of the Company's stock option activity and related information for the six month periods ended March 26, 2005 and March 27, 2004 is set forth in the following table (shares in thousands):

	Shares Available For Grant	Outstanding Options	
		Number of Shares	Weighted Average Exercise Price
Balance at 9/25/04	24,050	110,722	\$ 10.52
Options Granted	(3,798)	3,798	\$ 32.72
Options and Restricted Stock Units Cancelled	2,232	(2,232)	\$ 10.80
Options Exercised	—	(38,868)	\$ 9.96
Plan Shares Expired	(1,030)	—	—
Balance at 3/26/05	<u>21,454</u>	<u>73,420</u>	\$ 11.96
Balance at 9/27/03	91,660	126,024	\$ 9.54
Options Granted	(32,496)	32,496	\$ 11.07
Restricted Stock Units Granted	(4,800)	—	—
Options Cancelled	3,352	(3,352)	\$ 10.24
Options Exercised	—	(10,256)	\$ 8.84
Plan Shares Expired	(30,752)	—	—
Balance at 3/27/04	<u>26,964</u>	<u>144,912</u>	\$ 9.92

The options outstanding as of March 26, 2005 have been segregated into seven ranges for additional disclosure as follows (option amounts are presented in thousands):

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Options Outstanding as of 3/26/05	Weighted-Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Options Exercisable as of 3/26/05	Weighted Average Exercise Price
\$0.62 - \$8.66	11,988	4.78	\$ 7.16	9,430	\$ 7.04
\$8.67 - \$10.12	10,819	5.58	\$ 9.28	9,787	\$ 9.26
\$10.13 - \$10.23	11,232	6.54	\$ 10.20	6,721	\$ 10.20
\$10.24 - \$10.90	13,990	5.85	\$ 10.87	2,632	\$ 10.80
\$10.91 - \$11.73	11,907	5.80	\$ 11.39	4,339	\$ 11.40
\$11.74 - \$27.45	10,533	5.77	\$ 17.40	5,445	\$ 18.97
\$27.46 - \$44.50	<u>2,951</u>	6.75	\$ 36.03	<u>111</u>	\$ 30.58
\$0.62 - \$44.50	<u>73,420</u>	5.76	\$ 11.96	<u>38,465</u>	\$ 10.66

The Company had 4.830 million restricted stock units outstanding as of March 26, 2005, which were excluded from the options outstanding balances in the preceding tables. None of these restricted stock units were vested as of March 26, 2005. These restricted stock units have been deducted from the shares available for grant under the Company's stock option plans.

Note 7 – Stock-Based Compensation

The Company has provided pro forma disclosures in Note 1 of these Notes to Condensed Consolidated Financial Statements of the effect on net income and earnings per share as if the fair value method of accounting for stock compensation had been used for its employee stock option grants and employee stock purchase plan purchases. These pro forma effects have been estimated at the date of grant and beginning of the period, respectively, using the Black-Scholes option pricing model.

The assumptions used for the three and six month periods ended March 26, 2005 and March 27, 2004, and the resulting estimates of weighted-average fair value per share of options granted and for stock purchases during those periods are as follows:

	Three Months Ended		Six Months Ended	
	3/26/05	3/27/04	3/26/05	3/27/04
Expected life of stock options	3.5 years	3.5 years	3.5 years	3.5 years
Expected life of stock purchases	6 months	6 months	6 months	6 months
Interest rate - stock options	3.70%	2.33%	3.13% - 3.70%	2.33% - 2.35%
Interest rate - stock purchases	2.54%	0.96%	1.67% - 2.54%	0.96% - 1.10%
Volatility - stock options	40%	40%	40%	40%
Volatility - stock purchases	41%	34%	32% - 41%	34% - 44%
Expected dividend yields	—	—	—	—
Weighted-average fair value of options granted during the period	\$ 13.54	\$ 3.50	\$ 10.94	\$ 3.48
Weighted-average fair value of employee stock purchases during the period	\$ 7.30	\$ 2.47	\$ 5.53	\$ 2.46

Note 8 – Commitments and Contingencies

Lease Commitments

The Company leases various equipment and facilities, including retail space, under noncancelable operating lease arrangements. The Company does not currently utilize any other off-balance-sheet financing arrangements. The major facility leases are for terms of 5 to 10 years and generally provide renewal options for terms of 3 to 5 additional years. Leases for retail space are for terms of 5 to 16 years, the majority of which are for 10 years, and often contain multi-year renewal options. As of September 25, 2004, the Company's total future minimum lease payments under noncancelable operating leases were \$617 million, of which \$436 million related to leases for retail space. As of March 26, 2005, total future minimum lease payments related to leases for retail space increased to \$489 million.

Accrued Warranty and Indemnifications

The Company offers a basic limited parts and labor warranty on its hardware products. The basic warranty period for hardware products is typically one year from the date of purchase by the end-user. The Company also offers a 90-day basic warranty for Apple service parts used to repair Apple hardware products. The Company provides currently for the estimated cost that may be incurred under its basic limited product warranties at the time related revenue is recognized. Factors considered in determining appropriate accruals for product warranty obligations include the size of the installed base of products subject to warranty protection, 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. The Company assesses the adequacy of its preexisting warranty liabilities and adjusts the amounts as necessary based on actual experience and changes in future expectations.

The following table reconciles changes in the Company's accrued warranties and related costs for the three and six month periods ended March 26, 2005 and March 27, 2004 (in millions):

	Three Months Ended		Six Months Ended	
	3/26/05	3/27/04	3/26/05	3/27/04
Beginning accrued warranty and related costs	\$ 135	\$ 80	\$ 105	\$ 67
Cost of warranty claims	(43)	(27)	(77)	(48)
Accruals for product warranties	62	27	126	61
Ending accrued warranty and related costs	<u>\$ 154</u>	<u>\$ 80</u>	<u>\$ 154</u>	<u>\$ 80</u>

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 itself 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 have a material adverse effect on its financial condition, liquidity or results of operations. Therefore, the Company did not record a liability for infringement costs as of either March 26, 2005 or September 25, 2004.

Contingencies

Beginning on September 27, 2001, three shareholder class action lawsuits were filed in the United States District Court for the Northern District of California against the Company and its Chief Executive Officer. These lawsuits are substantially identical, and purport to bring suit on behalf of persons who purchased the Company's publicly traded common stock between July 19, 2000, and September 28, 2000. The complaints allege violations of the 1934 Securities Exchange Act and seek unspecified compensatory damages and other relief. The Company filed a motion to dismiss on June 4, 2002, which was heard by the Court on September 13, 2002. On December 11, 2002, the Court granted the Company's motion to dismiss for failure to state a cause of action, with leave to Plaintiffs to amend their complaint within thirty days. Plaintiffs filed their amended complaint on January 31, 2003, and on March 17, 2003, the Company filed a motion to dismiss the amended complaint. The Court heard the Company's motion on July 11, 2003 and dismissed Plaintiffs' claims with prejudice on August 12, 2003. Plaintiffs appealed the ruling. The Ninth Circuit Court of Appeal heard the matter on February 17, 2005 and affirmed the District Court's ruling in an unpublished decision dated April 4, 2005. Plaintiffs will not seek further review and the matter is concluded.

The Company is subject to certain other legal proceedings and claims that have arisen in the ordinary course of business and have not been fully adjudicated. In the opinion of management, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate have a material adverse effect on its financial condition, liquidity or results of operations. However, the results of legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations including, in some instances, the requirement to provide customers the ability to return product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have recently been passed in several jurisdictions in which the Company operates including various European Union member countries, Japan and certain states within the U.S. Although the Company does not anticipate any material adverse effects in the future based on the nature of its operations and the thrust of such laws, there is no assurance that such existing laws or future laws will not have a material adverse effect on the Company's results of operations and financial position.

Note 9 - Segment Information and Geographic Data

In accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, the Company reports segment information based on the “management” approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of the Company’s reportable segments.

The Company manages its business primarily on a geographic basis. The Company’s reportable operating segments are comprised of the Americas, Europe, Japan, and Retail. The Americas, Europe, and Japan reportable segments do not include activities related to the Retail segment. The Americas segment includes both North and South America. The Europe segment includes European countries as well as the Middle East and Africa. The Japan segment includes only Japan. The Retail segment operates Apple-owned retail stores in the U.S., Japan, and the U.K. Other operating segments include Asia-Pacific, which includes Australia and Asia except for Japan, and the Company’s subsidiary, FileMaker, Inc. Each reportable geographic operating segment provides similar hardware and software products and similar services, and the accounting policies of the various segments are the same as those described in the Company’s 2004 10-K in Note 1, “Summary of Significant Accounting Policies,” except as described below for the Retail segment.

The Company evaluates the performance of its operating segments based on net sales. The Retail segment’s performance is also evaluated based on operating income. Net sales for geographic segments are generally based on the location of the customers. Operating income for each segment includes net sales to third parties, related cost of sales, and operating expenses directly attributable to the segment. Operating income for each segment excludes other income and expense and certain expenses that are managed outside the operating segments. Costs excluded from segment operating income include various corporate expenses, manufacturing costs and variances not included in standard costs, income taxes, and various nonrecurring charges. Corporate expenses include research and development, corporate marketing expenses, manufacturing costs and variances not included in standard costs, and other separately managed general and administrative expenses including certain corporate expenses associated with support of the Retail segment. The Company does not include intercompany transfers between segments for management reporting purposes. Segment assets exclude corporate assets. Corporate assets include cash, short-term and long-term investments, manufacturing facilities, miscellaneous corporate infrastructure, goodwill and other acquired intangible assets, and retail store construction-in-progress that is not subject to depreciation. Except for the Retail segment, capital expenditures for long-lived assets are not reported to management by segment. Capital expenditures by the Retail segment were \$16 million and \$20 million during the second quarters of 2005 and 2004, respectively, and \$49 million and \$48 million during the first six months of 2005 and 2004, respectively.

Operating income for all segments, except Retail, includes cost of sales at manufacturing standard cost, other cost of sales, related sales and marketing costs, and certain general and administrative costs. This measure of operating income, which includes manufacturing profit, provides a comparable basis for comparison between the Company’s various geographic segments. Certain manufacturing expenses and related adjustments not included in segment cost of sales, including variances between standard and actual manufacturing costs and the mark-up above standard cost for product supplied to the Retail segment, are included in corporate expenses.

Management assesses the operating performance of the Retail segment differently than it assesses the operating performance of the Company’s geographic segments. The Retail segment revenue and operating income is intended to depict a measure comparable to that of the Company’s major channel partners in the U.S. operating retail stores so the Company can evaluate the Retail segment performance as if it were a channel partner. Therefore, the Company makes three significant adjustments to the Retail segment for management reporting purposes that are not included in the results of the Company’s other segments.

First, the Retail segment’s operating income includes cost of sales for Apple products at an amount normally charged to major channel partners in the U.S. operating retail stores, less the cost of sales programs and incentives provided to those channel partners and the Company’s cost to support those partners. For the second quarter of 2005 and 2004, this resulted in the recognition of additional cost of sales above standard cost by the Retail segment and an offsetting benefit to corporate expenses of approximately \$102 million and \$45 million, respectively. For the first six months of 2005 and 2004, this resulted in the recognition of additional cost of sales above standard cost by the Retail segment and an offsetting benefit to corporate expenses of approximately \$201 million and \$97 million, respectively.

Second, the Company's extended warranty, support and service contracts are transferred to the Retail segment at the same cost as that charged to the Company's major retail channel partners in the U.S., resulting in a measure of revenue and gross margin for those items that is comparable between the Company's Retail stores and those retail channel partners. The Retail segment recognizes the full amount of revenue and cost of sales of the Company's extended warranty, support and service contracts at the time of sale. Because the Company has not yet earned the revenue or incurred the costs associated with the sale of these contracts, an offset to these amounts is recognized in other operating segments' net sales and cost of sales. For the second quarter of 2005, this resulted in the recognition of net sales and cost of sales by the Retail segment, with corresponding offsets in other operating segments, of \$21 million and \$15 million, respectively. For the second quarter of 2004, the net sales and cost of sales of extended warranty, support and service contracts recognized by the Retail segment were \$12 million and \$8 million, respectively. For the first six months of 2005, this resulted in the recognition of additional net sales and cost of sales by the Retail segment, with corresponding offsets in other operating segments, of \$41 million and \$28 million, respectively. This compares to similar adjustments to net sales and cost of sales during the first six months of 2004 of \$24 million and \$16 million, respectively.

Third, the Company has opened seven high profile stores in New York, Los Angeles, Chicago, San Francisco, Tokyo, Japan, Osaka, Japan, and London, England as of March 26, 2005. These high profile stores are larger than the Company's typical retail stores and were designed to further promote brand awareness and provide a venue for certain corporate sales and marketing activities, including corporate briefings. As such, the Company allocates certain operating expenses associated with these stores to corporate marketing expense to reflect the estimated benefit realized Company-wide. The allocation of these operating costs is based on the amount incurred for a high profile store in excess of that incurred by a more typical Company retail location. Expenses allocated to corporate marketing resulting from the operations of these stores were \$7.1 million and \$4.0 million in the second quarters of 2005 and 2004, respectively, and \$14.0 million and \$6.2 million for the first six months of 2005 and 2004, respectively.

Summary information by operating segment follows (in millions):

	Three Months Ended		Six Months Ended	
	3/26/05	3/27/04	3/26/05	3/27/04
Americas:				
Net sales	\$ 1,443	\$ 881	\$ 3,080	\$ 1,805
Operating income	\$ 185	\$ 91	\$ 387	\$ 205
Europe:				
Net sales	\$ 705	\$ 449	\$ 1,552	\$ 968
Operating income	\$ 100	\$ 72	\$ 233	\$ 169
Japan:				
Net sales	\$ 284	\$ 173	\$ 469	\$ 330
Operating income	\$ 45	\$ 27	\$ 66	\$ 48
Retail:				
Net sales	\$ 571	\$ 266	\$ 1,132	\$ 539
Operating income	\$ 42	\$ 5	\$ 87	\$ 14
Other Segments (a):				
Net sales	\$ 240	\$ 140	\$ 500	\$ 273
Operating income	\$ 25	\$ 24	\$ 62	\$ 42

(a) Other Segments consists of Asia-Pacific and FileMaker.

A reconciliation of the Company's segment operating income to the consolidated financial statements follows (in millions):

	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>3/26/05</u>	<u>3/27/04</u>	<u>3/26/05</u>	<u>3/27/04</u>
Segment operating income	\$ 397	\$ 219	\$ 835	\$ 478
Corporate expenses, net (b)	5	(157)	(30)	(342)
Restructuring costs	—	(10)	—	(10)
Total operating income	<u>\$ 402</u>	<u>\$ 52</u>	<u>\$ 805</u>	<u>\$ 126</u>

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

Note 10 – Related Party Transactions and Certain Other Transactions

In March 2002, the Company entered into a Reimbursement Agreement with its CEO, Mr. Steven P. Jobs, for the reimbursement of expenses incurred by Mr. Jobs in the operation of his private plane when used for Apple business. The Reimbursement Agreement became effective for expenses incurred by Mr. Jobs for Apple business purposes since he took delivery of the plane in May 2001. The Company recognized a total of \$62,000 and \$40,000 in expenses pursuant to the Reimbursement Agreement during the second quarters of 2005 and 2004, respectively, and \$481,000 and \$322,000 in expenses for the first six months of 2005 and 2004. All expenses recognized pursuant to the Reimbursement Agreement have been included in selling, general, and administrative expenses in the condensed consolidated statements of operations.

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

This section and other parts of this Form 10-Q contain forward-looking statements that involve risks and uncertainties. Forward-looking statements can be identified by words such as "anticipates," "expects," "believes," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and the Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Factors That May Affect Future Results and Financial Condition" below. The following discussion should be read in conjunction with the 2004 Form 10-K and the condensed consolidated financial statements and notes thereto included elsewhere in this Form 10-Q. All information is based on the Company's fiscal calendar. Unless otherwise stated, references in this report to particular years or quarters refer to the Company's fiscal years ended in September and the associated quarters of those fiscal years. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Available Information

The Company's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available on its website at <http://www.apple.com/investor> when such reports are available on the Securities and Exchange Commission (SEC) website. The public may read and copy any materials filed by the Company with the SEC at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at <http://www.sec.gov>. The contents of these websites are not incorporated into this filing. Further, the Company's references to the URLs for these websites are intended to be inactive textual references only.

Executive Overview

The Company designs, manufactures and markets personal computers and related software, services, peripherals and networking solutions. The Company also designs, develops and markets a line of portable digital music players along with related accessories and services including the online distribution of third-party music and audio books. The Company's products and services include the Macintosh line of desktop and notebook computers, the iPod digital music player, the Xserve server and Xserve RAID storage products, a portfolio of consumer and professional software applications, the Mac OS X operating system, the online iTunes Music Store, a portfolio of peripherals that support and enhance the Macintosh and iPod product lines, and a variety of other service and support offerings. The Company sells its products worldwide through its online stores, its own retail stores, its direct sales force, and third-party wholesalers, resellers and value added resellers. In addition, the Company sells a variety of third-party Macintosh compatible products, including computer printers and printing supplies, storage devices, computer memory, digital video and still cameras, personal digital assistants, and various other computing products and supplies through its online and retail stores. The Company sells to education, consumer, creative professional, business and government customers. A further description of the Company's products may be found below and in Part I, Item 1 of the Company's 2004 Form 10-K.

The Company's business strategy leverages its ability, through the design and development of its own operating system, hardware and many software applications and technologies, to bring to its customers around the world compelling new products and solutions with superior ease-of-use, seamless integration and innovative industrial design.

The Company participates in several highly competitive markets, including personal computers with its Macintosh line of computers, consumer electronics with its iPod line of digital music players and distribution of third-party digital music through its online iTunes Music Store. While the Company is widely recognized as an innovator in the personal computer market as well as a leader in the emerging market for distribution of digital music, these are highly competitive markets that are subject to aggressive pricing and increased competition. In order to remain competitive, the Company believes that increased investment in research and development (R&D) and marketing and advertising is necessary in order to maintain and extend its position in the markets where it competes. The Company's R&D spending is focused on delivering timely updates and enhancements to its existing line of personal computers, displays, operating systems, software applications and portable music players; developing new digital lifestyle consumer and professional software applications; and investing in new product areas such as rack-mount

servers, RAID storage systems, and wireless technologies. The Company also believes that investment in marketing and advertising programs is critical to increasing product and brand awareness.

The Company utilizes a variety of direct and indirect distribution channels. The Company believes that sales of its innovative and differentiated products are enhanced by knowledgeable salespersons who can convey the value of the hardware, software and peripheral integration, demonstrate the unique digital lifestyle solutions that are available only on Macintosh computers, and demonstrate the compatibility of the Macintosh with the Windows platform and networks. The Company further believes that providing a high-quality sales and after-sales support experience is critical to attracting and retaining customers. To ensure a high-quality buying experience for its products in which service and education are emphasized, the Company has expanded and improved its distribution capabilities by opening its own retail stores in the U.S. and internationally. The Company had 103 stores open as of March 26, 2005.

The Company also staffs selected third-party stores with the Company's own employees to improve the buying experience through reseller channels. The Company has deployed Apple employees in reseller locations around the world including the U.S., Europe, Japan and Australia. The Company also sells to customers directly through its online stores around the world.

To improve the accessibility to its iPod product line, the Company has significantly expanded the number of distribution points where iPods are sold. The iPod product line can be purchased in certain department stores, member-only warehouse stores, large retail chains, and specialty retail stores.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles and the Company's discussion and analysis of its financial condition and results of operations require the Company's management to make judgments, assumptions, and estimates that affect the amounts reported in its consolidated financial statements and accompanying notes. Note 1 of the Notes to Consolidated Financial Statements in the Company's 2004 Form 10-K describes the significant accounting policies and methods used in the preparation of the Company's 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, allowance for doubtful accounts, inventory valuation and exposures related to inventory purchase commitments, valuation of long-lived assets including acquired intangibles, warranty costs, and income taxes. Management believes these policies to be critical because they are both important to the portrayal of the Company's financial condition and results, and they require management to make judgments and estimates about matters that are inherently uncertain. 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 products (e.g., hardware, software, music products, and peripherals), and extended warranty and support contracts. The Company recognizes revenue pursuant to applicable accounting standards, including Statement of Position (SOP) No. 97-2, *Software Revenue Recognition*, as amended, and Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition*.

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. Generally, 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, and for certain other sales, the Company defers revenue recognition until the customer receives the product because the Company legally retains a portion of the risk of loss on these sales during transit. If at the outset of an arrangement the Company determines the arrangement fee is not, or is presumed not to be, fixed or determinable, revenue is deferred and subsequently recognized as amounts become due and payable.

The Company records reductions to revenue for estimated commitments related to price protection and for customer incentive programs, including reseller and end-user rebates, and other sales programs and volume-based incentives. The estimated cost of these programs is accrued as a reduction to revenue in the period the Company has sold the product and committed to a plan. The Company also records reductions to revenue for expected future product returns based on the Company's historical experience. Future market conditions and product transitions may require the Company to increase customer incentive programs and incur incremental price protection obligations that could result in additional reductions to revenue at the time such programs are offered. Additionally, certain customer incentive programs require management to estimate the number of customers who will actually redeem the incentive based on historical experience and the specific terms and conditions of particular incentive programs. If a greater than estimated proportion of customers redeem such incentives, the Company would be required to record additional reductions to revenue, which could have a material adverse impact on the Company's results of operations.

Allowance for Doubtful Accounts

The Company distributes its products through third-party resellers and directly to certain education, consumer, and commercial customers. The Company generally does not require collateral from its customers. However, when possible the Company does attempt to limit credit risk on trade receivables with credit insurance for certain customers in Latin America, Europe and Asia and by arranging with third-party financing companies to provide flooring arrangements and other loan and lease programs to the Company's direct customers. These credit-financing arrangements are directly between the third-party financing company and the end customer. As such, the Company generally does not assume any recourse or credit risk sharing related to any of these arrangements. However, considerable trade receivables that are not covered by collateral, third-party flooring arrangements, or credit insurance are outstanding with the Company's distribution and retail channel partners.

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

Inventory Valuation and Inventory Purchase Commitments

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

The Company accrues necessary reserves for cancellation fees related to component orders that have been cancelled. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. These commitments typically cover the Company's requirements for periods ranging from 30 to 130 days. If there is an abrupt and substantial decline in demand for one or more of the Company's products or an unanticipated change in technological requirements for any of the Company's products, the Company may be required to record additional reserves for cancellation fees that would negatively affect gross margins in the period when the cancellation fees are identified.

Valuation of Long-Lived Assets Including Acquired Intangibles

The Company reviews property, plant, and equipment and certain identifiable intangible assets for impairment when events or changes in circumstances indicate the carrying amount of such an asset may not be recoverable.

Recoverability of these assets is measured by comparison of their carrying amount to future undiscounted cash flows the assets are expected to generate. If such assets are considered to be impaired, the impairment to be recognized in earnings equals the amount by which the carrying value of the assets exceeds their fair market value. Although the Company has recognized no material impairment adjustments related to its property, plant, and equipment or identifiable intangibles during the past two fiscal years, except those made in conjunction with restructuring actions, deterioration in the Company's business in a geographic region or business segment in the future, including deterioration in the performance of individual retail stores, could lead to such impairment adjustments in future periods in which such business issues are identified.

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, the Company performs a review of goodwill for impairment annually, or earlier if indicators of potential impairment exist. The review of goodwill for potential impairment is subjective and requires that: (1) goodwill be allocated to various reporting units of the Company's business to which it relates; (2) the Company estimate the fair value of those reporting units to which the goodwill relates; and (3) the Company determine the book value of those reporting units. If the estimated fair value of reporting units with allocated goodwill is determined to be less than their book value, the Company is required to estimate the fair value of all identifiable assets and liabilities of those reporting units in a manner similar to a purchase price allocation for an acquired business. This requires independent valuation of certain internally developed and unrecognized assets including in-process research and development and developed technology. Once this process is complete, the amount of goodwill impairment, if any, can be determined.

Based on the Company's estimates as of March 26, 2005 there was no impairment of goodwill. However, changes in various circumstances including changes in the Company's market capitalization, changes in the Company's forecasts, and changes in the Company's internal business structure could cause one or more of the Company's reporting units to be valued differently thereby causing an impairment of goodwill. Additionally, in response to changes in the personal computer and consumer electronics industries and changes in global or regional economic conditions, the Company may strategically realign its resources and consider restructuring, disposing, or otherwise exiting businesses, which could result in an impairment of property, plant, and equipment, identifiable intangibles, or goodwill.

Warranty Costs

The Company provides currently for the estimated cost for product warranties at the time the related revenue is recognized based on historical and projected warranty claim rates, historical and projected cost-per-claim, and knowledge of specific product failures that are outside of the Company's typical experience. Each quarter, the Company reevaluates its estimates to assess the adequacy of its recorded warranty liabilities considering the size of the installed base of products subject to warranty protection, and adjusts the amounts as necessary. If actual product failure rates or repair costs differ from estimates, revisions to the estimated warranty liability would be required and could negatively 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. In accordance with SFAS No. 109, *Accounting for Income Taxes*, 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 is currently evaluating the repatriation provisions of the American Jobs Creation Act of 2004, which, if implemented by the Company, would affect the Company's tax provision and deferred tax assets and liabilities.

Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets. In the event that all or part of the net deferred tax assets are determined not to be realizable in the future, an adjustment to the valuation allowance would be charged to earnings in the period such determination is made. Similarly, if the Company subsequently realizes deferred tax assets that were previously determined to be unrealizable, the respective valuation allowance would be reversed, resulting in a positive adjustment to earnings or a decrease in goodwill 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 complex tax laws. Resolution of these uncertainties in a manner inconsistent with management's expectations could have a material impact on the Company's results of operations and financial position.

Products

The Company offers a range of personal computing products including desktop and notebook personal computers, related devices and peripherals, and various third-party hardware products. In addition, the Company offers software products including Mac OS® X, the Company's proprietary operating system software for the Macintosh®; server software and related solutions; professional application software; and consumer, education and business oriented application software. The Company also designs, develops and markets to Macintosh and Windows users its line of iPod® digital music players along with related accessories and services including the online distribution of third-party music through the Company's iTunes Music Store®. A detailed discussion of the Company's products may be found in the 2004 Form 10-K. Certain newly introduced products and/or upgrades to existing products are discussed below.

Mac® mini

In January 2005, the Company introduced Mac mini, a Mac computer without a display, keyboard, or mouse, with a starting price of \$499 and weighing as little as 2.9 pounds. Mac mini is available in two models, one containing a 1.25 GHz PowerPC G4 processor and a 40GB hard drive, and one containing a 1.42 GHz PowerPC G4 processor and an 80GB hard drive. Both models include ATI Radeon 9200 graphics with 32MB of dedicated DDR memory and a slot-load Combo drive for watching DVD movies and burning CDs. Mac mini includes one FireWire® 400 and two USB 2.0 ports, and a DVI interface that also supports VGA so consumers can connect to LCD or CRT displays. The Mac mini includes built-in 10/100BASE-T Ethernet and a 56K V.92 modem for Internet access, and offers optional support for an AirPort® Extreme Card for 54 Mbps 802.11g wireless networking along with an internal Bluetooth module for the latest in wireless communications.

iPod® shuffle

In January 2005, the Company introduced iPod® shuffle, a flash-memory digital music player, which is based on iPod's shuffle feature that randomly selects songs from the user's music library or playlists. iPod shuffle works with iTunes® and its new patent-pending AutoFill feature that automatically selects songs to fill iPod shuffle from a user's music library on their computer. iPod shuffle can also be used as a portable USB flash drive with up to 1GB of storage space. It is available in a 512MB model holding up to 120 songs and a 1GB model holding up to 240 songs.

iTunes Music Store®

The Company introduced the iTunes Music Store in Canada in December 2004, and in Ireland in January 2005. The iTunes Music Store now serves customers in a total of 15 countries in North America and Europe.

iLife® '05

In January 2005, the Company introduced iLife '05, an upgrade to its digital lifestyle suite, which features major new versions of iPhoto™, iMovie®, iDVD® and GarageBand™ and includes the latest version of iTunes®.

iPhoto® 5 is the Company's consumer-oriented digital photo software application. iPhoto 5 includes advanced editing tools, adds support for uncompressed RAW photos throughout the application and includes a new slideshow builder, which allows users to apply effects, transitions and durations to each individual slide. iPhoto 5 features a new way to create hardcover and softcover photo books and includes new book layouts, double-sided printing, and online book ordering from within iPhoto 5.

iMovie® HD, a consumer-oriented digital video editing software application, enables users to import and edit digital videos on their Mac. iMovie HD now allows users to capture and edit High Definition Video (HDV) from HDV camcorders. iMovie HD also includes Magic iMovie, which automatically imports the video into separate clips, adds titles, transitions and music. iMovie HD imports video from HDV and standard DV camcorders, and from video cameras that generate MPEG-4 video.

iDVD® is a consumer-oriented software application that enables users to turn iMovie files, QuickTime® files

and digital pictures into DVDs that can be played on most consumer DVD players. iDVD 5 includes 15 new themes featuring moving drop zones that can display video clips or photos in motion across DVD menus. iDVD 5 also features OneStep DVD, which automatically creates a DVD from footage from a user's camcorder. With a compatible SuperDrive™, iDVD 5 now supports all single-sided DVD formats.

GarageBand™ is a consumer-oriented music creation software application. GarageBand 2 adds 8-track recording so that users can record multiple instruments at once, plus pitch and timing correction to fix tracks. GarageBand 2 now displays and edits musical notation in real time for people who know how to read and write music or want to learn. With GarageBand Jam Packs, including the latest, Jam Pack 4: Symphony Orchestra, GarageBand users can create music in their favorite genre.

iLife '05 also includes iTunes 4.7.1, the latest version of the Company's digital music jukebox software application that allows users to purchase music from the Company's iTunes Music Store. iTunes organizes music using searching, browsing and playlists, and also includes features such as iMix playlist sharing and provides integration with the complete family of iPods, including the new iPod shuffle.

iWork™ '05

In January 2005, the Company introduced iWork '05, productivity software designed to take advantage of both Mac OS X and iLife '05 to help users create, present and publish documents and presentations. iWork '05 introduces Pages™, a new word processor, and also features Keynote™ 2, a new version of the Company's presentation software.

Pages™ gives users the tools to create letters, newsletters, reports, brochures and resumes with advanced typography, multiple columns, footnotes, tables of content and styles. With features like text wrapping and alignment guides, Pages lets users create free-form arrangements of text, graphics, photos, tables and charts. An integrated iLife media browser lets users drag and drop photos from the iPhoto library directly into documents.

Keynote™ 2 is the Company's presentation software that gives users the ability to create presentations, portfolios, interactive slideshows and storyboards. Keynote 2 contains slide animations to synchronize the movement of multiple objects and cinematic real-time animated text. The iLife media browser within Keynote allows users to insert photos, movies and music directly into presentations and with image masking, users can frame the exact part of the photo they want to display. Keynote 2 can also work with a second monitor to display upcoming slides, notes and a timer.

Final Cut® Express HD

In January 2005, the Company announced Final Cut Express HD, an update to Final Cut Express, which began shipping in February 2005. This version enables users to capture, edit and output HDV over a single FireWire cable, without requiring any additional software or hardware. Final Cut Express HD supports Digital Cinema Desktop and includes sound editing tools including 99 audio tracks, real-time volume and audio filter adjustment and a voice-over tool. Final Cut Express HD includes LiveType™, which can add HD-quality animated text and motion graphics to videos. Final Cut Express HD also includes Soundtrack, music creation software that allows users to compose musical scores for their video.

Final Cut® Studio

In April 2005, the Company announced Final Cut Studio, a HD video production suite that features Final Cut Pro® 5, an upgrade to the editing software for DV, SD, HD and film. Final Cut Studio also includes tools that complement Final Cut Pro 5 such as Soundtrack® Pro, a new application that gives audio and video professionals a way to create, control and fix audio; Motion 2, an upgrade that now allows real-time motion graphics with GPU accelerated 32-bit float rendering; and DVD Studio Pro® 4, DVD authoring software that burns high definition DVDs to the latest HD DVD specification. These components of Final Cut Studio will also be sold separately.

Shake® 4

In April 2005, the Company announced Shake 4, an upgrade to the Company's compositing software. Used by artists and visual effects facilities to create visual effects for film and television, Shake 4 features 3D multi-plane compositing, optical flow image processing and integration with Final Cut Pro 5.

Mac OS® X Tiger

In April 2005, the Company began shipping Mac OS X version 10.4 (code named “Tiger”), the Company’s fifth major version of Mac OS X. Tiger incorporates more than 200 new features and innovations including Spotlight™, a desktop search technology that lets users find items stored on their Mac, including documents, emails, contacts and images; and Dashboard, a new way to instantly access information such as weather forecasts and stock quotes, using a new class of applications called widgets. The server version of the Mac OS operating system, Mac OS X Tiger Server, also began shipping in April 2005.

Net Sales

Net sales and Macintosh unit sales by operating segment and net sales and unit sales by product follow (net sales in millions and unit sales in thousands):

	Three Months Ended			Six Months Ended		
	3/26/05	3/27/04	Change	3/26/05	3/27/04	Change
Net Sales by Operating Segment :						
Americas net sales	\$ 1,443	\$ 881	64%	\$ 3,080	\$ 1,805	71%
Europe net sales	705	449	57%	1,552	968	60%
Japan net sales	284	173	64%	469	330	42%
Retail net sales	571	266	115%	1,132	539	110%
Other segments net sales (a)	240	140	71%	500	273	83%
Total net sales	<u>\$ 3,243</u>	<u>\$ 1,909</u>	70%	<u>\$ 6,733</u>	<u>\$ 3,915</u>	72%
Unit Sales by Operating Segment :						
Americas Macintosh unit sales	477	361	32%	953	739	29%
Europe Macintosh unit sales	276	187	48%	596	427	40%
Japan Macintosh unit sales	102	76	34%	166	153	8%
Retail Macintosh unit sales	144	70	106%	263	143	84%
Other segments Macintosh unit sales (a)	71	55	29%	138	116	19%
Total Macintosh unit sales	<u>1,070</u>	<u>749</u>	43%	<u>2,116</u>	<u>1,578</u>	34%
Net Sales by Product :						
Power Macintosh net sales (b)	\$ 320	\$ 349	(8)%	\$ 701	\$ 747	(6)%
PowerBook net sales	413	336	23%	720	735	(2)%
iMac net sales (c)	483	252	92%	1,103	503	119%
iBook net sales	278	223	25%	575	444	30%
Total Macintosh net sales	1,494	1,160	29%	3,099	2,429	28%
iPod	1,014	264	284%	2,225	520	328%
Other music products (d)	216	60	260%	393	107	267%
Peripherals and other hardware (e)	280	238	18%	564	460	23%
Software (f)	134	127	6%	251	276	(9)%
Service and other sales	105	60	75%	201	123	63%
Total net sales	<u>\$ 3,243</u>	<u>\$ 1,909</u>	70%	<u>\$ 6,733</u>	<u>\$ 3,915</u>	72%
Unit Sales by Product :						
Power Macintosh unit sales (b)	141	174	(19)%	308	380	(19)%
PowerBook unit sales	211	157	34%	363	352	3%
iMac unit sales (c)	467	217	115%	923	444	108%
iBook unit sales	251	201	25%	522	402	30%
Total Macintosh unit sales	<u>1,070</u>	<u>749</u>	43%	<u>2,116</u>	<u>1,578</u>	34%
iPod unit sales	<u>5,311</u>	<u>807</u>	558%	<u>9,891</u>	<u>1,540</u>	542%
Net sales per Macintosh unit sold (g)	<u>\$ 1,396</u>	<u>\$ 1,549</u>	(10)%	<u>\$ 1,465</u>	<u>\$ 1,539</u>	(5)%

Notes:

- Other Segments include Asia Pacific and FileMaker.
- Includes Xserve product line.
- Includes eMac and Mac mini product lines.
- Other music products consists of iTunes Music Store sales, iPod-related services, and Apple-branded and third-party iPod-related accessories.
- Net sales of Peripherals and other hardware include sales of Apple-branded and third-party displays, wireless connectivity and networking solutions, and other hardware accessories.
- Net sales of Software include sales of Apple-branded operating system and application software and sales of third-party software.
- Net sales per Macintosh unit sold is derived by dividing total Macintosh net sales by total Macintosh unit sales.

Net sales during the second quarter of 2005 increased 70% or \$1.334 billion from the same quarter in 2004, and were up 72% or \$2.818 billion for the first six months of fiscal 2005 compared to the same period of fiscal 2004. Several factors contributed to these increases including:

- Net sales of iPods increased \$750 million, or 284% during the second quarter of 2005 compared to the same period in 2004, and increased \$1.705 billion or 328% in the first half of 2005. Unit sales of iPods totaled 5.3 million during the second quarter of 2005, which represents an increase of 558% from the 807,000 units sold in the second quarter of 2004. For the first six months of 2005, iPod unit sales increased 542% to 9.9 million units sold compared to 1.5 million units sold in the prior year. Since introduction of the iPod product line in fiscal 2002, the Company has sold in excess of 15 million iPods. Strong iPod demand for the quarter and first six months continued to be experienced in all of the Company's operating segments. These results were driven by several factors, including strong sales of the new iPod shuffle in January 2005, the release of the new iPod mini in February 2005, price reductions associated with both iPod photo and iPod mini in the second quarter of 2005, and expansion of the iPod's distribution network during the first six months of 2005.
- Other music products consist of sales associated with the iTunes Music Store and iPod related services and accessories. Net sales of other music products increased 260% to \$216 million in the second quarter of 2005 compared to the same period in 2004. A similar increase of 267% in net sales of other music products was experienced for the first half of 2005 compared to the first half of 2004. The Company has experienced strong growth in sales of iPod services and accessories resulting from the increase in overall iPod unit sales for both the second quarter and first half of 2005. Likewise, the iTunes Music Store has experienced strong growth in sales in both the second quarter and first half of 2005 as a result of substantial growth in sales in the U.S. and expansion to Europe and Canada.
- Total Macintosh net sales increased by 29% and 28% during the second quarter and first six months of 2005 compared with the same periods in 2004. Unit sales during the second quarter and first half of 2005 also reflected increases of 43% and 34%, respectively, compared to the same period in the prior year. These increases in net sales and unit sales relate primarily to strong demand for the Company's consumer-oriented iMac and iBook products, offset by a slight decline in Power Macintosh net sales. Net sales of consumer-oriented products increased 60% and 77% for the three and six months ended March 26, 2005, respectively, compared to the same periods in 2004. Unit sales showed increases of approximately 71% for both the second quarter and first half of 2005 compared to the same period in the prior year. These increases are largely attributable to the introduction of the Mac mini in January 2005, the iMac G5 at the end of fiscal 2004 and the upgrade of the iBook in October 2004. In addition, PowerBook net sales increased 23% in the second quarter of 2005 compared with the same period in 2004, primarily as a result of a refresh and a simultaneous price drop to the PowerBook product line in the second quarter of 2005. The Company also believes that a shift in customer preference from desktop systems to portable systems continues. Net sales per Macintosh unit sold during the second quarter of 2005 decreased 10% to \$1,396 compared to the same quarter in 2004, and decreased 5% to \$1,465 during the first six months of 2005 from \$1,539 in 2004. These decreases were the result of changes in overall unit mix towards relatively lower-priced consumer products, specifically the impact of the new Mac mini product, partially offset by an increase in direct sales.
- The Retail segment's net sales grew 115% to \$571 million during the second quarter of 2005 and grew by 110% to \$1.132 billion in the first half of 2005 compared to the same periods in the prior year. These increases are largely attributable to the increase in total stores from 78 at the end of the second quarter of 2004 to 103 as of March 26, 2005, as well as a 60% year-over-year increase in average revenue per store. While the Company's customers in areas where the Retail segment has opened stores may elect to purchase from the Retail segment stores rather than the Company's preexisting sales channels in the U.S., Japan, and the U.K., the Company believes that a substantial portion of the Retail segment's net sales is incremental to the Company's total net sales. See additional comments below related to the Retail segment under the heading "Segment Operating Performance."
- Net sales of peripherals and other hardware rose \$42 million or 18% during the second quarter of 2005 compared to the same quarter in 2004, and increased \$104 million or 23% in the first half of 2005 as a

result of increased net sales of displays and other computer accessories. Net sales of other computer accessories include AirPort cards and base stations, iSight digital video cameras, and third-party hardware products. The increase in total net sales of peripherals and other hardware was experienced by all of the Company's operating segments.

- The Company's U.S. education channel experienced an increase in net sales and unit sales of 25% and 21%, respectively for the second quarter of 2005 compared to the same period in the prior year. For the first six months of 2005, net sales and unit sales increased 22% and 16%, respectively, compared to the first half of 2004. These increases were driven predominantly by strength in the higher education market. While revenue from the K-12 market was slightly higher in the second quarter and first half of 2005 than the same periods of 2004, the Company believes this market continues to be subject to budget constraints.
- Net sales of software rose \$7 million or 6% during the second quarter of 2005 compared to the same quarter in 2004, while decreasing \$25 million or 9% for the first six months of 2005 compared to the same period in the prior year. The slight increase in software for the quarter reflects higher sales of application software in 2005 compared to 2004. The year-over-year decrease in software for the first half of 2005 is attributable primarily to a decrease in sales of the Company's Mac OS X Panther operating system, which was originally released in the first quarter of 2004, as customers awaited the release of the Company's newest operating system, Mac OS X Tiger, which became available at the end of April 2005.
- Service and other sales rose over 75% during the second quarter and rose 63% for the first six months of 2005 compared to the same periods in 2004. These increases are the result of significant year-over-year increases in net sales associated with AppleCare Protection Plan (APP) extended maintenance and support services, as well as increases in net sales associated with the Company's .Mac Internet service. Increased net sales associated with APP are primarily the result of higher Macintosh unit sales and higher attach rates on APP over the last several years.

Offsetting the favorable factors discussed above, the Company's net sales during the second quarter and first half of 2005 were negatively impacted by the following factors:

- Net sales and unit sales of the Company's Power Macintosh declined in the second quarter of 2005 and for the first half of 2005, compared to the same periods in the prior year. The Company's Power Macintosh net sales decreased 8% and 6% for the second quarter and first half of 2005, respectively, compared to the same periods in 2004. Unit sales also decreased 19% for both the three and six month periods ending March 26, 2005, compared to the same periods in 2004. These declines in Power Macintosh are partially attributable to strong sales in the first and second quarters of 2004, following the products' introduction at the end of the fourth quarter of 2003. In addition, the Company believes that the Power Macintosh decline in 2005 may have resulted from a shift in customer preference away from the single processor Power Mac G5 towards the iMac G5 and the continued shift to portable systems.

Segment Operating Performance

The Company manages its business primarily on a geographic basis. The Company's reportable operating segments are comprised of the Americas, Europe, Japan, and Retail. The Americas, Europe, and Japan reportable segments do not include activities related to the Retail segment within those geographies. The Americas segment includes both North and South America. The Europe segment includes European countries as well as the Middle East and Africa. The Japan segment includes only Japan. The Retail segment currently operates Apple-owned retail stores in the U.S., Japan, and the U.K. Each reportable geographic operating segment provides similar hardware and software products and similar services. Further information regarding the Company's operating segments may be found in Part I, Item 1 of this Form 10-Q in the Notes to Condensed Consolidated Financial Statements at Note 9, "Segment Information and Geographic Data."

Americas

Net sales in the Americas segment grew 64% or \$562 million in the second quarter of 2005 compared with the same quarter in 2004. For the first six months of 2005, net sales grew \$1.275 billion, a 71% increase, compared to the same period of 2004. The increase in net sales for the second quarter and first half of 2005 was primarily attributable to the significant year-over-year increase in iPod sales, sales of other music products, and strong sales of the Company's consumer-oriented iMac and iBook products, partially offset by lower Power Macintosh sales. For the

three and six month periods ended March 26, 2005, Macintosh unit sales in the Americas segment increased by 32% and 29%, respectively.

As noted above, the Company experienced an increase in U.S. education channel net sales of 25% and 22% for the second quarter and first six months of 2005, respectively, compared to the same periods in the prior year. This increase in U.S. education net sales relates primarily to strength in higher education net sales that drove year-over-year growth of 45% and 35% for the three and six months periods ended March 26, 2005, respectively. Strength in higher education sales related primarily to strong demand for the refreshed PowerBook product introduced in the second quarter of 2005 and continued demand for the iMac G5 introduced in the fourth quarter of 2004. The Company's K-12 net sales increased by 5% and 10% for the second quarter and first half of 2005, respectively, compared with the same periods in the prior year. The Company believes the K-12 market continues to be subject to budgetary constraints, which have limited year-over-year growth in net sales.

Europe

Net sales in Europe increased \$256 million or 57% during the second quarter of 2005 as compared to the same quarter in 2004, and increased \$584 million or 60% for the first six months of 2005 compared to the same period in 2004. Total Macintosh unit sales in Europe were up 48% and 40% in the second quarter and first half of 2005 compared to the same periods in 2004, respectively. Consistent with the Americas segment, Europe experienced strong net sales of iPod, other music products and consumer-oriented iMac and iBook products. In addition, the Europe segment experienced strong sales of peripherals and other hardware, including sales of Apple-branded and third-party displays and other hardware accessories.

Japan

Japan's net sales increased 64% to \$284 million during the second quarter of 2005 compared to the same quarter in 2004, and increased \$139 million or 42% for the first six months of 2005 compared to the same period in 2004. The net sales increase in Japan was the result of strong net sales of iPod, other music products, iMac products, and peripherals and other hardware. These increases were partially offset by lower iBook sales. Unit sales in Japan increased 34% and 8% for the second quarter and first half of 2005, respectively, compared to the same periods in the prior year. When net sales from the Japan retail stores are added in the results for the Japan segment the combined revenue in Japan resulted in a increase of 72% and 50% for the second quarter of 2005 and first half of 2005, respectively, compared to the same periods in 2004.

Retail

The Company opened two new retail stores during the second quarter of 2005, including its fourth international store, which is located in Nagoya, Japan. At the end of the second quarter of 2005, the Company had 103 retail stores open compared to 78 open stores at the end of the second quarter of 2004. The Retail segment's second quarter 2005 net sales grew by \$305 million or 115% from the same quarter in 2004. Net sales for the first six months of 2005 grew to \$1.132 billion from \$539 million during the same period of 2004, a 110% increase. The Retail segment experienced strong net sales for the second quarter and first half of 2005 across all product lines, except for the Power Macintosh, net sales of which were relatively flat. With an average of 102 stores open during the quarter, average quarterly revenue per store increased 60% to \$5.6 million, up from \$3.5 million in the year-ago quarter.

As measured by the Company's operating segment reporting, the Retail segment reported profit of \$42 million and \$87 million during the second quarter and first six months of 2005 as compared to profit of \$5 million and \$14 million during the second quarter and first six months of 2004. This improvement in profitability is primarily attributable to the segment's year-over-year growth in average quarterly revenue per store, the impact of opening 25 new stores, and the segment's overall increase in net sales for the second quarter and first six months of 2005, which resulted in higher leverage on occupancy, depreciation and other fixed costs.

Expansion of the Retail segment has required and will continue to require a substantial investment in fixed assets and related infrastructure, operating lease commitments, personnel, and other operating expenses. Capital expenditures associated with the Retail segment since its inception totaled \$394 million through the end of fiscal 2004, and totaled \$49 million during the first six months of 2005. As of March 26, 2005, the Retail segment had approximately 2,831 employees and had outstanding operating lease commitments associated with retail store space and related facilities of approximately \$489 million.

Gross Margin

Gross margin for the three and six months ended March 26, 2005 and March 27, 2004 was as follows (in millions, except gross margin percentages):

	Three Months Ended		Six Months Ended	
	3/26/05	3/27/04	3/26/05	3/27/04
Net sales	\$ 3,243	\$ 1,909	\$ 6,733	\$ 3,915
Cost of sales	2,275	1,379	4,769	2,849
Gross margin	\$ 968	\$ 530	\$ 1,964	\$ 1,066
Gross margin percentage	29.8%	27.8%	29.2%	27.2%

Gross margin of 29.8% and 29.2% for the three and six months ended March 26, 2005, respectively, increased from 27.8% and 27.2% for the same periods in 2004. The year-over-year increases in quarterly and year-to-date gross margins were primarily due to more favorable pricing on certain commodity components, a greater mix of direct sales, and higher overall revenue that provided for more effective leverage on fixed production costs. In addition, gross margins during the second quarter and first half of 2004 were negatively impacted due to pricing actions on certain Power Mac G5 models that were transitioned during 2004 and purchase order cancellation costs associated with those product transitions.

The Company expects gross margin to be approximately 130 basis points lower in the third quarter of 2005 than in the second quarter of 2005 primarily due to the following factors: an expected third quarter increase in K-12 education sales which typically consist of products with lower average selling prices and corresponding lower margins, such as iBooks and iMacs; the full quarter impact of the lower margin iPod shuffle and Mac mini products, which were introduced in January 2005; and the full quarter impact of price reductions taken in the second quarter of 2005 on certain products, including iPod photo, iPod mini, displays and PowerBooks. Partially offsetting these factors is an expected favorable impact on gross margins from Mac OS X software sales, related to Mac OS X "Tiger," which began shipping in April 2005.

The foregoing statements regarding the Company's expected gross margin, increased K-12 education sales, and Mac OS X sales are forward-looking. Gross margin could differ from anticipated levels because of several factors, including certain of those set forth below in the subsection entitled "Factors That May Affect Future Results and Financial Condition." There can be no assurance that current gross margins will be maintained, targeted gross margin levels will be achieved, or current margins on existing individual products will be maintained.

Operating Expenses

Operating expenses for the three and six months ended March 26, 2005 and March 27, 2004 were as follows (in millions, except for percentages):

	Three Months Ended		Six Months Ended	
	3/26/05	3/27/04	3/26/05	3/27/04
Research and development	\$ 119	\$ 123	\$ 242	\$ 242
Percentage of net sales	3.7%	6.4%	3.6%	6.2%
Selling, general, and administrative expenses	\$ 447	\$ 345	\$ 917	\$ 688
Percentage of net sales	13.8%	18.1%	13.6%	17.6%
Restructuring costs	\$ —	\$ 10	\$ —	\$ 10

Research and Development (R&D)

R&D remained relatively flat decreasing 3% or \$4 million to \$119 million in the second quarter of 2005 compared to \$123 million in the same period in 2004, while R&D during the first half of 2005 remained unchanged from the levels experienced in the first half of 2004. The slight year-over-year decrease in quarterly R&D relates primarily to capitalization of \$14.7 million in software development costs associated with Mac OS X Tiger in the second quarter of 2005, offset by an increase in R&D headcount to support expanded R&D activities. The Company also capitalized software development costs in the second quarter of 2004 totaling \$2.3 million related to the development of FileMaker Pro 7. In the first half of 2005, the Company capitalized approximately \$30 million of software development costs associated with Mac OS X Tiger, which was offset by an increase in R&D headcount to support expanded R&D activities. R&D as a percentage of net sales decreased to approximately 4% for the three and six months ended March 26, 2005 as compared to approximately 6% in the same periods of the prior year due to the significant increase in total net sales for the Company of 70% and 72% for the three and six month periods,

respectively. The Company continues to believe that focused investments in R&D are critical to its future growth and competitive position in the marketplace and expects to continue to invest heavily in R&D to remain competitive.

Selling, General, and Administrative Expense (SG&A)

Expenditures for SG&A increased \$102 million and \$229 million, respectively, for the three and six month periods ended March 26, 2005, or approximately 30% and 33%, respectively, compared to the same periods in 2004. These increases are due primarily to higher direct and channel variable selling expenses resulting from the significant year-over-year increase in total net sales for the second quarter and first half of 2005, the Company's continued expansion of its Retail segment in both domestic and international markets, and a current year increase in discretionary spending on marketing and advertising. SG&A as a percentage of net sales decreased to approximately 14% for the three and six months ended March 26, 2005 as compared to approximately 18% in the same periods of the prior year due to the leverage realized on fixed costs as a result of the significant year-over-year increase in total net sales for the Company of 70% and 72% for the three and six month periods, respectively.

Other Income and Expense

Other income and expense for the three and six months ended March 26, 2005 and March 27, 2004 was as follows (in millions):

	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>3/26/05</u>	<u>3/27/04</u>	<u>3/26/05</u>	<u>3/27/04</u>
Gains on non-current investments	—	—	—	4
Interest income	\$ 39	\$ 15	\$ 67	\$ 29
Interest expense	—	(1)	—	(3)
Other income (expense), net	(6)	(2)	(8)	(5)
Interest and other income, net	33	12	59	21
Total other income and expense	<u>\$ 33</u>	<u>\$ 12</u>	<u>\$ 59</u>	<u>\$ 25</u>

Gain on Non-current Investments

During the first quarter of 2004, the Company sold its remaining non-current investments in public companies consisting of 986,164 shares of Akamai Technologies for net proceeds of approximately \$5 million and a gain before taxes of \$4 million. As of March 26, 2005, the Company does not have any material non-current public company investments reflected in its condensed consolidated balance sheet.

Interest and Other Income, Net

Total interest and other income, net increased \$21 million or 175% to \$33 million during the second quarter of 2005 compared to the same quarter in 2004 and increased \$38 million or 181% for the first six months of 2005 from the same period in 2004. These increases are attributable primarily to higher cash and short-term investment balances and increasing investment yields resulting from higher market interest rates. The weighted average interest rate earned by the Company on its cash, cash equivalents and short-term investments increased to 2.37% in the second quarter of 2005 compared to the 1.32% rate earned during the same period in 2004. The Company occasionally sells short-term investments prior to their stated maturities. No gains or losses on early sales of short-term investments were recognized in either the second quarter or first half of 2005 or 2004.

Interest expense in the prior year consisted primarily of interest on the Company's \$300 million aggregate principal amount unsecured notes, which were repaid upon their maturity in February 2004, partially offset by amortization of deferred gains realized in 2002 and 2001 that resulted from the closure of swap positions associated with the unsecured notes.

Provision for Income Taxes

The Company's effective tax rate for the three and six months ended March 26, 2005 was approximately 33% and 32% respectively compared with approximately 28% for the same periods of 2004. The Company's effective rate for both periods differs from the statutory federal income tax rate of 35% due primarily to certain undistributed foreign earnings for which no U.S. taxes are provided because such earnings are intended to be indefinitely reinvested outside the U.S. The higher tax rate in the first six months of 2005 versus 2004 is due primarily to an overall increase in earnings as well as a greater mix of earnings in the U.S.

The Internal Revenue Service (IRS) has completed its field audit of the Company's federal income tax returns for all years prior to 2001 and proposed certain adjustments. Certain of these adjustments are being contested through the IRS Appeals Office. Substantially all IRS audit issues for these years have been resolved. In addition, the Company is also subject to audits by state, local, and foreign tax authorities. Management believes that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. Should any issues addressed in the Company's tax audits be 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.

On October 22, 2004, the American Jobs Creation Act (AJCA) was signed into law. The AJCA includes a provision for the deduction of 85% of certain foreign earnings that are repatriated, as defined in the AJCA. The Company may elect to apply this provision to repatriations of qualifying earnings in either fiscal year 2005 or 2006. The Company is currently evaluating the effects of the repatriation provision. Important factors in the Company's evaluation include additional clarification of key elements of the provision to be issued by the U.S. Treasury Department and pending technical corrections by Congress. Assuming there is sufficient additional guidance from the U.S. Treasury Department and Congress, the Company expects to complete its evaluation of the effects of the repatriation provision in the fourth quarter of 2005. A maximum of \$755 million may be eligible for repatriation under the reduced tax rate provided by AJCA. However, given the uncertainties and complexities of the repatriation provision and the preliminary stage of the Company's evaluation, it is not possible at this time to determine the amount that may be repatriated or the related potential income tax effects of such repatriation.

Recent Accounting Pronouncements

In March 2004, the FASB issued Emerging Issues Task Force (EITF) Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. EITF 03-1 includes new guidance for evaluating and recording impairment losses on debt and equity investments, as well as new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the FASB issued FASB Staff Position (FSP) EITF 03-1-1, which delays the effective date until additional guidance is issued for the application of the recognition and measurement provisions of EITF 03-1 to investments in securities that are impaired. Although the Company will continue to evaluate the application of EITF 03-1, management does not currently believe adoption will have a material impact on the Company's results of operations or financial position.

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs*, which amends the guidance in Accounting Research Bulletin (ARB) No. 43, Chapter 4, *Inventory Pricing*, to clarify the accounting for abnormal amounts of facility expense, freight, handling costs, and wasted material (spoilage). ARB 43, Chapter 4, previously stated that "under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges." SFAS 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal." In addition, SFAS 151 requires that allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the production facilities. SFAS 151 is effective for fiscal years beginning after June 15, 2005. Although the Company will continue to evaluate the application of SFAS 151, management does not currently believe adoption will have a material impact on the Company's results of operations or financial position.

In December 2004, the FASB issued FSP 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004*. FSP 109-2 provides additional time to companies beyond the financial reporting period of enactment to evaluate the effects of the AJCA on their plans for repatriation of foreign earnings for purposes of applying SFAS 109, *Accounting for Income Taxes*. The Company is currently evaluating the repatriation provisions of AJCA, which if implemented by the Company would affect the Company's tax provision and deferred tax assets and liabilities. However, given the preliminary stage of the Company's evaluation, it is not possible at this time to determine the amount that may be repatriated or the related potential income tax effects of such repatriation.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets*, which amends Accounting Principles Board (APB) Opinion No. 29, *Accounting for Nonmonetary Transactions*. The guidance in APB Opinion 29 is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. The guidance in APB Opinion 29, however, included certain exceptions to that principle. SFAS 153 amends APB Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and

replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS 153 is effective for fiscal periods beginning after June 15, 2005. Although the Company will continue to evaluate the application of SFAS 153, management does not currently believe adoption will have a material impact on the Company's results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123 (revised 2004) (SFAS 123R), *Share-Based Payment*, that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. SFAS 123R eliminates the ability to account for share-based compensation transactions using the intrinsic value method under APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and generally would require instead that such transactions be accounted for using a fair-value-based method. The Company is currently evaluating SFAS 123R to determine which fair-value-based model and transitional provision it will follow upon adoption. The options for transition methods as prescribed in SFAS 123R include either the modified prospective or the modified retrospective methods. The modified prospective method requires that compensation expense be recorded for all unvested stock options and restricted stock as the requisite service is rendered beginning with the first quarter of adoption, while the modified retrospective method would record compensation expense for stock options and restricted stock beginning with the first period restated. Under the modified retrospective method, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. In April 2005, the SEC deferred the effective date of SFAS 123R to years beginning after June 15, 2005. Therefore, SFAS 123R will be effective for the Company beginning in its first quarter of fiscal 2006. Although the Company will continue to evaluate the application of SFAS 123R, management expects adoption to have a material impact on the Company's results of operations.

In March 2005, the FASB issued Interpretation No. (FIN) 47, *Accounting for Conditional Asset Retirement Obligations*, to clarify the requirement to record liabilities stemming from a legal obligation to clean up and retire fixed assets, such as a plant or factory, when an asset retirement depends on a future event. The Company plans to adopt FIN 47 in the first quarter of fiscal 2006, and does not expect the application of FIN 47 to have a material impact on its results of operations, cash flows or financial position.

Liquidity and Capital Resources

The following table presents selected financial information and statistics for each of the fiscal quarters ended on the dates indicated (dollars in millions):

	3/26/05	9/25/04
Cash, cash equivalents, and short-term investments	\$ 7,057	\$ 5,464
Accounts receivable, net	\$ 888	\$ 774
Inventory	\$ 164	\$ 101
Working capital	\$ 5,655	\$ 4,404
Days sales in accounts receivable (DSO) (a)	25	30
Days of supply in inventory (b)	7	5
Days payables outstanding (DPO) (c)	71	76
Operating cash flow (quarterly)	\$ 536	\$ 443

(a) DSO is based on ending net trade receivables and most recent quarterly net sales for each period.

(b) Days supply of inventory is based on ending inventory and most recent quarterly cost of sales for each period.

(c) DPO is based on ending accounts payable and most recent quarterly cost of sales adjusted for the change in inventory.

As of March 26, 2005, the Company had \$7.057 billion in cash, cash equivalents, and short-term investments, an increase of \$1.593 billion over the same balances at the end of fiscal 2004. The principal components of this increase were cash generated by operating activities of \$1.311 billion and proceeds of \$406 million from the issuance of common stock under stock plans, partially offset by purchases of property, plant, and equipment of \$101 million. The Company's short-term investment portfolio is primarily invested in high credit quality, liquid investments. Approximately \$3.9 billion of this cash, cash equivalents, and short-term investments is held by the Company's foreign subsidiaries and would be subject to U.S. income taxation on repatriation to the U.S. The Company is

currently assessing the impact of the one-time favorable foreign dividend provisions recently enacted as part of the AJCA, and may decide to repatriate earnings from some of its foreign subsidiaries.

The Company believes its existing balances of cash, cash equivalents, and short-term investments will be sufficient to satisfy its working capital needs, capital expenditures, stock repurchase activity, outstanding commitments, and other liquidity requirements associated with its existing operations over the next 12 months.

Capital Expenditures

The Company's total capital expenditures were \$101 million during the first six months of fiscal 2005, \$49 million of which were for retail store facilities and equipment related to the Company's Retail segment and \$52 million of which were for corporate infrastructure, including information systems enhancements and operating facilities enhancements and expansions. The Company currently anticipates it will utilize approximately \$280 million for capital expenditures during 2005, approximately \$140 million of which is expected to be utilized for expansion of the Company's Retail segment and the remainder utilized to support normal replacement of existing capital assets and enhancements to general corporate infrastructure.

Stock Repurchase Plan

In July 1999, the Company's Board of Directors authorized a plan for the Company to repurchase up to \$500 million of its common stock. This repurchase plan does not obligate the Company to acquire any specific number of shares or acquire shares over any specified period of time. Since inception of the stock repurchase plan, the Company had repurchased a total of 13.2 million shares at a cost of \$217 million. The Company was authorized to repurchase up to an additional \$283 million of its common stock as of March 26, 2005.

Common Stock Split

On February 28, 2005 the Company effected a two-for-one stock split to shareholders of record as of February 18, 2005. All share and per share information has been retroactively adjusted to reflect the stock split.

Off-Balance Sheet Arrangements and Contractual Obligations

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

Lease Commitments

As of September 25, 2004, the Company had total outstanding commitments on noncancelable operating leases of approximately \$617 million, \$436 million of which related to the lease of retail space and related facilities. Remaining terms on the Company's existing operating leases range from 2 to 16 years. Total outstanding commitments on noncancelable operating leases related to the lease of retail space rose to \$489 million as of March 26, 2005.

Purchase Commitments with Contract Manufacturers and Component Suppliers

The Company utilizes several contract manufacturers to manufacture sub-assemblies for the Company's products and to perform final assembly and test of finished products. These contract manufacturers acquire components and build product based on demand information supplied by the Company, which typically covers periods ranging from 30 to 130 days. The Company also obtains individual components for its products from a wide variety of individual suppliers. Consistent with industry practice, the Company acquires components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. Such purchase commitments typically cover the Company's forecasted component and manufacturing requirements for periods ranging from 30 to 130 days. The nature of the Company's outstanding third-party manufacturing commitments and component purchase commitments has not changed significantly since the end of its fiscal 2004. As of March 26, 2005, the Company had outstanding third-party manufacturing commitments and component purchase commitments of approximately \$1.13 billion.

Asset Retirement Obligations

The Company's asset retirement obligations are associated with commitments to return property subject to operating leases to original condition upon lease termination. As of September 25, 2004, the Company estimated that gross

expected future cash flows of approximately \$12 million would be required to fulfill these obligations. No significant changes to this estimate have been made during the first six months of 2005.

Other Obligations

As of September 25, 2004, the Company's other obligations of approximately \$24 million are primarily related to telecommunications services. No significant changes to this estimate have been made in the first six months of 2005.

Indemnifications

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

Factors That May Affect Future Results and Financial Condition

Because of the following factors, as well as other factors affecting the Company's operating results and financial condition, 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.

General economic conditions and current economic and political uncertainty could adversely affect the demand for the Company's products and the financial health of its suppliers, distributors, and resellers.

The Company's operating performance depends significantly on general economic conditions in the U.S. and abroad. Over the past several years, demand for the Company's products has been negatively impacted by difficult global economic conditions. Additionally, some of the Company's education customers appeared to be delaying technology purchases due to concerns about the overall impact of the weaker economy and state budget deficits on their available funding. Although recent macroeconomic trends seem to indicate an economic recovery, continued uncertainty about future economic conditions makes it difficult to forecast future demand for the Company's products and related operating results. Should global and/or regional economic conditions deteriorate, demand for the Company's products could be adversely affected, as could the financial health of its suppliers, distributors, and resellers.

War, terrorism, public health issues or other business interruptions could disrupt supply, delivery or demand of products, which could negatively affect the Company's operations and performance.

War, terrorism, public health issues and other business interruptions whether in the U.S. or abroad, have caused and could continue to cause damage or disruption to international commerce by creating economic and political uncertainties that may have a strong negative impact on the global economy, the Company, and the Company's suppliers or customers. The Company's major business operations are subject to interruption by earthquake, other natural disasters, fire, power shortages, terrorist attacks and other hostile acts, labor disputes, medical conditions, and other events beyond its control. The majority of the Company's research and development activities, its corporate headquarters, information technology systems, and other critical business operations, including certain component suppliers and manufacturing vendors, are located near major seismic faults. Because the Company does not carry earthquake insurance for direct quake-related losses, the Company's operating results and financial condition could be materially adversely affected in the event of a major earthquake or other natural or manmade disaster.

Although it is impossible to predict the occurrences or consequences of any such events, such events could result in a decrease in demand for the Company's products, make it difficult or impossible to deliver products to its customers or to receive components from its suppliers, and could create delays and inefficiencies in the Company's supply chain. In addition, should major public health issues, including epidemics, arise the Company could be negatively impacted by the need for more stringent employee travel restrictions, additional limitations in the availability of freight services, governmental actions limiting the movement of products between various regions, delays in production ramps of new products, and disruptions in the operations of the Company's manufacturing vendors and component suppliers. The Company's operating results and financial condition have been, and in the future may be adversely affected by these events.

The market for personal computers and related peripherals and services, as well as digital music devices and related services, is highly competitive. If the Company is unable to effectively compete in these markets, its results of operations could be adversely affected.

The personal computer industry is highly competitive and is characterized by aggressive pricing practices, 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, price sensitivity on the part of consumers, and a large number of competitors. Over the past several years, price competition in the market for personal computers and related peripherals has been particularly intense as competitors who sell Windows and Linux based personal computers have aggressively cut prices and lowered their product margins for personal computing products. The Company's results of operations and financial condition have been, and in the future may continue to be, adversely affected by these and other industry-wide pricing pressures and downward pressures on gross margins.

The personal computer industry has also been characterized by rapid technological advances in software functionality, hardware performance, and features based on existing or emerging industry standards. Further, as the personal computer industry and its customers place more reliance on the Internet, an increasing number of Internet devices that are smaller and simpler than traditional personal computers may compete for market share with the Company's existing products. Several competitors of the Company have either targeted or announced their intention to target certain of the Company's key market segments, including consumer, education, professional and consumer digital video editing, and design and publishing. Several of the Company's competitors have introduced or announced plans to introduce digital music products and/or online stores offering digital music distribution that mimic many of the unique design, technical features, and solutions of the Company's products. The Company has a significant number of competitors, many of whom have greater financial, marketing, manufacturing, and technological resources, as well as broader product lines and larger installed customer bases than those of the Company. Additionally, there has been a trend towards consolidation in the personal computer industry that has resulted in larger and potentially stronger competitors in the Company's markets.

The Company is currently the only maker of hardware using the Mac OS. The Mac OS has a minority market share in the personal computer market, which is dominated by makers of computers utilizing other competing operating systems, including Windows and Linux. The Company's future operating results and financial condition are substantially dependent on its ability to continue to develop improvements to the Macintosh platform in order to maintain perceived design and functional advantages over competing platforms.

The Company is currently focused on market opportunities related to digital music distribution and related consumer electronic devices, including iPods. The Company faces increasing competition from other companies promoting their own digital music products and distribution services and free peer-to-peer music services. These competitors include both new entrants with different market approaches, such as subscription services models, and also larger companies that may have greater technical, marketing, distribution and other resources than those of the Company, as well as established hardware, software and music content supplier relationships. Failure to effectively compete could negatively affect the Company's operating results and financial position. There can be no assurance that the Company will be able to continue to provide products and services that effectively compete in these markets or successfully distribute and sell digital music outside the U.S. The Company may also have to respond to price competition by lowering prices and/or increasing features which could adversely affect the Company's music product gross margins as well as overall Company gross margins.

The Company also faces increased competition in the U.S. education market. Sales in the U.S. to both elementary and secondary schools, as well as for college and university customers, remain a core market for the Company. Uncertainty in this channel remains as several competitors of the Company have either targeted or announced their intention to target the education market for personal computers, which could negatively affect the Company's market share. In an effort to regain market share and remain competitive, the Company has been and will continue to pursue one-to-one (1:1) learning solutions in education. The Company's 1:1 learning solutions are a complete solution consisting of an iBook portable system for every student and teacher along with a wireless network connected to a central server. These 1:1 learning solutions and other strategic sales are generally priced more aggressively and could result in significantly less profitability or even in financial losses, particularly for larger deals. Although the Company believes it has taken certain steps to strengthen its position in the education market, there can be no assurance that the Company will be able to increase or maintain its share of the education market or execute

profitably on large strategic arrangements. Failure to do so may have an adverse impact on the Company's operating results and financial condition.

The Company must successfully manage frequent product introductions and transitions in order to remain competitive and effectively stimulate customer demand.

Due to the highly volatile and competitive nature of the personal computer and consumer electronics industries, which are characterized by dynamic customer demand patterns and rapid technological advances, the Company must continually introduce new products and technologies, enhance existing products in order to remain competitive, and effectively stimulate customer demand for new products and upgraded versions of the Company's existing products. The success of new product introductions is dependent on a number of factors, including market acceptance; the Company's ability to manage the risks associated with product transitions, including production ramp issues; the availability of application software for new products; the effective management of inventory levels in line with anticipated product demand; the availability of products in appropriate quantities to meet anticipated demand; and the risk that new products may have quality or other defects in the early stages of introduction. Accordingly, the Company cannot determine in advance the ultimate effect that new products will have on its sales or results of operations.

The Company's products, from time to time, experience quality problems that can result in decreased net sales and operating profits.

The Company sells highly complex hardware and software products that can contain defects in design and manufacture. Sophisticated operating system software and applications, such as those sold by the Company, often contain "bugs" that can unexpectedly interfere with the operation of the software. Defects may also occur in components and products the Company purchases from third-parties. There can be no assurance that the Company will be able to detect and fix all defects in the hardware and software it sells. Failure to do so could result in lost revenue, loss of reputation, and significant warranty and other expense to remedy.

Because orders for components, and in some cases commitments to purchase components, must be placed in advance of customer orders, the Company faces substantial inventory risk.

The Company records a write-down for inventories of components and products that have become obsolete or are in excess of anticipated demand or net realizable value and accrues necessary reserves for cancellation fees of orders for inventories that have been cancelled. Although the Company believes its inventory and related provisions are adequate, given the rapid and unpredictable pace of product obsolescence in the computer and consumer electronics industries, no assurance can be given that the Company will not incur additional inventory and related charges. In addition, such charges have had, and may have, a material effect on the Company's financial position and results of operations.

The Company must order components for its products and build inventory in advance of product shipments. Because the Company's markets are volatile and subject to rapid technology and price changes, there is a risk the Company will forecast incorrectly and produce or order from third parties excess or insufficient inventories of particular products. Consistent with industry practice, components are normally acquired through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. Such purchase commitments typically cover the Company's forecasted component and manufacturing requirements for periods ranging from 30 to 130 days. The Company's operating results and financial condition have been in the past and may in the future be materially adversely affected by the Company's ability to manage its inventory levels and respond to short-term shifts in customer demand patterns.

Future operating results are dependent upon the Company's ability to obtain a sufficient supply of components, including microprocessors, some of which are in short supply or available only from limited sources.

Although most components essential to the Company's business are generally available from multiple sources, certain key components including microprocessors and ASICs are currently obtained by the Company from single or limited sources. Some key components (including without limitation DRAM, and TFT-LCD flat-panel displays), while currently available to the Company from multiple sources, are at times subject to industry-wide availability and pricing pressures. In addition, new products introduced by the Company often initially utilize custom components obtained from only one source until the Company has evaluated whether there is a need for, and subsequently qualifies, additional suppliers. In situations where a component or product utilizes new technologies, initial capacity constraints may exist until such time as the suppliers' yields have matured. The Company and other producers in the personal computer industry also compete for various components with other industries that have experienced

increased demand for their products. The Company uses some components that are not common to the rest of the personal computer industry including certain microprocessors and ASICs. Continued availability of these components may be affected if producers were to decide to concentrate on the production of components other than those customized to meet the Company's requirements. If the supply of a key component were to be delayed or constrained on a new or existing product, the Company's results of operations and financial condition could be adversely affected.

The Company's ability to produce and market competitive products is also dependent on the ability and desire of IBM and Freescale Semiconductor, Inc. (Freescale), the sole suppliers of the PowerPC RISC-based microprocessor for the Company's Macintosh computers, to provide the Company with a sufficient supply of microprocessors with price/performance features that compare favorably to those supplied to the Company's competitors by Intel Corporation and other developers and producers of microprocessors used by personal computers using other operating systems. Further, despite its efforts to educate the marketplace to the contrary, the Company believes that many of its current and potential customers believe that the relatively slower MHz rating or clock speed of the microprocessors it utilizes in its Macintosh systems compares unfavorably to those utilized by other operating systems and translates to slower overall system performance. There have been instances in recent years where the inability of the Company's suppliers to provide advanced PowerPC microprocessors in sufficient quantity has had significant adverse effects on the Company's results of operations. In addition, IBM is currently the Company's sole supplier of the PowerPC G5 processor, which is used in the Company's current Power Mac, Xserve, and iMac G5 products. Freescale is the sole supplier of the G4 processor, which is used in the Company's eMac, Mac mini, and portable products. IBM has recently experienced manufacturing problems with the PowerPC G5 processor, which resulted in the Company delaying the shipment of various products and constrained certain product shipments during the second half of fiscal 2004 and the first quarter of fiscal 2005. Manufacturing problems of either of these suppliers in the future, or failure by them to deliver microprocessors to the Company in sufficient quantities with competitive price/performance features could adversely affect the Company's results of operations and financial condition.

The Company is dependent on manufacturing and logistics services provided by third parties, many of whom are located outside of the U.S. Most of the Company's products are manufactured in whole or in part by third-party manufacturers. In addition, the Company has outsourced much of its transportation and logistics management. While outsourcing arrangements may lower the cost of operations, 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 the products manufactured or services rendered, or the flexibility of the Company to respond to changing market conditions. Moreover, although arrangements with such manufacturers may contain provisions for warranty expense reimbursement, the Company may remain at least initially responsible to the ultimate consumer for warranty service in the event of product defects. Any unanticipated product defect or warranty liability, whether pursuant to arrangements with contract manufacturers or otherwise, could adversely affect the Company's future operating results and financial condition.

Final assembly of products sold by the Company is currently conducted in the Company's manufacturing facility in Cork, Ireland, and by external vendors in Fremont, California, Fullerton, California, Taiwan, Korea, the Netherlands, the People's Republic of China, and the Czech Republic. Currently, manufacture of many of the components used in the Company's products and final assembly of substantially all of the Company's portable products including PowerBooks, iBooks, and the iPod is performed by third-party vendors in Taiwan and China. If for any reason manufacturing or logistics in any of these locations is disrupted by events such as regional economic, business, environmental, medical, political, information technology system failures, or military actions, the Company's results of operations and financial condition could be adversely affected.

The Company's future operating performance is dependent on the performance of distributors and other resellers of the Company's products. The Company distributes its products through wholesalers, resellers, national and regional retailers and cataloguers, many of whom distribute products from competing manufacturers. In addition, the Company also sells many of its products and resells certain third-party products in most of its major markets directly to end users, certain education customers, and certain resellers through its online stores around the world and its retail stores. Many of the Company's significant resellers operate on narrow product margins and have been negatively affected by recent economic conditions. Considerable trade receivables that are not covered by collateral or credit insurance are outstanding with the Company's distribution and retail channel partners. The Company's business and financial results could be adversely affected if the financial condition of these resellers weaken, if resellers within consumer

channels were to cease distribution of the Company's products, or if uncertainty regarding demand for the Company's products caused resellers to reduce their ordering and marketing of the Company's products. The Company has invested and will continue to invest in various programs to enhance reseller sales, including staffing selected resellers' stores with Company employees. These programs could require a substantial investment from the Company, while providing no assurance of return or incremental revenue to offset this investment.

Over the past several years, an increasing proportion of the Company's net sales have been made by the Company directly to end-users through its online stores around the world and through its retail stores in the U.S., Japan, and the U.K. Some of the Company's resellers have perceived this expansion of the Company's direct sales as conflicting with their own business and economic interests as distributors and resellers of the Company's products. Perception of such a conflict could discourage the Company's resellers from investing additional resources in the distribution and sale of the Company's products or lead them to limit or cease distribution of the Company's products. The Company's business and financial results could be adversely affected if expansion of its direct sales to end-users causes some or all of its resellers to cease or limit distribution of the Company's products.

Further information regarding risks associated with Marketing and Distribution may be found in Part I, Item 1 of the 2004 Form 10-K for the year ended September 25, 2004 under the heading "Markets and Distribution."

The Company relies on third-party music content, which may not be available to the Company on commercially reasonable terms or at all. The Company contracts with third parties to offer their music content to customers through the Company's iTunes Music Store. The Company pays substantial fees to obtain the rights to offer to its customers this third-party music. The Company's licensing arrangements with these third-party content providers are short-term in nature and do not guarantee the future renewal of these arrangements at commercially reasonable terms, if at all. Certain parties in the music industry have announced their intent to consolidate their music distribution operations, which could limit the availability and increase the fees required to offer music content to customers through the iTunes Music Store. Further, some third-party content providers currently, or may in the future, offer music products and services that compete with the Company's music products and services, and could take action to make it more difficult or impossible for the Company to license their music content in the future. If the Company is unable to continue to offer a wide variety of music content at reasonable prices with acceptable usage rules, or continue to expand its geographic reach outside the U.S., then sales and gross margins of the Company's iTunes Music Store as well as related hardware and peripherals, including iPods, may be adversely affected.

Third-party content providers and artists require that the Company provide certain digital rights management solutions and other security mechanisms. If the requirements from content providers or artists change, then the Company may be required to further develop or license technology to address such new rights and requirements. There is no assurance that the Company will be able to develop or license such solutions at a reasonable cost and in a timely manner, if at all, which could have a materially adverse effect on the Company's operating results and financial position.

The Company's future performance is dependent upon support from third-party software developers. If third-party software applications cease to be developed or available for the Company's hardware products, then customers may choose not to buy the Company's products. The Company believes that decisions by customers to purchase the Company's personal computers, as opposed to Windows-based systems, are often based on the availability of third-party software for particular applications such as Microsoft Office. The Company also believes the availability of third-party application software for the Company's hardware products depends in part on third-party developers' perception and analysis of the relative benefits of developing, maintaining, and upgrading such software for the Company's products versus software for the larger Windows market or growing Linux market. This analysis is based on factors such as the perceived strength of the Company and its products, the anticipated potential revenue that may be generated, continued acceptance by customers of Mac OS X, and the costs of developing such software products. To the extent the minority market share held by the Company in the personal computer market has caused software developers to question the Company's prospects in the personal computer market, developers could be less inclined to develop new application software or upgrade existing software for the Company's products and more inclined to devote their resources to developing and upgrading software for the larger Windows market or growing Linux market. Moreover, there can be no assurance software developers will continue to develop software for Mac OS X, the Company's operating system, on a timely basis or at all.

In addition, past and future development by the Company of its own software applications and solutions may negatively impact the decision of software developers to develop, maintain, and upgrade similar or competitive software for the Company's products. The Company currently markets and sells a variety of software applications for use by professionals, consumers, and education customers that could influence the decisions of third-party software developers to develop or upgrade Macintosh-compatible software products. Software applications currently marketed by the Company include software for professional film and video editing, professional compositing and visual effects for large format film and video productions, professional music production and music post production, professional and consumer DVD encoding and authoring, consumer digital video and digital photo editing and management, digital music management, desktop-based database management, word processing, and high-quality presentations. The Company also markets an integrated productivity application that incorporates word processing, page layout, image manipulation, spreadsheets, databases, and presentations in a single application.

In August 1997, the Company and Microsoft Corporation entered into patent cross license and technology agreements. In addition, for a period of five years through August 2002, and subject to certain limitations related to the number of Macintosh computers sold by the Company, Microsoft was required to make versions of its Microsoft Office and Internet Explorer products for the Mac OS. Although Microsoft has released Microsoft Office and Internet Explorer for Mac OS X, Microsoft has not been obligated to produce future versions of its products subsequent to August 2002. While the Company believes its relationship with Microsoft has been and will continue to be beneficial to the Company and to its efforts to increase the installed base for the Mac OS, the Company does compete directly with Microsoft in a number of key areas. Accordingly, Microsoft's interest in producing application software for the Mac OS following expiration of the agreements may be influenced by Microsoft's perception of its interests as the vendor of the Windows operating system and competing digital media applications, including music distribution service and technology. In June of 2003, Microsoft stated that it would no longer develop new versions of Internet Explorer for the Mac OS, subsequent to the Company's introduction during 2003 of its own web browser, Safari. Further discontinuance of products for the Macintosh platform, including Microsoft Office and other Microsoft products could have an adverse effect on the Company's net sales and results of operations.

The Company's business relies on access to patents and intellectual property obtained from third parties, and the Company's future results could be adversely affected if it is alleged or found to have infringed on the intellectual property rights of others.

Many of the Company's products are designed to include intellectual property obtained from third-parties. While it may be necessary in the future to seek or renew licenses relating to various aspects of its products and business methods, the Company believes that based upon past experience and industry practice, such licenses generally could be obtained on commercially reasonable terms. However, there can be no assurance that the necessary licenses would be available or available on acceptable terms.

Because of technological changes in the computer and consumer electronics industries, current extensive patent coverage, and the rapid rate of issuance of new patents, it is possible certain components of the Company's products and business methods may unknowingly infringe existing patents of others. The Company has from time to time been notified that it may be infringing certain patents or other intellectual property rights of others. Responding to such claims, regardless of their merit, can be time consuming, result in significant expenses, and cause the diversion of management and technical personnel. Several pending claims are in various stages of evaluation. The Company may consider the desirability of entering into licensing agreements in certain of these cases. However, no assurance can be given that such licenses can be obtained on acceptable terms or that litigation will not occur. In the event there is a temporary or permanent injunction entered prohibiting the Company from marketing or selling certain of its products or a successful claim of infringement against the Company requiring it to pay royalties to a third-party, the Company's future operating results and financial condition could be adversely affected. Information regarding certain claims and litigation involving the Company related to alleged patent infringement and other matters is set forth in Part II, Item 1 of this Form 10-Q and Part I, Item 3 of the 2004 Form 10-K. In the opinion of management, the Company does not have a potential liability for damages or royalties from any current legal proceedings or claims related to the infringement of patent or other intellectual property rights of others that would individually or in the aggregate have a material adverse effect on its results of operations, or financial condition. However, the results of such legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of the matters related to infringement of patent or other intellectual property rights of others described in Part II, Item 1 of this Form 10-Q and Part I, Item 3 of the 2004 Form 10-K or should several of these matters be resolved against the

Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

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

Through April 2005, the Company has opened 105 retail stores. The Company's retail initiative has required substantial investment in equipment and leasehold improvements, information systems, inventory, and personnel. The Company has also entered into substantial operating lease commitments for retail space with lease terms ranging from 5 to 16 years, the majority of which are for 10 years. The Company could incur substantial costs should it choose to terminate this initiative or close individual stores. Such costs could adversely affect the Company's results of operations and financial condition. Additionally, a relatively high proportion of the Retail segment's costs are fixed because of depreciation on store construction costs and lease expense. As a result, significant losses would result should the Retail segment experience a decline in sales for any reason.

Certain of the Company's stores have been designed and built to serve as high profile venues that function as vehicles for general corporate marketing, corporate events, and brand awareness. Because of their unique design elements, locations and size, these stores require substantially more investment in equipment and leasehold improvements than the Company's more typical retail stores. The Company has opened seven such stores through March 2005. Because of their location and size, these high profile stores also require the Company to enter into substantially larger operating lease commitments compared to those required for its more typical stores. Current leases on such locations have terms ranging from 10 to 16 years with total commitments per location over the lease terms ranging from \$25 million to \$50 million. Closure or poor performance of one of these high profile stores could have a particularly significant negative impact on the Company's results of operations and financial condition.

Many of the general risks and uncertainties the Company faces could also have an adverse impact on its Retail segment. Also, many factors unique to retail operations present risks and uncertainties, some of which are beyond the Company's control, that could adversely affect the Retail segment's future results, cause its actual results to differ from those currently expected, and/or have an adverse effect on the Company's consolidated results of operations. Potential risks and uncertainties unique to retail operations that could have an adverse impact on the Retail segment include, among other things, macro-economic factors that have a negative impact on general retail activity; inability to manage costs associated with store construction and operation; failure to attract new users to the Macintosh platform; inability to sell third-party hardware and software products at adequate margins; failure to manage relationships with existing retail channel partners; lack of experience in managing retail operations outside the U.S.; costs associated with unanticipated fluctuations in the value of Apple-branded and third-party retail inventory; and inability to obtain quality retail locations at reasonable cost.

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

The Company may decide to invest in new business strategies or engage in acquisitions that complement the Company's strategic direction and product roadmap. Such endeavors may involve significant risks and uncertainties, including distraction of management's attention away from normal business operations; insufficient revenue generation to offset liabilities assumed and expenses associated with the strategy; and unidentified issues not discovered in the Company's due diligence process. Because these new ventures are inherently risky, no assurance can be given that such strategies and initiatives will be successful and will not materially adversely affect the Company's business, operating results or financial condition.

Declines in the sales of the Company's professional products or increases in sales of consumer products, including iPods, may negatively impact the Company's gross margin and operating margin percentages.

Unit sales of the Company's professional products, including Power Macintosh and PowerBook systems, generally have higher gross margins than the Company's consumer products, including iMacs, iBooks, iPods, and content from the iTunes Music Store. A shift in sales mix away from higher margin professional products towards lower margin consumer products could adversely affect the Company's future gross margin and operating margin percentages. The Company's traditional professional customers may choose to buy consumer products, specifically the iMac G5 and iBook, instead of professional products. Professional users may choose to buy the iMac G5 due to its relative price performance, use of the same PowerPC G5 processor used in the Company's Power Macs, and unique design featuring a flat panel screen. Potential PowerBook customers may also choose to purchase iBooks instead due to their price performance and screen size. Additionally, significant future growth in iPod sales without corresponding growth in higher margin product sales could also reduce gross margin and operating margin percentages.

The Company believes that weak economic conditions over the past several years are having a pronounced negative impact on its professional and creative customers who are significant users of its professional systems. Also, it is likely that many of the Company's current and potential professional, creative, and small business customers, who are most likely to utilize professional systems, believe that the relatively slower MHz rating or clock speed of the microprocessors the Company utilizes in its Macintosh systems compares unfavorably to those utilized by other computer manufacturers and translates to slower overall system performance. These factors may result in an adverse impact to sales of the Company's professional products as well as to gross margin and operating margin percentages.

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

The Company's profit margins vary among its products and its distribution channels. The Company's direct sales, primarily through its retail and online stores, generally have higher associated profitability than its indirect sales. Additionally, the Company's direct channels have traditionally had more sales of software and higher priced hardware products, which generally have higher gross margins, than through its indirect channels. As a result, the Company's gross margin and operating margin percentages as well as overall profitability may be adversely impacted as a result of a shift in product, geographic or channel mix. In addition, the Company generally sells more products during the third month of each quarter than it does during either of the first two months, a pattern typical in the personal computer industry. This sales pattern can produce pressure on the Company's internal infrastructure during the third month of a quarter and may adversely impact the Company's ability to predict its financial results accurately. Developments late in a quarter, such as lower-than-anticipated demand for the Company's products, an internal systems failure, or failure of one of the Company's key logistics, components suppliers, or manufacturing partners, can have significant adverse impacts on the Company and its results of operations and financial condition.

The Company has higher research and development and selling, general and administrative costs, as a percentage of revenue, than many of its competitors.

The Company's ability to compete successfully and maintain attractive gross margins and revenue growth is heavily dependent upon its ability to ensure a continuing and timely flow of innovative and competitive products and technologies to the marketplace. As a result, the Company incurs higher research and development costs as a percentage of revenue than its competitors who sell personal computers based on other operating systems. Many of these competitors seek to compete aggressively on price and maintain very low cost structures. Further, as a result of the expansion of the Company's Retail segment and costs associated with marketing the Company's brand including its unique operating system, the Company incurs higher selling costs as a percentage of revenue than many of its competitors. If the Company is unable to continue to develop and sell innovative new products with attractive gross margins, its results of operations may be materially adversely affected by its operating cost structure.

The Company is exposed to credit risk on its accounts receivable. This risk is heightened during periods when economic conditions worsen.

The Company distributes its products through third-party computer resellers and retailers and directly to certain educational institutions and commercial customers. A substantial majority of the Company's outstanding trade receivables are not covered by collateral or credit insurance. The Company also has unsecured non-trade receivables from certain of its manufacturing vendors resulting from the sale by the Company of raw material components to these manufacturing vendors who manufacture sub-assemblies or assemble final products for the Company. While the Company has procedures in place to monitor and limit exposure to credit risk on its trade and non-trade receivables, there can be no assurance that such procedures will be effective in limiting its credit risk and avoiding losses. Additionally, if the global economy and regional economies fail to improve or continue to deteriorate, it becomes more likely that the Company will incur a material loss or losses as a result of the weakening financial condition of one or more of its customers or manufacturing vendors.

The Company's success depends largely on its ability to attract and retain key personnel.

Much of the future success of the Company depends on the continued service and availability of skilled personnel, including its Chief Executive Officer, members of its executive team, and those in technical, marketing and staff positions. Experienced personnel in the information technology industry are in high demand and competition for their talents is intense, especially in the Silicon Valley, where the majority of the Company's key employees are located. The Company has relied on its ability to grant stock options as one mechanism for recruiting and retaining this highly skilled talent. Recent accounting regulations requiring the expensing of stock options will impair the Company's future ability to provide these incentives without incurring significant compensation costs. There can be no assurance that the Company will continue to successfully attract and retain key personnel.

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

The Company has observed rapidly changing conditions in the insurance markets relating to nearly all areas of traditional commercial insurance. Such conditions have and may continue to result in higher premium costs, higher policy deductibles, lower coverage limits and may also yield possible policy form exclusions. For some risks, because of cost and/or availability, the Company does not have insurance coverage. Because the Company retains some portion of its insurable risks, and in some cases self insures completely, unforeseen or catastrophic losses in excess of insured limits may have a material adverse effect on the Company's results of operations and financial position.

Failure of information technology systems and breaches in the security of data upon which the Company relies could adversely affect the Company's future operating results.

Information technology system failures and breaches of data security could disrupt the Company's ability to function in the normal course of business by potentially causing delays or cancellation of customer orders, impeding the manufacture or shipment of products, or resulting in the unintentional disclosure of customer or Company information. Management has taken steps to address these concerns for its own systems by implementing sophisticated network security and internal control measures. However, there can be no assurance that a system failure or data security breach of the Company or a third-party vendor will not have a material adverse effect on the Company's results of operations.

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

A large portion of the Company's revenue is derived from its international operations. As a result, the Company's operating results and financial condition could be significantly affected by risks associated with international activities, including economic and labor conditions, political instability, tax laws (including U.S. taxes on foreign subsidiaries), and changes in the value of the U.S. dollar versus the local currency in which the products are sold and goods and services are purchased. The Company's primary exposure to movements in foreign currency exchange rates relate to non-dollar denominated sales in Europe, Japan, Australia, Canada, and certain parts of Asia and non-dollar denominated operating expenses incurred throughout the world. Weaknesses in foreign currencies, particularly the Japanese Yen and the Euro, can adversely impact consumer demand for the Company's products and the U.S. dollar value of the Company's foreign currency denominated sales. Conversely, strengthening in these and other foreign currencies can increase the cost to the Company of product components, negatively affecting the Company's results of operations.

Margins on sales of the Company's products in foreign countries, and on sales of products that include components obtained from foreign suppliers, can be adversely affected by foreign currency exchange rate fluctuations and by international trade regulations, including tariffs and antidumping penalties.

Derivative instruments, such as foreign exchange forward and option positions have been utilized by the Company to hedge exposures to fluctuations in foreign currency exchange rates. The use of such hedging activities may not offset more than a portion of the adverse financial impact resulting from unfavorable movements in foreign exchange rates.

Further information related to the Company's global market risks may be found in Part II, Item 7A of the 2004 Form 10-K for the year ended September 25, 2004 under the subheading "Foreign Currency Risk" and may be found in Part II, Item 8 of the 2004 Form 10-K for the year ended September 25, 2004 at Notes 1 and 2 of Notes to Consolidated Financial Statements.

The Company is subject to risks associated with environmental regulations.

Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations including, in some instances, the requirement to provide customers the ability to return product at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the Company. Such laws and regulations have recently been passed in several jurisdictions in which the Company operates, including various European Union member countries, Japan and certain states within the U.S. In the future, these laws could have a material adverse affect on the Company's results of operations.

Changes in accounting rules could affect the Company's future operating results.

Financial statements are prepared in accordance with U.S. generally accepted accounting principles. These principles are subject to interpretation by various governing bodies, including the FASB and the Securities and Exchange

Commission (SEC), who interpret and create appropriate accounting standards. A change from current accounting standards could have a significant effect on the Company's results of operations. In December 2004, the FASB issued new guidance that addresses the accounting for share-based payments, SFAS 123R. In April 2005, the SEC deferred the effective date of SFAS 123R to years beginning after June 15, 2005. Therefore, SFAS 123R will be effective for the Company beginning in its first fiscal quarter of 2006. Although the Company will continue to evaluate the application of SFAS 123R, management expects adoption to have a material adverse affect on the Company's results of operations.

Changes in the Company's tax rates could affect its future results.

The Company's future effective tax rates could be favorably or unfavorably affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of the Company's deferred tax assets and liabilities, or by changes in tax laws or their interpretation. In addition, the Company is subject to the continuous examination of its income tax returns by the Internal Revenue Service and other tax authorities. The Company regularly assesses the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of its provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse affect on the Company's net income and financial condition.

The Company's stock price may be volatile.

The Company's stock has at times experienced substantial price volatility as a result of variations between its actual and anticipated financial results and as a result of announcements by the Company and its competitors. The stock market has experienced extreme price and volume fluctuations that have affected the market price of many technology companies in ways that may have been unrelated to the operating performance of these companies. These factors, including lack of positive general economic and political conditions and investors' concerns regarding the credibility of corporate financial reporting and integrity of financial markets, may materially adversely affect the market price of the Company's stock in the future. In addition, increases in the Company's stock price may result in greater dilution of earnings per share.

For a discussion of these and other factors affecting the Company's future results and financial condition, see Item 7, "Management's Discussion and Analysis - Factors That May Affect Future Results and Financial Condition" and Item 1, "Business" in the Company's 2004 Form 10-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's market risk profile has not changed significantly from that described in the 2004 Form 10-K.

Interest Rate and Foreign Currency Risk Management

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

Interest Rate Risk

While the Company is exposed to interest rate fluctuations in many of the world's leading industrialized countries, the Company's interest income and expense is most sensitive to fluctuations in the general level of U.S. interest rates. In this regard, changes in U.S. interest rates affect the interest earned on the Company's cash, cash equivalents, and short-term investments as well as costs associated with foreign currency hedges.

The Company's short-term investment policy and strategy is to ensure the preservation of capital, meet liquidity requirements, and optimize return in light of current credit and interest rate trends. The Company benchmarks its performance by utilizing external money managers to manage a small portion of the aggregate investment portfolio. The external managers adhere to the Company's investment policies and also provide occasional research and market information that supplements internal research used to make credit decisions in the investment process.

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's investment portfolio. The Company places its short-term investments in highly liquid securities issued by high credit quality issuers and, by policy, limits the amount of credit exposure to any one issuer. The Company's general policy is to limit the risk of principal loss and ensure the safety of invested funds by limiting market and credit risk. All highly liquid investments with initial maturities of three months or less are classified as cash equivalents; highly liquid investments with maturities greater than three months are classified as short-term investments. As of March 26, 2005, approximately \$327 million of the Company's short-term investments had underlying maturities ranging from 1 to 5 years. The remainder all had underlying maturities between 3 and 12 months. The Company may sell its investments prior to their stated maturities for strategic purposes, in anticipation of credit deterioration, or for duration management. The Company recognized no material net gains or losses during the three and six month periods ended March 26, 2005 or March 27, 2004 related to such sales.

From time to time, the Company has entered into interest rate derivative transactions with financial institutions in order to better match the Company's floating-rate interest income on its cash equivalents and short-term investments with its fixed-rate interest expense on its debt, and/or to diversify a portion of the Company's exposure away from fluctuations in short-term U.S. interest rates. The Company did not enter into any interest rate derivatives during the first six months of either fiscal year 2005 or 2004.

Foreign Currency Risk

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

The Company may enter into foreign currency forward and option contracts with financial institutions to protect against foreign exchange risks associated with existing assets and liabilities, certain firmly committed transactions, forecasted future cash flows, and net investments in foreign subsidiaries. Generally, the Company's practice is to hedge a majority of its existing material foreign exchange transaction exposures. However, the Company may not hedge certain foreign exchange transaction exposures due to immateriality, prohibitive economic cost of hedging particular exposures, and limited availability of appropriate hedging instruments.

Item 4. 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 under the Securities Exchange Act of 1934, as amended (*Exchange Act*)) were effective as of March 26, 2005 to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

There were no significant changes in the Company's internal control over financial reporting identified in management's evaluation during the second quarter of fiscal 2005 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 various legal proceedings and claims that are discussed below. The Company is also subject to certain other legal proceedings and claims that have arisen in the ordinary course of business and which have not been fully adjudicated. In the opinion of management, the Company does not have a potential liability related to any current legal proceedings and claims that would individually or in the aggregate have a material adverse effect on its financial condition, liquidity or results of operations. However, the results of legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected. The Company settled certain matters during the first six months of 2005, which did not individually or in the aggregate have a material impact on the Company's results of operations.

Advanced Audio Devices LLC v Apple Computer, Inc.

Plaintiff Advanced Audio Devices (AAD) filed this action on March 3, 2005 in the United States District Court for the Northern District of Illinois, Eastern Division, alleging infringement by the Company of U.S. Patent 6,587,403 entitled "Music Jukebox." The complaint seeks unspecified damages and other relief. The Company filed an answer on May 4, 2005 denying all material allegations and asserting numerous affirmative defenses. The Company is investigating this claim.

Apple Corps Ltd. v. Apple Computer, Inc.; Apple Computer, Inc. v. Apple Corps Ltd.

Plaintiff Apple Corps filed this action on July 4, 2003 in the High Court of Justice, Chancery Division, in London alleging that the Company has breached a 1991 agreement that resolved earlier trademark litigation between the parties regarding use of Apple marks. Plaintiff seeks an injunction, unspecified damages and other relief. The Company filed a motion on October 13, 2003, challenging jurisdiction in the U.K. The Court denied this motion on April 7, 2004. The Company filed an appeal of the Court's decision but subsequently withdrew the appeal. In November 2004, Apple Corps served the Company with an Amended Bill of Particulars and on December 23, 2004 the Company filed a Defence. Trial is set for the week of March 27, 2006.

On October 8, 2003, the Company filed a lawsuit against Apple Corps in the United States District Court for the Northern District of California requesting a declaratory judgment that the Company has not breached the 1991 agreement. Apple Corps challenged jurisdiction in the California case but the Court denied that challenge on March 25, 2004. Apple Corps subsequently prevailed on a motion to stay the California case during the pendency of the U.K. action. The Company has dismissed the California lawsuit without prejudice.

Blumenau v Apple Computer, Inc.

Plaintiff Trevor Blumenau filed this action on September 29, 2004 in the United States District Court for the Northern District of Texas alleging infringement of U.S. Patent 5,664,216 entitled "Iconic Audiovisual Data Editing Environment". Plaintiff's complaint alleges that the Company's Shake software infringes the patent. The Company received service of the complaint on March 8, 2005 and its response is not yet due. The Company is investigating this claim.

Branning et al. v Apple Computer, Inc.

Plaintiffs filed this purported class action in San Francisco County Superior Court on February 17, 2005. The complaint alleges violations of California Business & Professions Code section 17200 (unfair competition) regarding

a variety of purportedly unfair and unlawful conduct including, but not limited to, allegedly selling used computers as new, failing to honor warranties, misappropriating trade secrets and breach of contract. Plaintiffs request unspecified damages and other relief. The Company received service of the complaint on March 12, 2005 and on March 13, 2005 the Company filed a motion to transfer the case to Santa Clara County Superior Court. Plaintiffs filed an amended complaint on or about April 29, 2005 adding two new named Plaintiffs and three new causes of action. The Company is investigating these claims and has commenced discovery against Plaintiffs.

Burrow v Apple Computer, Inc.

Plaintiff filed this purported class action in Orange County Superior Court on February 17, 2005 alleging false advertising regarding the copy protection capabilities of DVD Studio Pro. The Complaint alleges violations of California Business & Professions Code section 17200 (unfair competition) and Code section 17500 (false advertising) and negligent misrepresentation. Plaintiff requests unspecified damages and other relief. The Company was served on March 8, 2005 and filed an answer on April 7, 2005 denying all allegations and asserting numerous affirmative defenses. The Company is investigating these claims.

Cagney v. Apple Computer, Inc.

Plaintiff filed this purported class action on January 9, 2004 in Los Angeles County Superior Court, alleging improper collection of sales tax in transactions involving mail-in rebates. The complaint alleges violations of California Business and Professions Code Section 17200 (unfair competition) and seeks unspecified damages and other relief. The Company was served on January 21, 2004, and filed an answer on February 20, 2004, denying all allegations and asserting numerous affirmative defenses. The Company is investigating these allegations. The Company filed a motion to disqualify Plaintiff's counsel, which the Court denied. The Company filed a petition for a writ of mandate with respect to this ruling and the Court of Appeal issued an order to show cause as to why the writ should not issue. Plaintiff's lead counsel subsequently withdrew. The hearing on the show cause order took place on January 26, 2005. On February 17, 2005 the Court ruled that the trial court abused its discretion in failing to grant the Company's motion to disqualify and ordered the trial court to disqualify both of Plaintiff's law firms upon remand. The opinion was designated for publication and Plaintiff has asked the Court to de-publish it. The Company has opposed that request. The Company has obtained an opinion on the tax issue from the State Board of Equalization.

Clark v Apple Computer, Inc.

Plaintiff filed this purported class action on February 2, 2005 in Santa Clara County Superior Court alleging defects in the Company's "yo-yo" power adapters. Plaintiffs request unspecified damages and other relief. The parties have reached a tentative settlement in this matter. The Court granted preliminary approval of the settlement on April 19, 2005 and the final approval hearing is set for September 27, 2005. Settlement of this matter will not have a material effect on the Company's financial position or results of operation.

Compression Labs, Inc. v. Apple Computer, Inc., et al.; Apple v. Compression Labs, Inc., et al.

Plaintiff Compression Labs, Inc. filed this patent infringement action on April 22, 2004 against the Company and twenty-seven other defendants in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement of U.S. patent 4,698,672. Plaintiff alleges that the Company infringes the patent by complying with the JPEG standard as defined by CCITT Recommendation T.81 entitled "Information Technology—Digital Compression and Coding of Continuous Tone Still Images—Requirements and Guidelines." Plaintiff seeks unspecified damages and other relief.

On July 2, 2004, the Company and several other defendants in the Texas action filed a lawsuit in the United States District Court in Delaware against Compression Labs, Inc. and two other companies, requesting a declaratory judgment of noninfringement, invalidity, implied license and unenforceability with respect to the '672 patent. Additional actions regarding this patent have been filed in other jurisdictions. On February 16, 2005, the Panel on Multi-District Litigation (MDL) granted a petition filed by certain defendants, seeking coordination and transfer of all of these cases to one court for pre-trial proceedings. The MDL Panel has transferred all of the cases to the Northern District of California. The defendants in the Texas and Delaware actions had filed a motion to dismiss prior to the transfer and both motions are still pending.

Craft v. Apple Computer, Inc. (filed December 23, 2003, Santa Clara County Superior Court); *Chin v. Apple Computer, Inc.* (filed December 23, 2003, San Mateo County Superior Court); *Hughes v. Apple Computer, Inc.* (filed December 23, 2003, Santa Clara County Superior Court); *Westley v. Apple Computer, Inc.* (filed December 26, 2003, San Francisco County Superior Court); *Keegan v. Apple Computer, Inc.* (filed December 30, 2003,

Alameda County Superior Court); *Wagya v. Apple Computer, Inc.* (filed February 19, 2004, Alameda County Superior Court); *Yamin v. Apple Computer, Inc.* (filed February 24, 2004, Los Angeles County Superior Court); *Kieta v. Apple Computer, Inc.* (filed July 8, 2004, Alameda County Superior Court)

Eight separate plaintiffs filed purported class action cases in various California courts alleging misrepresentations by the Company relative to iPod battery life. The complaints include causes of action for violation of California Business and Professions Code Section 17200 (unfair competition), the Consumer Legal Remedies Action (“CLRA”) and claims for false advertising, fraudulent concealment and breach of warranty. The complaints seek unspecified damages and other relief. The Company is investigating these claims. The cases have been consolidated in San Mateo County. On July 26, 2004, Plaintiffs filed a consolidated complaint. On August 25, 2004, the Company filed an answer denying all allegations and asserting numerous affirmative defenses. Discovery is stayed pending settlement discussions among the parties.

In addition, a similar complaint relative to iPod battery life, *Mosley v. Apple Computer, Inc.* was filed in Westchester County, New York on June 23, 2004 alleging violations of New York General Business Law Sections 349 (unfair competition) and 350 (false advertising). The Company removed the case to Federal Court and Plaintiff filed a motion for remand, which the Court has not yet decided. The case is also stayed.

Davis v. Apple Computer, Inc.

Plaintiff filed this purported class action in San Francisco County Superior Court on December 5, 2002, alleging that the Company engaged in unfair and deceptive business practices relating to its AppleCare Extended Service and Warranty Plan. Plaintiff asserts causes of action for violation of the California Business and Professions Code Sections 17200 and 17500, breach of the Song-Beverly Warranty Act, intentional misrepresentation and concealment. Plaintiff requests unspecified damages and other relief. The Company filed a demurrer and motion to strike which were granted, in part, and Plaintiff filed an amended complaint. The Company filed an answer on April 17, 2003 denying all allegations and asserting numerous affirmative defenses. Plaintiff subsequently amended its complaint. On October 29, 2003, the Company filed a motion to disqualify Plaintiff’s counsel in his role as counsel to the purported class and to the general public. The Court granted the motion, but allowed Plaintiff to retain substitute counsel. Plaintiff did engage new counsel for the general public, but not for the class. The Company moved to disqualify Plaintiff’s new counsel and to have the Court dismiss the general public claims for equitable relief. The Court declined to disqualify Plaintiff’s new counsel or to dismiss the equitable claims, but did confirm that the class action claims are dismissed. The case is stayed pending an appeal.

East Texas Technology Partners LP v. Apple Computer, Inc.

Plaintiff filed this patent infringement action on January 23, 2004 in the United States District Court in the Eastern District of Texas alleging infringement by the Company and seven other defendants of U.S. patent 6,574,239 relating to “Virtual Connection of a Remote Unit to a Server.” The complaint seeks unspecified damages and other relief. The Plaintiff’s law firm withdrew from the case because of a conflict of interest and dismissed the complaint without prejudice. The case was re-filed on February 10, 2004 in the Northern District of Texas by a new law firm. The Company received service of the new complaint on May 17, 2004 and filed a response on August 6, 2004, denying all material allegations and asserting numerous affirmative defenses. The Company is investigating this claim, and the case is in discovery.

European Commission Investigation

The European Commission has notified the Company that it is investigating certain matters relating to the iTunes Music Store in the European Union (EU). The European Commission is investigating claims made by Which?, a United Kingdom (UK) consumer association, that the Company is violating EU competition law by charging more for online music in the UK than in Eurozone countries and preventing UK consumers from purchasing online music from the iTunes Music Store for Eurozone countries. The Which? claims were originally lodged with the UK Office of Fair Trading, which subsequently referred them to the European Commission. The European Commission is investigating the charges under Article 81 and/or 82 of the European Commission Treaty.

Gobeli Research Ltd. v. Apple Computer, Inc., et al.

Plaintiff Gobeli Research Ltd. filed this patent infringement action against the Company and Sun Microsystems, Inc. on April 15, 2004 in the United States District Court for the Eastern District of Texas, Marshall Division, alleging infringement of U.S. patent 5,418,968 related to a “System and Method of Controlling Interrupt Processing.” Plaintiff alleges that the Company’s Mac OS 9 and Mac OS X operating systems infringe Plaintiff’s patent. Plaintiff seeks unspecified damages and other relief. The Company is investigating this claim. The Company filed an answer

on June 9, 2004, denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims requesting declaratory judgment of non-infringement and invalidity. A Markman hearing is set for August 9, 2005 and the trial is scheduled for February 6, 2006.

Goldberg, et al. v. Apple Computer, Inc., et al. (f.k.a. "Dan v. Apple Computer, Inc.")

Plaintiffs filed this purported class action on September 22, 2003 in Los Angeles County Superior Court against the Company and other members of the industry on behalf of an alleged nationwide class of purchasers of certain computer hard drives. The case alleges violations of California Business and Professions Code Section 17200 (unfair competition), the Consumer Legal Remedies Act ("CLRA") and false advertising related to the size of the drives. Plaintiffs allege that calculation of hard drive size using the decimal method misrepresents the actual size of the drive. The complaint seeks unspecified damages and other relief. Plaintiff filed an amended complaint on March 30, 2004 and the Company filed an answer on September 23, 2004, denying all allegations and asserting numerous affirmative defenses. The Company is investigating this claim. Defendants filed a motion to strike portions of the complaint based on sales by resellers and filed a motion for judgment on the pleadings based upon Proposition 64. The Court granted both motions at a hearing on April 6, 2005. Plaintiff has until May 6, 2005 to file an amended complaint.

Hawaii Structural Iron Workers and Pension Trust Fund v. Apple Computer, Inc. and Steven P. Jobs; Young v. Apple Computer, Inc., et al.; Hsu v. Apple Computer Inc., et al.

Beginning on September 27, 2001, three shareholder class action lawsuits were filed in the United States District Court for the Northern District of California against the Company and its Chief Executive Officer. These lawsuits are substantially identical, and purport to bring suit on behalf of persons who purchased the Company's publicly traded common stock between July 19, 2000, and September 28, 2000. The complaints allege violations of the 1934 Securities Exchange Act and seek unspecified compensatory damages and other relief. The Company filed a motion to dismiss on June 4, 2002, which was heard by the Court on September 13, 2002. On December 11, 2002, the Court granted the Company's motion to dismiss for failure to state a cause of action, with leave to Plaintiffs to amend their complaint within thirty days. Plaintiffs filed their amended complaint on January 31, 2003, and on March 17, 2003, the Company filed a motion to dismiss the amended complaint. The Court heard the Company's motion on July 11, 2003 and dismissed Plaintiffs' claims with prejudice on August 12, 2003. Plaintiffs appealed the ruling. The Ninth Circuit Court of Appeal heard the matter on February 17, 2005 and affirmed the District Court's ruling in an unpublished decision dated April 4, 2005. Plaintiffs will not seek further review and the matter is concluded.

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

Plaintiffs Honeywell International, Inc. and Honeywell Intellectual Properties, Inc. filed this action on October 6, 2004 in the United States District Court in Delaware alleging infringement by the Company and other defendants of U.S. patent 5,280,371 entitled "Directional Diffuser for a Liquid Crystal Display." Plaintiffs seek unspecified damages and other relief. The Company is investigating this claim. The Company filed an answer on December 21, 2004 denying all material allegations, and asserting numerous affirmative defenses. The Company also asserted counterclaims requesting declaratory judgment of non-infringement and invalidity. The case is in discovery.

MacTech Systems v. Apple Computer, Inc.; Macadam v. Apple Computer, Inc.; Computer International, Inc. v. Apple Computer, Inc.; Elite Computers and Software, Inc. v. Apple Computer, Inc.; The Neighborhood Computer Store v. Apple Computer, Inc. MacAccessory Center, Inc. v. Apple Computer Inc. (all in Santa Clara County Superior Court)

Six resellers have filed similar lawsuits against the Company for various causes of action including breach of contract, fraud, negligent and intentional interference with economic relationship, negligent misrepresentation, trade libel, unfair competition and false advertising. Plaintiffs request unspecified damages and other relief. The Company answered the Computer International complaint on November 12, 2003, denying all allegations and asserting numerous affirmative defenses. Three of the other plaintiffs filed amended complaints on February 7, 2005 and on March 16, 2005, the Company filed answers denying all allegations and asserting numerous affirmative defenses. The Company filed an answer in the Macadam case on December 3, 2004 denying all allegations and asserting numerous defenses. All Plaintiffs except Computer International hired new counsel in December 2004. All cases except Macadam are in discovery. A sixth Plaintiff, MacAccessory Center filed a complaint on February 23, 2005. The Company filed a response on April 20, 2005.

On October 1, 2003, one of the reseller Plaintiffs, Macadam, was deauthorized as an Apple reseller. Macadam filed a motion for a temporary order to reinstate it as a reseller, which the Court denied. The Court denied Macadam's

motion for a preliminary injunction on December 19, 2003. On December 6, 2004 Macadam filed for Chapter 11 Bankruptcy in the Northern District of California, which placed a stay on the litigation as to Macadam only. The Company filed a claim in the bankruptcy proceedings on February 16, 2005 to which Macadam has objected. The Company took Macadam's debtor examination in April 2005. Macadam filed a motion to employ the same lawyers working for four of the other reseller plaintiffs as special litigation counsel to Macadam but subsequently withdrew the motion following the Company's opposition. The Company filed a motion to convert the bankruptcy to Chapter 7 (liquidation) on April 29, 2005.

Slattery v. Apple Computer, Inc.

Plaintiff filed this purported class action on January 3, 2005 in the United States District Court for the Northern District of California alleging various claims including alleged unlawful tying of music purchased on the iTunes Music Store with the purchase of iPods and vice versa and unlawful acquisition or maintenance of monopoly market power. Plaintiff's complaint alleges violations of Sections 1 and 2 of the Sherman Act (15 U.S.C. §§1 and 2), California Business and Professions Code Section 16700 et seq. (the Cartwright Act), California Business and Professions Code Section 17200 (unfair competition), common law unjust enrichment and common law monopolization. Plaintiff seeks unspecified damages and other relief. The Company is investigating this claim. The Company filed a motion to dismiss on February 10, 2005 and a hearing is set for June 6, 2005.

Stamm v. Apple Computer, Inc./Allen v. Apple Computer, Inc.

Plaintiff Stamm filed a purported class action on November 12, 2004 in Circuit Court, Cook County, Illinois alleging that a defect in Apple's 17" Studio Display monitors results in dimming of half of the screen and constant blinking of the power light. The Company is investigating the claim. The Company removed the case to federal court on December 22, 2004. The Court remanded it to State Court on March 22, 2005 on Plaintiff's motion. The Company had filed a motion to dismiss on January 27, 2005 which is now off calendar due to the remand. On January 28, 2005 a second Plaintiff, Allen, filed a purported class action in Los Angeles Superior Court alleging identical claims. Mediation for both cases is scheduled for August 2005.

Teleshuttle Technologies, LLC and BTG International Inc. v. Microsoft and Apple Computer, Inc.

Plaintiffs filed this case on July 20, 2004 in United States District Court for the Northern District of California alleging infringement of U.S. patent 6,557,054, entitled "Method and System for Distributing Updates by Presenting Directory of Software Available for User Installation That is Not Already Installed on User Station." Plaintiffs seek unspecified damages and other relief. Plaintiffs filed an amended complaint on September 7, 2004, adding a second patent, U.S. patent 6,769,009 entitled "Method and System for Selecting a Personalized Set of Information Channels." The Company filed an answer on October 18, 2004, denying all material allegations and asserting numerous affirmative defenses. The case is in discovery. Tentative Markman hearing dates are set for September 9, and 16, 2005.

Tiger Direct, Inc. v Apple Computer, Inc.

Plaintiff Tiger Direct, Inc. filed this trademark infringement action in the United States District Court for the Southern District of Florida on April 26, 2005 alleging infringement of the word mark TIGER. Plaintiff claims to have a valid registration in the mark TIGER and alleges that the Company's use of TIGER in reference to the latest version of Mac OS X infringes the mark allegedly owned by Plaintiff. Plaintiff attempted to obtain an ex parte preliminary injunction barring the Company's use of the TIGER mark on April 27, 2005 but the motion was denied. Plaintiff served the Company on April 27, 2005 and again moved for a preliminary injunction which was heard on May 3, 2005. The Company denied all allegations and vigorously opposed Plaintiff's motion. On May 3, 2005 the court heard the matter and has not yet issued a ruling. The Company will continue investigating this claim. The Company's response to the Complaint is not yet due.

Union Federale des Consummateurs - Que Choisir v Apple Computer France S.A.R.L. and iTunes S.A.R.L.

Plaintiff, a consumer association in France, filed this complaint on February 9, 2005 alleging that the entities above are violating consumer law by 1) omitting to mention that the iPod is allegedly not compatible with music from online music services other than the iTunes Music Store and that the music from the iTunes Music Store is only compatible with the iPod and 2) tying the sales of iPods to the iTunes Music Store and vice versa. Plaintiff seeks damages, injunctive relief and other relief. The Company is investigating these claims. The Company's response is not yet due. The first hearing on the case is scheduled for May 24, 2005.

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

The annual meeting of shareholders was held on April 21, 2005. Proposals 1, 2, 3, 4 and 5 were approved. Proposal 6 was not approved. The results are as follows:

Proposal 1

The following directors were elected at the meeting to serve a one-year term as directors:

	<u>For</u>	<u>Authority Withheld</u>
Fred D. Anderson	707,238,106	9,231,642
William V. Campbell	651,919,698	64,550,050
Millard S. Drexler	702,872,466	13,597,282
Albert A. Gore, Jr.	700,761,446	15,708,302
Steven P. Jobs	707,679,121	8,790,627
Arthur D. Levinson	688,971,355	27,498,393
Jerome B. York	707,526,554	8,943,194

Proposal 2

The proposal to approve the Performance Bonus Plan, a performance-based annual cash incentive plan for executive officers.

<u>For</u>	<u>Against</u>	<u>Abstained</u>
690,194,315	21,392,464	4,882,969

Proposal 3

The proposal to amend the Company's 2003 Employee Stock Option Plan, including increasing the number of shares of Common Stock reserved for issuance thereunder by 49 million shares.

<u>For</u>	<u>Against</u>	<u>Abstained</u>	<u>Broker Non-Vote</u>
449,367,467	79,922,593	5,386,280	181,793,408

Proposal 4

The proposal to amend the Company's Employee Stock Purchase Plan to increase the number of shares of Common Stock reserved for issuance thereunder by 2 million shares.

<u>For</u>	<u>Against</u>	<u>Abstained</u>	<u>Broker Non-Vote</u>
496,598,541	32,937,718	5,056,260	181,877,229

Proposal 5

Ratification of appointment of KPMG LLP as the Company's independent auditors for fiscal year 2005.

<u>For</u>	<u>Against</u>	<u>Abstained</u>
694,477,755	17,825,757	4,166,236

Proposal 6

A shareholder proposal requesting that the Board of Directors adopt a performance and time-based restricted share grant program for senior executives.

For	Against	Abstained	Broker Non-Vote
181,658,488	343,482,069	9,439,561	181,889,630

The proposals above are described in detail in the Company's definitive proxy statement dated March 14, 2005, for the Annual Meeting of Shareholders held on April 21, 2005.

Item 6. Exhibits**(a) Index to Exhibits**

<u>Exhibit Number</u>	<u>Exhibit Description</u>	<u>Incorporated by Reference</u>		<u>Filed herewith</u>
		<u>Form</u>	<u>Filing Date/ Period End Date</u>	
3.1	Restated Articles of Incorporation, filed with the Secretary of State of the State of California on January 27, 1988.	S-3	7/27/88	
3.2	Amendment to Restated Articles of Incorporation, filed with the Secretary of State of the State of California on May 4, 2000.	10-Q	5/11/00	
3.3	By-Laws of the Company, as amended through June 7, 2004.	10-Q	6/26/04	
3.4	Certificate of Amendment to Restated Articles of Incorporation, as amended, filed with the Secretary of State of the State of California on February 25, 2005.			X
4.2	Indenture dated as of February 1, 1994, between the Company and Morgan Guaranty Trust Company of New York.	10-Q	4/01/94	
4.3	Supplemental Indenture dated as of February 1, 1994, among the Company, Morgan Guaranty Trust Company of New York, as resigning trustee, and Citibank, N.A., as successor trustee.	10-Q	4/01/94	
4.5	Form of the Company's 6 1/2% Notes due 2004.	10-Q	4/01/94	
4.8	Registration Rights Agreement, dated June 7, 1996 among the Company and Goldman, Sachs & Co. and Morgan Stanley & Co. Incorporated.	S-3	8/28/96	
4.9	Certificate of Determination of Preferences of Series A Non-Voting Convertible Preferred Stock of Apple Computer, Inc.	10-K	9/26/97	
10.A.3	Apple Computer, Inc. Savings and Investment Plan, as amended and restated effective as of October 1, 1990.	10-K	9/27/91	
10.A.3-1	Amendment of Apple Computer, Inc. Savings and Investment Plan dated March 1, 1992.	10-K	9/25/92	
10.A.3-2	Amendment No. 2 to the Apple Computer, Inc. Savings and Investment Plan.	10-Q	3/28/97	
10.A.5	1990 Stock Option Plan, as amended through November 5, 1997.	10-Q	12/26/97	
10.A.6	Apple Computer, Inc. Employee Stock Purchase Plan, as amended through April 21, 2005.			X
10.A.8	Form of Indemnification Agreement between	10-K	9/26/97	

	the Registrant and each officer of the Registrant.			
10.A.43	NeXT Computer, Inc. 1990 Stock Option Plan, as amended.	S-8	3/21/97	
10.A.49	1997 Employee Stock Option Plan, as amended through October 19, 2001.	10-K	9/28/02	
10.A.50	1997 Director Stock Option Plan.	10-Q	3/27/98	
10.A.51	2003 Employee Stock Plan, as amended through April 21, 2005.			X
10.A.52	Reimbursement Agreement dated as of May 25, 2001 by and between the Registrant and Steven P. Jobs.	10-Q	6/29/02	
10.A.53	Option Cancellation and Restricted Stock Award Agreement dated as of March 19, 2003 by and between The Registrant and Steven P. Jobs.	10-Q	6/28/03	
10.A.54	Form of Restricted Stock Unit Award Agreement	10-Q	3/27/04	
10.A.55	Apple Computer, Inc. Performance Bonus Plan dated April 21, 2005.			X
10.B.18	Custom Sales Agreement effective October 21, 2002 between the Registrant and International Business Machines Corporation.	10-K	9/27/03	
14.1	Code of Ethics of the Company	10-K	9/27/03	
31.1	Rule13a-14(a) / 15d-14(a) Certification of Chief Executive Officer			X
31.2	Rule13a-14(a) / 15d-14(a) Certification of Chief Financial Officer			X
32.1	Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer			X

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.

APPLE COMPUTER, INC.
(Registrant)

By: /s/ Peter Oppenheimer

Peter Oppenheimer
Senior Vice President and Chief Financial Officer
May 4, 2005

58

Exhibit 3.4

*Conformed Copy as filed with the Secretary of State
of the State of California on February 25, 2005*

**CERTIFICATE OF AMENDMENT
TO
RESTATED ARTICLES OF INCORPORATION, AS AMENDED,
OF
APPLE COMPUTER, INC.**

Gary Wipfler and Michelle A. LaVally certify that:

1. They are the Vice President and Treasurer, and the Associate General Counsel and Assistant Secretary, respectively, of Apple Computer, Inc., a California corporation.
2. Article III of the Restated Articles of Incorporation, as amended, of this corporation is amended to read in its entirety as follows:

“III.

This corporation is authorized to issue two classes of shares designated respectively “Common Stock” and “Preferred Stock.” The number of shares of Common Stock which this corporation is authorized to issue is 1,800,000,000. The number of shares of Preferred Stock which this corporation is authorized to issue is 5,000,000. Effective at 5 p.m., California time, on the date of filing of the Certificate of Amendment of Restated Articles of Incorporation, as amended, amending this Article hereby, each share of Common Stock outstanding as of 5p.m. California time on February 18, 2005 shall be automatically and with no further action by the holder of such shares split into two shares of Common Stock.”

3. The foregoing amendment to the Restated Articles of Incorporation, as amended, was duly approved by the Board of Directors at its meeting held on February 8, 2005, at which a quorum was present and acting throughout; the corporation has only one class of shares outstanding and no approval of the outstanding shares of the corporation is required pursuant to Section 902(c) of the General Corporation Law of the State of California.

The undersigned declare under penalty of perjury that the matters set forth in the foregoing certificate are true of their own knowledge.

Executed at Cupertino, California on February 25, 2005.

/S/ Gary Wipfler
Gary Wipfler
Vice President and Treasurer

/S/ Michelle A. LaVally
Michelle A. LaVally
*Associate General Counsel and
Assistant Secretary*

APPLE COMPUTER, INC.
EMPLOYEE STOCK PURCHASE PLAN
(*as amended and restated effective as of April 21, 2005*)

The following constitute the provisions of the Employee Stock Purchase Plan (herein called the "Plan") of Apple Computer, Inc. (herein called the "Company").

1. *Purpose* . The purpose of the Plan is to provide employees of the Company and its subsidiaries with an opportunity to purchase Common Stock of the Company through payroll deductions. It is the intention of the Company to have the Plan qualify as an "Employee Stock Purchase Plan" under Section 423 of the Internal Revenue Code of 1986. The provisions of the Plan shall, accordingly, be construed so as to extend and limit participation in a manner consistent with the requirements of that section of the Code.

2. *Definitions* .

(a) " *Board* " shall mean the Board of Directors of the Company.

(b) " *Common Stock* " shall mean the Common Stock, no par value, of the Company.

(c) " *Company* " shall mean Apple Computer, Inc., a California corporation.

(d) " *Compensation* " shall mean all regular straight time earnings, payments for overtime, shift premium, incentive compensation, incentive payments, bonuses and commissions (except to the extent that the exclusion of any such items is specifically directed by the Board or its committee).

(e) " *Designated Subsidiaries* " shall mean the Subsidiaries which have been designated by the Board from time to time in its sole discretion as eligible to participate in the Plan.

(f) " *Employee* " shall mean:

(1) any person, including an officer, who is customarily employed for at least twenty (20) hours per week and more than five (5) months in a calendar year by the Company or one of its Designated Subsidiaries.

(2) Notwithstanding subsection (1), a different rule shall apply to an individual during any period (A) he or she receives compensation which is not initially treated by the Company as "wages": for payroll tax purposes, (i.e. payments to such individual are not initially subjected by the Company to income tax, FICA tax, or other withholdings applicable to wages), if (B) he or she is ultimately determined to have been a common law employee of the Company during the period, although initially reported as an independent contractor or treated as employed by a payroll agency for the period in question. In that case, to the extent Section 423 requires such individual to be treated as retroactively eligible to have participated in the Plan, such individual shall be treated as an "Employee" during an offering period only to the extent that he or she satisfies the criteria set forth in the next sentence as of the start of the offering period. The two criteria are that: (A) the individual must be employed by the Company at least two years and (B) the individual is not a "highly compensated employee" within the meaning of Section 414(q) of the Internal Revenue Code of 1986. For the purpose of computing years of service, all service prior to a break in service shall be ignored to the extent permitted by Section 423. For the purpose of determining an individual's status as a "highly compensated employee", the rules in the Company's Savings and Investment Plan shall apply.

(g) “ *Plan* ” shall mean this Employee Stock Purchase Plan.

(h) “ *Section 16 Person* ” shall mean any person participating in the Plan who has been designated by the Board of Directors as having authority to carry out policy-making functions such that the person is subject to the reporting and short-swing profit regulations of Section 16 of the Securities Exchange Act of 1934.

(i) “ *Subsidiary* ” shall mean a corporation, domestic or foreign, of which not less than 50% of the voting shares are held by the Company or a Subsidiary, whether or not such corporation now exists or is hereafter organized or acquired by the Company or a Subsidiary.

(j) “ *1934 Act Section 16* ” shall mean Section 16 of the Securities Exchange Act of 1934 and the rules and regulations promulgated thereunder.

3. *Eligibility* .

(a) Any Employee as defined in Section 2 who shall be employed by the Company or one of its Designated Subsidiaries on the date his or her participation in the Plan is effective shall be eligible to participate in the Plan, subject to the limitations imposed by Section 423 (b) of the Internal Revenue Code of 1986, as amended.

(b) Any provisions of the Plan to the contrary notwithstanding, no Employee shall be granted an option under the Plan (i) if, immediately after the grant, such Employee would own shares and/or hold outstanding options to purchase stock possessing five percent (5%) or more of the total combined voting power or value of all classes of shares of the Company or of any Subsidiary of the Company, or (ii) which permits his or her rights to purchase shares under all employee stock purchase plans of the Company and its Subsidiaries to accrue at a rate which exceeds Twenty-Five Thousand Dollars (\$25,000) of the fair market value of the shares (determined at the time such option is granted) for each calendar year in which such stock option is outstanding at any time.

4. *Offering Dates* . The Plan shall be implemented by one offering during each six-month period of the Plan, commencing on or about January 1, 1981 and continuing thereafter until terminated in accordance with Section 19 hereof. The Board of Directors of the Company shall have the power to change the duration of offering periods with respect to future offerings without shareholder approval if such change is announced at least fifteen (15) days prior to the scheduled beginning of the first offering period to be affected.

5. *Participation* .

(a) An eligible Employee may become a participant in the Plan by completing a subscription agreement authorizing payroll deductions on the form provided by the Company and filing it with the Company’s payroll office prior to the applicable offering date. Once filed, the subscription agreement shall remain effective for all subsequent offering periods until the participant withdraws from the Plan as provided in Section 10 hereof or files another subscription agreement.

(b) Payroll deductions for a participant shall commence on the first payroll following the commencement offering date and shall continue at the same rate until such time as the participant withdraws from the Plan as provided in Section 10 hereof or another subscription agreement is filed which changes the rate of payroll deductions.

6. *Payroll Deductions* .

(a) At the time a participant files his or her subscription agreement, he or she shall elect to have payroll deductions made on each payday during subsequent offering periods at a rate not exceeding ten percent (10%) of the Compensation which he or she received on such payday, and

the aggregate of such payroll deductions during any offering period shall not exceed ten percent (10%) of his or her aggregate Compensation during said offering period.

(b) All payroll deductions made by a participant shall be credited to his or her account under the Plan. A participant may not make any additional payments into such account.

(c) A participant may discontinue his or her participation in the Plan as provided in Section 10, or may lower, but not increase, the rate of his or her payroll deductions (within the limitations set forth in subsection (a) above) during an offering period by completing and filing with the Company a new authorization for payroll deductions. The change in rate shall be effective within fifteen (15) days following the Company's receipt of the new authorization.

(d) A participant may increase his or her rate of payroll deductions (within the limitations set forth in subsection (a) above) to be effective for the next offering period by completing and filing with the Company a new authorization for payroll deductions at least fifteen (15) days before the beginning of said offering period.

7. *Grant of Option* .

(a) At the beginning of each six-month offering period, each eligible Employee participating in the Plan shall be granted an option to purchase (at the per share option price) up to a number of shares of the Company's Common Stock determined by dividing the Employee's accumulated payroll deductions (not to exceed an amount equal to ten percent (10%) of his or her Compensation during the applicable offering period) by the lower of (i) eighty-five percent (85%) of the fair market value of a share of the Company's Common Stock on the date of the commencement of said offering period, or (ii) eighty-five percent (85%) of the fair market value of a share of the Company's Common Stock on the date of the expiration of the offering period, subject to the limitations set forth in Sections 3(b) and 12 hereof, and subject to the following limitation: The number of shares of the Company's Common Stock subject to any option granted to an Employee pursuant to this Plan shall not exceed two hundred percent (200%) of the number of shares of the Company's Common Stock determined by dividing an amount equal to ten percent (10%) of the Employee's semi-annual Compensation as of the date of the commencement of the applicable offering period by eighty-five percent (85%) of the fair market value of a share of the Company's Common Stock on the date of the commencement of said offering period. Fair market value of a share of the Company's Common Stock shall be determined as provided in Section 7(b) herein.

(b) The option price per share of such shares shall be the lower of: (i) 85% of the fair market value of a share of the Common Stock of the Company at the commencement of the six-month offering period; or (ii) 85% of the fair market value of a share of the Common Stock of the Company at the time the option is exercised at the termination of the six-month offering period. The fair market value of the Company's Common Stock on a given date shall be the mean of the reported bid and asked prices for that date, or if the Common Stock is listed on an exchange or quoted on the Nasdaq National Market, the closing sale price on such exchange or quotation system for that date.

8. *Exercise of Option* . Unless a participant withdraws from the Plan as provided in Section 10, his or her option for the purchase of shares will be exercised automatically at the end of the offering period, and the maximum number of full shares subject to option will be purchased for him or her at the applicable option price with the accumulated payroll deductions in his or her account. During his or her lifetime, a participant's option to purchase shares hereunder is exercisable only by him or her.

9. *Delivery; Roll-Over of Fractional Share Interests .*

As promptly as practicable after the termination of each offering, the Company shall arrange for the delivery to each participant, as appropriate, of a certificate representing the number of full shares purchased upon exercise of his or her option. No fractional shares shall be issued. Any cash remaining to the credit of a participant's account under the Plan after a purchase by him or her of shares at the termination of each offering period which is insufficient to purchase a full share of Common Stock of the Company subject to option shall remain in such participant's account and shall be applied to the next succeeding offering period unless the participant has withdrawn as to future offering periods, in which case such cash shall be returned to said participant. Any cash attributable to shares in excess of the number of shares subject to option to the participant (as determined in accordance with Section 7(a) hereof) shall be returned to the participant.

10. *Withdrawal; Termination of Employment .*

(a) A participant may withdraw all but not less than all the payroll deductions credited to his or her account under the Plan at any time prior to the end of the offering period by giving written notice to the Company. All of the participant's payroll deductions credited to his or her account will be paid to him or her promptly after receipt of his or her notice of withdrawal and his or her option for the current period will be automatically terminated, and no further payroll deductions for the purchase of shares will be made during the offering period.

(b) Upon termination of the participant's employment prior to the end of the offering period for any reason, including retirement or death, the payroll deductions credited to his or her account will be returned to him or her or, in the case of his or her death, to the person or persons entitled thereto under Section 14, and his or her option will be automatically terminated.

(c) In the event an Employee fails to remain in the continuous employ of the Company or one of its Designated Subsidiaries for at least twenty (20) hours per week during the offering period in which the employee is a participant, he or she will be deemed to have elected to withdraw from the Plan and the payroll deductions credited to his or her account will be returned to him or her and his or her option terminated.

(d) Except as provided in Section 3(a) with respect to Section 16 Persons, a participant's withdrawal from an offering will not have any effect upon his or her eligibility to participate in a succeeding offering or in any similar plan which may hereafter be adopted by the Company. However, a new subscription agreement will have to be filed in such case.

11. *No Interest .* No interest shall accrue on the payroll deductions of a participant in the Plan.

12. *Stock .*

(a) The maximum number of shares of the Company's Common Stock which shall be made available for sale under the Plan shall be seventy million (70,000,000) shares, subject to adjustment upon changes in capitalization of the Company as provided in Section 18. The shares to be sold to participants under the Plan may, at the election of the Company, be either treasury shares or shares authorized but unissued. The maximum number of shares of the Company's Common Stock available for sale in any offering period will be established by the committee of the members of the Board administering the Plan from time to time, prior to an offering period for all options to be granted during such offering period, subject to adjustment upon changes in capitalization of the Company as provided in Section 18. If at the termination of any offering period the total number of shares which would otherwise be subject to options granted pursuant to Section 7(a) hereof exceeds the number of shares then available under the Plan (after deduction of all shares for which options have been exercised or are then outstanding), the Company shall promptly notify the participants, and shall, in its sole discretion (i) make a pro rata allocation of the shares remaining

available for option grant in as uniform a manner as shall be practicable and as it shall determine to be equitable, (ii) terminate the offering period without issuance of any shares or (iii) obtain shareholder approval of an increase in the number of shares authorized under the Plan such that all options could be exercised in full. The Company may delay determining which of (i), (ii) or (iii) above it shall decide to effect, and may accordingly delay issuances of any shares under the Plan, for such time as is necessary to attempt to obtain shareholder approval of any increase in shares authorized under the Plan. The Company shall promptly notify participants of its determination to effect (i), (ii) or (iii) above upon making such decision. A participant may withdraw all but not less than all the payroll deductions credited to his or her account under the Plan at any time prior to such notification from the Company. In the event the Company determines to effect (i) or (ii) above, it shall promptly upon such determination return to each participant all payroll deductions not applied towards the purchase of shares.

(b) The participant will have no interest or voting right in shares covered by his or her option until such option has been exercised.

(c) Shares to be delivered to a participant under the Plan will be registered in the name of the participant or in the name of the participant and the spouse of the participant.

13. *Administration* . The Plan shall be administered by a committee of members of the Board of Directors, which committee shall be appointed by the Board. The administration, interpretation or application of the Plan by such committee shall be final, conclusive and binding upon all participants. Members of the committee shall not be permitted to participate in the Plan.

14. *Designation of Beneficiary* .

(a) A participant may indicate in his or her subscription agreement, or may file a written designation of beneficiary with respect to, a person who is to receive any shares and cash, if any, from the participant's account under the Plan in the event of such participant's death subsequent to the end of the offering period but prior to delivery to him or her of such shares and cash. In addition, a participant may file a written designation of a beneficiary who is to receive any cash from the participant's account under the Plan in the event of such participant's death prior to the end of the offering period.

(b) Such designation of beneficiary may be changed by the participant at any time by written notice. In the event of the death of a participant and in the absence of a beneficiary validly designated under the Plan who is living at the time of such participant's death, the Company shall deliver such shares and/or cash to the executor or administrator of the estate of the participant, or if no such executor or administrator has been appointed (to the knowledge of the Company), the Company, in its discretion, may deliver such shares and/or cash to the spouse or to any one or more dependents or relatives of the participant, or if no spouse, dependent or relative is known to the Company, then to such other person as the Company may designate.

15. *Transferability* . Neither payroll deductions credited to a participant's account nor any rights with regard to the exercise of an option or to receive shares under the Plan may be assigned, transferred, pledged or otherwise disposed of in any way (other than by will, the laws of descent and distribution or as provided in Section 14 hereof) by the participant. Any such attempt at assignment, transfer, pledge or other disposition shall be without effect, except that the Company may treat such act as an election to withdraw funds in accordance with Section 10.

16. *Use of Funds* . All payroll deductions received or held by the Company under the Plan may be used by the Company for any corporate purpose, and the Company shall not be obligated to segregate such payroll deductions.

17. *Reports* . Individual accounts will be maintained for each participant in the Plan. Statements of account will be given to participating Employees semi-annually within a reasonable period of time following the stock purchase date, which statements will set forth the amounts of payroll deductions, the per share purchase price, the number of shares purchased, the amount of cash rolled over into the next offering period and the remaining cash balance, if any.

18. *Adjustments Upon Changes in Capitalization* . Subject to any required action by the shareholders of the Company, the number of shares of Common Stock covered by each option under the Plan which has not yet been exercised and the number of shares of Common Stock which have been authorized for issuance under the Plan but have not yet been placed under option (collectively, the “Reserves”), as well as the price per share of Common Stock covered by each option under the Plan which has not yet been exercised, shall be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock resulting from a stock split or the payment of a stock dividend (but only on the Common Stock) or any other increase or decrease in the number of shares of Common Stock effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been “effected without receipt of consideration”. Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issue by the Company of shares of stock of any class, or securities convertible into or exercisable for shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock subject to an Option.

The Board may, if it so determines in the exercise of its sole discretion, also make provision for adjusting the Reserves, as well as the price per share of Common Stock covered by each outstanding option under the Plan, in the event that the Company effects one or more reorganizations, recapitalizations, rights offerings or other increases or reductions of shares of its outstanding Common Stock, and in the event of the Company being consolidated with or merged into any other corporation.

19. *Amendment and Termination of the Plan* .

(a) *Amendment and Termination* . The Board may at any time amend, alter, suspend or discontinue the Plan, but no amendment, alteration, suspension or discontinuation shall be made which would impair the rights of any participant under any option theretofore granted without his or her consent.

(b) *Shareholder Approval* . The Company shall obtain shareholder approval of any Plan amendment to the extent necessary and desirable to comply with Rule 16b-3 promulgated under the Securities Exchange Act of 1934, as amended, or with Section 423 of the Internal Revenue Code of 1986, as amended (or any successor statute or rule or other applicable law, rule or regulation), such shareholder approval to be obtained in such a manner and to such a degree as is required by the applicable law, rule or regulation.

(c) *Effect of Amendment or Termination* . Any such amendment or termination of the Plan shall not affect options already granted hereunder and such options shall remain in full force and effect as if this Plan had not been amended or terminated.

20. *Notices* . All notices or other communications by a participant to the Company under or in connection with the Plan shall be deemed to have been duly given when received in the form specified by the Company at the location, or by the person, designated by the Company for the receipt thereof. All notices or other communications to a participant by the Company shall be deemed to have been duly given when sent by the Company by regular mail to the address of the participant on the human resources records of the Company or when posted on AppleLink or any substitute general electronic messaging and bulletin board system utilized by the Company.

21. *Conditions Upon Issuance of Shares* . Shares shall not be issued with respect to an option unless the exercise of such option and the issuance and delivery of such shares pursuant thereto shall comply with all applicable provisions of law, domestic or foreign, including, without limitation, the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the rules and regulations promulgated thereunder, and the requirements of any stock exchange or automated quotation system upon which the shares may then be listed or quoted, and shall be further subject to the approval of counsel for the Company with respect to such compliance.

As a condition to the exercise of an option, the Company may require the person exercising such option to represent and warrant at the time of any such exercise that the shares are being purchased only for investment and without any present intention to sell or distribute such shares if, in the opinion of counsel for the Company, such a representation is required by any of the aforementioned applicable provisions of Law.

22. *Non-U.S. Employees* . With respect to the Company or any of its Designated Subsidiaries which employs Participants who reside outside of the United States, and notwithstanding anything herein to the contrary, the Board may in its sole discretion amend or vary the terms of the Plan in order to conform such terms with the requirements of local law to meet the objectives and purpose of the Plan, and the Board may, where appropriate, establish one or more sub-plans to reflect such amended or varied provisions.

APPLE COMPUTER, INC.
2003 Employee Stock Plan
(amended and restated effective as of April 21, 2005)

1. *Purposes of the Plan*. The purposes of this Stock Plan are:

- to attract and retain talented Employees
- to further align Employee and shareholder interests; and
- to closely link Employee compensation with Company performance.

Awards granted under the Plan may be Incentive Stock Options, Nonstatutory Stock Options, Restricted Stock subject to Stock Purchase Rights, Stock Appreciation Rights, Performance Shares or Restricted Stock Units, as determined by the Administrator at the time of grant.

2. *Definitions* . As used herein, the following definitions shall apply:

(a) “*Administrator*” means the Board or any of its Committees as shall be administering the Plan, in accordance with Section 4 of the Plan.

(b) “*Annual Revenue*” means the Company’s or a business unit’s net sales for the Fiscal Year, determined in accordance with generally accepted accounting principles.

(c) “*Applicable Laws*” means the requirements relating to the administration of stock plans under U.S. state corporate laws, U.S. federal and state securities laws, the Code, any stock exchange or quotation system on which the Common Stock is listed or quoted and the applicable laws of any foreign country or jurisdiction where Awards are, or will be, granted under the Plan.

(d) “*Award*” means, individually or collectively, a grant under the Plan of Options, Restricted Stock subject to Stock Purchase Rights, Stock Appreciation Rights, Performance Shares or Restricted Stock Units.

(e) “*Award Agreement*” means the written or electronic agreement setting forth the terms and provisions applicable to each Award granted under the Plan. The Award Agreement is subject to the terms and conditions of the Plan.

(f) “*Awarded Stock*” means the Common Stock subject to an Award.

(g) “*Board*” means the Board of Directors of the Company.

(h) “*Cash Position*” means the Company’s level of cash and cash equivalents.

(i) “*Chairman*” means the Chairman of the Board.

(j) “*Code*” means the Internal Revenue Code of 1986, as amended.

(k) “*Committee*” means a committee of Directors appointed by the Board in accordance with Section 4 of the Plan.

(l) “*Common Stock*” means the common stock of the Company.

(m) “ *Company* ” means Apple Computer, Inc., a California corporation.

(n) “ *Continuous Status as Chairman* ” unless determined otherwise by the Administrator, means the absence of any interruption or termination as Chairman of the Board with the Company. Continuous Status as Chairman shall not be considered interrupted in the case of medical leave,

military leave, family leave, or any other leave of absence approved by the Administrator, provided, in each case, that such leave does not result in termination as Chairman with the Company. Neither service as a Director nor payment of a director's fee by the Company shall be sufficient to constitute status as "Chairman" by the Company.

(o) "*Continuous Status as an Employee*" means the absence of any interruption or termination of the employment relationship with the Company or any Subsidiary. Continuous Status as an Employee shall not be considered interrupted in the case of (i) medical leave, military leave, family leave, or any other leave of absence approved by the Administrator, provided, in each case, that such leave does not result in termination of the employment relationship with the Company or any Subsidiary, as the case may be, under the terms of the respective Company policy for such leave; however, vesting may be tolled while an employee is on an approved leave of absence under the terms of the respective Company policy for such leave; or (ii) in the case of transfers between locations of the Company or between the Company, its Subsidiaries, or its successor. For purposes of Incentive Stock Options, no such leave may exceed ninety days, unless reemployment upon expiration of such leave is guaranteed by statute or contract. If reemployment upon expiration of a leave of absence approved by the Company is not so guaranteed, on the 91st day of such leave any Incentive Stock Option held by the Participant shall cease to be treated as an Incentive Stock Option and shall be treated for tax purposes as a Nonstatutory Stock Option. Neither service as a Chairman nor as a Director nor payment of a director's fee by the Company shall be sufficient to constitute "employment" by the Company.

(p) "*Director*" means a member of the Board.

(q) "*Dividend Equivalent*" means a credit, payable in cash, made at the discretion of the Administrator, to the account of a Participant in an amount equal to the cash dividends paid on one Share for each Share represented by an Award held by such Participant.

(r) "*Earnings Per Share*" means as to any Fiscal Year, the Company's or a business unit's Net Income, divided by a weighted average number of common shares outstanding and dilutive common equivalent shares deemed outstanding, determined in accordance with generally accepted accounting principles.

(s) "*Fiscal Year*" means a fiscal year of the Company.

(t) "*Individual Performance Objective*" means any individual Company business-related objective that is objectively determinable within the meaning of Code Section 162(m) and the Treasury Regulations promulgated thereunder. Individual Performance Objectives shall include, but not be limited to, improvement in customer satisfaction, opening of additional retail stores, and similar objectively determinable performance objectives related to the Participant's job responsibilities with the Company.

(u) "*Employee*" means any person employed by the Company or any Parent or Subsidiary of the Company subject to (k) above.

(v) "*Exchange Act*" means the Securities Exchange Act of 1934, as amended.

(w) "*Fair Market Value*" means, as of any date, the value of Common Stock determined as follows:

(i) If the Common Stock is listed on any established stock exchange or a national market system, including without limitation the Nasdaq National Market or The Nasdaq SmallCap Market of The Nasdaq Stock Market, its Fair Market Value shall be the closing sales price for such stock (or the closing bid, if no sales were reported) as quoted on such exchange or system, on the date of determination or, if the date of determination is not a trading day, the immediately preceding trading day;

(ii) If the Common Stock is regularly quoted by a recognized securities dealer but selling prices are not reported, the Fair Market Value of a Share of Common Stock shall be the mean between the high bid and low asked prices for the Common Stock on the date of determination or, if there are no quoted prices on the date of determination, on the last day on which there are quoted prices prior to the date of determination; or

(iii) In the absence of an established market for the Common Stock, the Fair Market Value shall be determined in good faith by the Administrator.

(x) “*Incentive Stock Option*” means an Option intended to qualify as an incentive stock option within the meaning of Section 422 of the Code and the regulations promulgated thereunder and is expressly designated by the Administrator at the time of grant as an incentive stock option.

(y) “*Net Income*” means as to any Fiscal Year, the income after taxes of the Company for the Fiscal Year determined in accordance with generally accepted accounting principles.

(z) “*Operating Cash Flow*” means the Company’s or a business unit’s sum of Net Income plus depreciation and amortization less capital expenditures plus changes in working capital comprised of accounts receivable, inventories, other current assets, trade accounts payable, accrued expenses, product warranty, advance payments from customers and long-term accrued expenses, determined in accordance with generally acceptable accounting principles.

(aa) “*Operating Income*” means the Company’s or a business unit’s income from operations determined in accordance with generally accepted accounting principles.

(bb) “*Nonstatutory Stock Option*” means an Option not intended to qualify as an Incentive Stock Option.

(cc) “*Option*” means a stock option granted pursuant to the Plan.

(dd) “*Optioned Stock*” means the Common Stock subject to an Option, SAR or Stock Purchase Right.

(ee) “*Participant*” means the holder of an outstanding Award granted under the Plan.

(ff) “*Parent*” means a “parent corporation,” whether now or hereafter existing, as defined in Section 424(e) of the Code.

(gg) “*Performance Goals*” means the goal(s) (or combined goal(s)) determined by the Committee (in its discretion) to be applicable to a Participant with respect to an Award. As determined by the Committee, the Performance Goals applicable to an Award may provide for a targeted level or levels of achievement using one or more of the following measures: (a) Annual Revenue, (b) Cash Position, (c) Earnings Per Share, (d) Net Income, (e) Operating Cash Flow, (f) Operating Income, (g) Return on Assets, (h) Return on Equity, (i) Return on Sales, (j) Total Stockholder Return, and (k) Individual Performance Objectives. The Performance Goals may differ from Participant to Participant and from Award to Award. The Administrator shall appropriately adjust any evaluation of performance under a Performance Goal to exclude (i) any extraordinary non-recurring items as described in Accounting Principles Board Opinion No. 30 and/or in management’s discussion and analysis of financial conditions and results of operations appearing in the Company’s annual report to shareholders for the applicable year, or (ii) the effect of any changes in accounting principles affecting the Company’s or a business units’ reported results.

(hh) “*Performance Share*” means a performance share Award granted to a Participant pursuant to Section 14.

(ii) “*Plan*” means this 2003 Employee Stock Plan.

(jj) “ *Restricted Stock* ” means shares of Common Stock acquired pursuant to a grant of Stock Purchase Rights under Section 12 of the Plan.

(kk) “ *Restricted Stock Unit* ” means a bookkeeping entry representing an amount equal to the Fair Market Value of one Share, granted pursuant to Section 13. Each Restricted Stock Unit represents an unfunded and unsecured obligation of the Company.

(ll) “ *Return on Assets* ” means the percentage equal to the Company’s or a business unit’s Operating Income before incentive compensation, divided by average net Company or business unit, as applicable, assets, determined in accordance with generally accepted accounting principles.

(mm) “ *Return on Equity* ” means the percentage equal to the Company’s Net Income divided by average shareholder’s equity, determined in accordance with generally accepted accounting principles.

(nn) “ *Return on Sales* ” means the percentage equal to the Company’s or a business unit’s Operating Income before incentive compensation, divided by the Company’s or the business unit’s, as applicable, revenue, determined in accordance with generally accepted accounting principles.

(oo) “ *Rule 16b-3* ” means Rule 16b-3 of the Exchange Act or any successor to Rule 16b-3, as in effect when discretion is being exercised with respect to the Plan.

(pp) “ *Stock Appreciation Right* ” or “SAR” means a stock appreciation right granted pursuant to Section 10 below.

(qq) “ *Section 16(b)* ” means Section 16(b) of the Exchange Act.

(rr) “ *Share* ” means a share of the Common Stock, as adjusted in accordance with Section 17 of the Plan.

(ss) “ *Stock Purchase Right* ” means the right to purchase Common Stock pursuant to Section 12 of the Plan, as evidenced by an Award Agreement.

(tt) “ *Subsidiary* ” means a “subsidiary corporation”, whether now or hereafter existing, as defined in Section 424(f) of the Code.

(uu) “ *Total Stockholder Return* ” means the total return (change in share price plus reinvestment of any dividends) of a share of the Company’s common stock.

3. *Stock Subject to the Plan* . Subject to the provisions of Section 17 of the Plan, the maximum aggregate number of Shares which may be issued under the Plan is 145,000,000 Shares. The Shares may be authorized, but unissued, or reacquired Common Stock.

Any Shares subject to Options or SARs shall be counted against the numerical limits of this Section 3 as one Share for every Share subject thereto. With respect to Awards granted on or after the date of receiving shareholder approval of the amended Plan in 2005, any Shares subject to Stock Purchase Rights, Performance Shares or Restricted Stock Units with a per share or unit purchase price lower than 100% of Fair Market Value on the date of grant shall be counted against the numerical limits of this Section 3 as two Shares for every one Share subject thereto. To the extent that a Share that was subject to an Award that counted as two Shares against the Plan reserve pursuant to the preceding sentence is recycled back into the Plan under the next paragraph of this Section 3, the Plan shall be credited with two Shares.

If an Award expires or becomes unexercisable without having been exercised in full, or, with respect to Restricted Stock, Performance Shares or Restricted Stock Units, is forfeited to or repurchased by the Company, the unpurchased Shares (or for Awards other than Options and SARs, the forfeited or repurchased shares) which were subject thereto shall become available for future grant or sale under the Plan (unless the Plan has terminated). With respect to SARs, when a stock settled SAR is exercised, the Shares subject to a SAR grant agreement shall be counted against the numerical limits of Section 3 above, as one share for every share subject thereto, regardless of the number of shares used to settle the SAR

upon exercise. Shares that have actually been issued under the Plan under any Award shall not be returned to the Plan and shall not become available for future distribution under the Plan; provided, however, that if Shares of Restricted Stock, Performance Shares or Restricted Stock Units are repurchased by the Company at their original purchase price or are forfeited to the Company, such Shares shall become available for future grant under the Plan. Shares used to pay the exercise price of an Option shall not become available for future grant or sale under the Plan. Shares used to satisfy tax withholding obligations shall not become available for future grant or sale under the Plan. To the extent an Award under the Plan is paid out in cash rather than stock, such cash payment shall not reduce the number of Shares available for issuance under the Plan. Any payout of Dividend Equivalents, because they are payable only in cash, shall not reduce the number of Shares available for issuance under the Plan. Conversely, any forfeiture of Dividend Equivalents shall not increase the number of Shares available for issuance under the Plan.

4. *Administration of the Plan* .

(a) *Procedure*.

(i) *Multiple Administrative Bodies* . If permitted by Rule 16b-3 promulgated under the Exchange Act or any successor rule thereto, as in effect at the time that discretion is being exercised with respect to the Plan, and by the legal requirements of the Applicable Laws relating to the administration of stock plans such as the Plan, if any, the Plan may (but need not) be administered by different administrative bodies with respect to (a) Directors who are Employees, (b) Officers who are not Directors, and (c) Employees who are neither Directors nor Officers.

(ii) Section 162(m). To the extent that the Administrator determines it to be desirable to qualify Awards granted hereunder as “performance-based compensation” within the meaning of Section 162(m) of the Code, the Plan shall be administered by a Committee of two or more “outside directors” within the meaning of Section 162(m) of the Code.

(iii) *Rule 16b-3* . To the extent desirable to qualify transactions hereunder as exempt under Rule 16b-3, the transactions contemplated hereunder shall be structured to satisfy the requirements for exemption under Rule 16b-3.

(iv) *Other Administration* . Other than as provided above, the Plan shall be administered by (a) the Board or (b) a Committee, which committee shall be constituted to satisfy Applicable Laws.

(b) *Powers of the Administrator* . Subject to the provisions of the Plan, and in the case of a Committee, subject to the specific duties delegated by the Board to such Committee, the Administrator shall have the authority, in its discretion:

(i) to determine the Fair Market Value;

(ii) to select the person(s) to whom Awards may be granted hereunder;

(iii) to determine the number of shares of Common Stock to be covered by each Award granted hereunder;

(iv) to approve forms of Award Agreement for use under the Plan;

(v) to determine the terms and conditions, not inconsistent with the terms of the Plan, of any Award granted hereunder. Such terms and conditions include, but are not limited to, the exercise price, the date of grant, the time or times when Awards may be exercised (or are earned) (which may be based on performance criteria), any vesting acceleration or waiver of forfeiture restrictions, and any restriction or limitation regarding any Award or the shares of Common Stock relating thereto, based in each case on such factors as the Administrator, in its sole discretion, shall determine; provided, however, that with respect to Shares of Restricted Stock subject to Stock Purchase Rights, Performance Shares or Restricted Stock Units vesting solely

based on continuing as an Employee or Chairman, they will vest in full no earlier (except if accelerated pursuant to Sections 17 or 4(b)(ix) hereof) than the three (3) year anniversary of the grant date; provided, further, that if vesting is not solely employment- or Chairmanship-based, they will vest in full no earlier (except if accelerated pursuant to Sections 17 or 4(b)(ix) hereof) than the one (1) year anniversary of the grant date;

(vi) the Administrator may not “reprice” Options, SARs or Stock Purchase Rights, including 6-months-plus-1-day option exchange programs, without shareholder approval.

(vii) to construe and interpret the terms of the Plan and Awards granted pursuant to the Plan;

(viii) to prescribe, amend and rescind rules and regulations relating to the Plan, including rules and regulations relating to sub-plans established for the purpose of qualifying for preferred tax treatment under foreign tax laws;

(ix) to modify or amend each Award (subject to Section 19(c) of the Plan), including the discretionary authority to extend the post-termination exercisability period of Options and SARs longer than is otherwise provided for in the Plan; however, the Administrator may not extend the post-termination exercisability period beyond the earlier of the date the Award would otherwise expire by its terms due to the passage of time from the date of grant or seven (7) years;

(x) to allow Participants to satisfy withholding tax obligations by electing to have the Company withhold from the Shares to be issued upon exercise of an Option, SAR or Stock Purchase Right or upon vesting or payout of another Award, that number of Shares or cash having a Fair Market Value equal to the amount required to be withheld. The Fair Market Value of the Shares to be withheld shall be determined on the date that the amount of tax to be withheld is to be determined. All elections by a Participant to have Shares or cash withheld for this purpose shall be made in such form and under such conditions as the Administrator may deem necessary or advisable;

(xi) to determine whether Awards will be adjusted for Dividend Equivalents;

(xii) to authorize any person to execute on behalf of the Company any instrument required to effect the grant of an Award previously granted by the Administrator; and

(xiii) to make all other determinations deemed necessary or advisable for administering the Plan.

(c) *Effect of Administrator’s Decision* . The Administrator’s decisions, determinations and interpretations shall be final and binding on all Participants and any other holders of Awards.

5. *Eligibility* . Awards may be granted to Employees and the Chairman. Incentive Stock Options may be granted only to Employees.

6. *No Employment Rights* . Neither the Plan nor any Award shall confer upon a Participant any right with respect to continuing the Participant’s relationship as an Employee with or Chairman of the Company, nor shall they interfere in any way with the Participant’s right or the Company’s right to terminate such relationship at any time, with or without cause.

7. *Code Section 162(m) Provisions* .

(a) *Option and SAR Annual Share Limit* . No Participant shall be granted, in any Fiscal Year, Options and Stock Appreciation Rights to purchase more than 34,000,000 Shares.

(b) *Restricted Stock Subject to Stock Purchase Rights, Performance Share and Restricted Stock Unit Annual Limit* . No Participant shall be granted, in any Fiscal Year, more than 10,000,000 Shares in the aggregate of the following: (i) Restricted Stock subject to Stock Purchase Rights, (ii) Performance Shares, or (iii) Restricted Stock Units.

(c) *Section 162(m) Performance Restrictions* . For purposes of qualifying grants of Restricted Stock subject to Stock Purchase Rights, Performance Shares or Restricted Stock Units as “performance-based compensation” under Section 162(m) of the Code, the Administrator, in its discretion, may set restrictions based upon the achievement of Performance Goals. The Performance Goals shall be set by the Administrator on or before the latest date permissible to enable the Restricted Stock subject to Stock Purchase Rights, Performance Shares or Restricted Stock Units to qualify as “performance-based compensation” under Section 162(m) of the Code. In granting Restricted Stock subject to Stock Purchase Rights, Performance Shares or Restricted Stock Units which are intended to qualify under Section 162(m) of the Code, the Administrator shall follow any procedures determined by it from time to time to be necessary or appropriate to ensure qualification of the Award under Section 162(m) of the Code (e.g., in determining the Performance Goals).

(d) *Changes in Capitalization* . The numerical limitations in Sections 7(a) and (b) shall be adjusted proportionately in connection with any change in the Company’s capitalization as described in Section 18(a).

8. *Term of Plan* . Subject to Section 23 of the Plan, the Plan shall continue in effect until February 8, 2015.

9. *Stock Options* .

(a) *Type of Option* . Each Option shall be designated in the Award Agreement as either an Incentive Stock Option or a Nonstatutory Stock Option. However, notwithstanding such designation, to the extent that the aggregate Fair Market Value of the Shares with respect to which Incentive Stock Options are exercisable for the first time by the Participant during any calendar year (under all plans of the Company and any Parent or Subsidiary) exceeds \$100,000, such Options shall be treated as Nonstatutory Stock Options. For purposes of this Section 9(a), Incentive Stock Options shall be taken into account in the order in which they were granted. The Fair Market Value of the Shares shall be determined as of the time the Option with respect to such Shares is granted.

(b) *Term* . The term of each Option shall be seven (7) years from the date of grant or such shorter term as may be provided in the Award Agreement. Moreover, in the case of an Incentive Stock Option granted to a Participant who, at the time the Incentive Stock Option is granted, owns stock representing more than ten percent (10%) of the total combined voting power of all classes of stock of the Company or any Parent or Subsidiary, the term of the Incentive Stock Option shall be five (5) years from the date of grant or such shorter term as may be provided in the Award Agreement.

(c) *Option Exercise Price and Consideration* .

(i) *Exercise Price* . The per share exercise price for the Shares to be issued pursuant to exercise of an Option shall be no less than 100% of the Fair Market Value per Share on the date of grant; provided, however, that in the case of an Incentive Stock Option granted to an Employee who, at the time the Incentive Stock Option is granted, owns stock representing more than ten percent (10%) of the voting power of all classes of stock of the Company or any Parent or Subsidiary, the per Share exercise price shall be no less than 110% of the Fair Market Value per Share on the date of grant.

(ii) *Waiting Period and Exercise Dates* . At the time an Option is granted, the Administrator shall fix the period within which the Option may be exercised and shall determine any conditions which must be satisfied before the Option may be exercised.

(iii) *Form of Consideration* . The Administrator shall determine the acceptable form of consideration for exercising an Option, including the method of payment. In the case of an Incentive Stock Option, the Administrator shall determine the acceptable form of consideration at the time of grant. Such consideration may consist entirely of:

(1) cash;

(2) check;

(3) promissory note;

(4) other Shares which have a Fair Market Value on the date of surrender equal to the aggregate exercise price of the Shares as to which said Option shall be exercised (which may include Shares that would otherwise be issued pursuant to the Option);

(5) consideration received by the Company under a cashless exercise program implemented by the Company in connection with the Plan;

(6) a reduction in the amount of any Company liability to the Participant, including any liability attributable to the Participant's participation in any Company-sponsored deferred compensation program or arrangement;

(7) any combination of the foregoing methods of payment; or

(8) such other consideration and method of payment for the issuance of Shares to the extent permitted by Applicable Laws.

10. *Stock Appreciation Rights* .

(a) *Granted in Connection with Options* . At the sole discretion of the Administrator, SARs may be granted in connection with all or any part of an Option, either concurrently with the grant of the Option or at any time thereafter during the term of the Option. The following provisions apply to SARs that are granted in connection with Options:

(i) The SAR shall entitle the Participant to exercise the SAR by surrendering to the Company unexercised a portion of the related Option. The Participant shall receive in exchange from the Company an amount equal to the excess of (x) the Fair Market Value on the date of exercise of the SAR of the Common Stock covered by the surrendered portion of the related Option over (y) the exercise price of the Common Stock covered by the surrendered portion of the related Option. Notwithstanding the foregoing, the Administrator may place limits on the amount that may be paid upon exercise of a SAR; provided, however, that such limit shall not restrict the exercisability of the related Option;

(ii) When a SAR is exercised, the related Option, to the extent surrendered, shall no longer be exercisable;

(iii) A SAR shall be exercisable only when and to the extent that the related Option is exercisable and shall expire no later than the date on which the related Option expires; and

(iv) A SAR may only be exercised at a time when the Fair Market Value of the Common Stock covered by the related Option exceeds the exercise price of the Common Stock covered by the related Option.

(b) *Independent SARs* . At the sole discretion of the Administrator, SARs may be granted without related Options. The following provisions apply to SARs that are not granted in connection with Options:

(i) The SAR shall entitle the Participant, by exercising the SAR, to receive from the Company an amount equal to the excess of (x) the Fair Market Value of the Common Stock covered by exercised portion of the SAR, as of the date of such exercise, over (y) the Fair Market Value of the Common Stock covered by the exercised portion of the SAR, as of the date on which the SAR was granted; provided, however, that the Administrator may place limits on the amount that may be paid upon exercise of a SAR; and

(ii) SARs shall be exercisable, in whole or in part, at such times as the Administrator shall specify in the Participant's Award Agreement;

(iii) The term of each SAR shall be seven (7) years from the date of grant or such shorter term as may be provided in the Award Agreement.

(c) *Form of Payment* . The Company's obligation arising upon the exercise of a SAR may be paid in Common Stock or in cash, or in any combination of Common Stock and cash, as the Administrator, in its sole discretion, may determine. Shares issued upon the exercise of a SAR shall be valued at their Fair Market Value as of the date of exercise.

(d) *Rule 16b-3* . SARs granted hereunder shall contain such additional restrictions as may be required to be contained in the Plan or Award Agreement in order for the SAR to qualify for the maximum exemption provided by Rule 16b-3.

11. *Exercise of Option or SAR* .

(a) *Procedure for Exercise; Rights as a Shareholder* . Any Option or SAR granted hereunder shall be exercisable according to the terms of the Plan and at such times and under such conditions as determined by the Administrator and set forth in the Award Agreement. An Option may not be exercised for a fraction of a Share.

An Option or SAR shall be deemed exercised when the Company receives: (i) written or electronic notice of exercise (in accordance with the terms of the Option or SAR) from the person entitled to exercise the Option or SAR, and (ii) full payment for the Shares with respect to which the Option is exercised. Full payment may consist of any consideration and method of payment authorized by the Administrator and permitted by the Award Agreement and the Plan. Shares issued upon exercise of an Option shall be issued in the name of the Participant or, if requested by the Participant, in the name of the Participant and his or her spouse. Until the Shares are issued (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company), no right to vote or receive dividends or any other rights as a shareholder shall exist with respect to the Optioned Stock, notwithstanding the exercise of the Option. The Company shall issue (or cause to be issued) such Shares promptly after the Option is exercised. No adjustment will be made for a dividend or other right for which the record date is prior to the date the Shares are issued, except as provided in Section 17 of the Plan.

Exercising an Option in any manner shall decrease the number of Shares thereafter available, both for purposes of the Plan and for sale under the Option, by the number of Shares as to which the Option is exercised. Exercise of a SAR in any manner shall, to the extent the SAR is exercised, result in a decrease in the number of Shares which thereafter shall be available for purposes of the Plan, and the SAR shall cease to be exercisable to the extent it has been exercised.

(b) *Termination of Continuous Status as Chairman* . Upon termination of a Participant's Continuous Status as Chairman (other than termination by reason of the Participant's death), the Participant may, but only within ninety (90) days after the date of such termination, exercise his or her Option or SAR to the extent that it was exercisable at the date of such termination. Notwithstanding

the foregoing, however, an Option or SAR may not be exercised after the date the Option or SAR would otherwise expire by its terms due to the passage of time from the date of grant.

(c) *Termination of Continuous Employment* . Upon termination of a Participant's Continuous Status as Employee (other than termination by reason of the Participant's death), the Participant may, but only within ninety (90) days after the date of such termination, exercise his or her Option or SAR to the extent that it was exercisable at the date of such termination. Notwithstanding the foregoing, however, an Option or SAR may not be exercised after the date the Option or SAR would otherwise expire by its terms due to the passage of time from the date of grant.

(d) *Death of Participant* . If a Participant dies (i) while an Employee or Chairman, the Option or SAR may be exercised at any time within six (6) months (or such other period of time not exceeding twelve (12) months as determined by the Administrator) following the date of death by the Participant's estate or by a person who acquired the right to exercise the Option by bequest or inheritance, but only to the extent of the right to exercise that would have accrued had the Participant continued living and terminated his or her employment six (6) months (or such other period of time not exceeding twelve (12) months as determined by the Administrator) after the date of death; or (ii) within ninety (90) days after the termination of Continuous Status as an Employee or Chairman, the Option or SAR may be exercised, at any time within six (6) months (or such other period of time not exceeding twelve (12) months as determined by the Administrator) following the date of death by the Participant's estate or by a person who acquired the right to exercise the Option or SAR by bequest or inheritance, but only to the extent of the right to exercise that had accrued at the date of termination. If the Option or SAR is not so exercised within the time specified herein, the Option or SAR shall terminate, and the Shares covered by such Option or SAR shall revert to the Plan.

Notwithstanding the foregoing, however, an Option or SAR may not be exercised after the date the Option or SAR would otherwise expire by its terms due to the passage of time from the date of grant.

(e) *Buyout Provisions* . The Administrator may at any time offer to buy out for a payment in cash or Shares an Option or SAR previously granted based on such terms and conditions as the Administrator shall establish and communicate to the Participant at the time that such offer is made.

12. *Stock Purchase Rights* .

(a) *Rights to Purchase* . Stock Purchase Rights may be issued either alone, in addition to, or in tandem with other Awards and/or cash awards made outside of the Plan. After the Administrator determines that it will offer Stock Purchase Rights under the Plan, it shall advise the Participant in writing or electronically, of the terms, conditions and restrictions related to the offer, including the number of Shares that the Participant shall be entitled to purchase, the price to be paid, and the time within which the Participant must accept such offer. The offer shall be accepted by execution of an Award Agreement in the form determined by the Administrator.

(b) *Repurchase Option* . Unless the Administrator determines otherwise, the Award Agreement shall grant the Company a repurchase option exercisable upon the voluntary or involuntary termination of the purchaser's service with the Company for any reason (including death or Disability). The purchase price for Shares repurchased pursuant to the Award Agreement shall be the original price paid by the purchaser and may be paid by cancellation of any indebtedness of the purchaser to the Company. The repurchase option shall lapse at a rate determined by the Administrator.

(c) *Other Provisions* . The Award Agreement shall contain such other terms, provisions and conditions not inconsistent with the Plan as may be determined by the Administrator in its sole discretion.

(d) *Rights as a Shareholder* . Once the Stock Purchase Right is exercised, the purchaser shall have the rights equivalent to those of a shareholder, and shall be a shareholder when his or her purchase is entered upon the records of the duly authorized transfer agent of the Company. No adjustment will be made for a dividend or other right for which the record date is prior to the date the Stock Purchase Right is exercised, except as provided in Section 17 of the Plan.

13. *Restricted Stock Units* .

(a) *Grant* . Restricted Stock Units may be granted at any time and from time to time as determined by the Administrator. After the Administrator determines that it will grant Restricted Stock Units under the Plan, it shall advise the Participant in writing or electronically of the terms, conditions, and restrictions related to the grant, including the number of Restricted Stock Units and the form of payout, which, subject to Section 13(d), may be left to the discretion of the Administrator.

(b) *Vesting Criteria and Other Terms* . The Administrator shall set vesting criteria in its discretion, which, depending on the extent to which the criteria are met, will determine the number of Restricted Stock Units that will be paid out to the Participant. The Administrator may set vesting criteria based upon the achievement of Company-wide, business unit, or individual goals (including, but not limited to, continued employment), or any other basis determined by the Administrator in its discretion.

(c) *Earning Restricted Stock Units* . Upon meeting the applicable vesting criteria, the Participant shall be entitled to receive a payout as specified in the Restricted Stock Unit Award Agreement. Notwithstanding the foregoing, at any time after the grant of Restricted Stock Units, the Administrator, in its sole discretion, may reduce or waive any vesting criteria that must be met to receive a payout.

(d) *Form and Timing of Payment* . Payment of earned Restricted Stock Units shall be made as soon as practicable after the date(s) set forth in the Restricted Stock Unit Award Agreement. The Administrator, in its sole discretion, may pay earned Restricted Stock Units in cash, Shares, or a combination thereof. Shares represented by Restricted Stock Units that are fully paid in cash again shall be available for grant under the Plan.

(e) *Cancellation* . On the date set forth in the Restricted Stock Unit Award Agreement, all unearned Restricted Stock Units shall be forfeited to the Company.

14. *Performance Shares* .

(a) *Grant of Performance Shares* . Subject to the terms and conditions of the Plan, Performance Shares may be granted to Participants at any time as shall be determined by the Administrator, in its sole discretion. Subject to Section 7(b) hereof, the Administrator shall have complete discretion to determine (i) the number of Shares subject to a Performance Share award granted to any Participant, and (ii) the conditions that must be satisfied, which typically will be based principally or solely on achievement of performance milestones but may include a service-based component, upon which is conditioned the grant or vesting of Performance Shares. Performance Shares shall be granted in the form of units to acquire Shares. Each such unit shall be the equivalent of one Share for purposes of determining the number of Shares subject to an Award. Until the Shares are issued, no right to vote or receive dividends or any other rights as a stockholder shall exist with respect to the units to acquire Shares.

(b) *Other Terms* . The Administrator, subject to the provisions of the Plan, shall have complete discretion to determine the terms and conditions of Performance Shares granted under the Plan. Performance Share grants shall be subject to the terms, conditions, and restrictions determined by the Administrator at the time the stock is awarded, which may include such performance-based milestones as are determined appropriate by the Administrator. The Administrator may require the recipient to sign a Performance Shares Award Agreement as a condition of the award. Any certificates

representing the Shares of stock awarded shall bear such legends as shall be determined by the Administrator.

(c) *Performance Share Award Agreement* . Each Performance Share grant shall be evidenced by an Award Agreement that shall specify such other terms and conditions as the Administrator, in its sole discretion, shall determine.

15. *Transferability of Awards* . Unless determined otherwise by the Administrator, an Award may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution or pursuant to a qualified domestic relations order as defined by the Code or Title 1 of the Employee Retirement Income Security Act, and may be exercised, during the lifetime of the Participant, only by the Participant. If the Administrator makes an Award transferable, such Award shall contain such additional terms and conditions as the Administrator deems appropriate.
16. *Stock Withholding to Satisfy Withholding Tax Obligations* . When a Participant incurs tax liability in connection with the exercise, vesting or payout, as applicable, of an Award, which tax liability is subject to tax withholding under applicable tax laws, and the Participant is obligated to pay the Company an amount required to be withheld under applicable tax laws, the Participant may satisfy the withholding tax obligation by electing to have the Company withhold from the Shares to be issued upon exercise of the Option, SAR or Stock Purchase Right or the Shares to be issued upon payout or vesting of the other Award, if any, that number of Shares having a Fair Market Value equal to the amount required to be withheld. The Fair Market Value of the Shares to be withheld shall be determined on the date that the amount of tax to be withheld is to be determined (the "Tax Date").

All elections by a Participant to have Shares withheld for this purpose shall be made in writing in a form acceptable to the Administrator and shall be subject to the following restrictions:

- (a) the election must be made on or prior to the applicable Tax Date; and
- (b) all elections shall be subject to the consent or disapproval of the Administrator.

In the event the election to have Shares subject to an Option, SAR or Stock Purchase Right withheld is made by a Participant and the Tax Date is deferred under Section 83 of the Code because no election is filed under Section 83(b) of the Code, the Participant shall receive the full number of Shares with respect to which the Option, SAR or Stock Purchase Right is exercised but such Participant shall be unconditionally obligated to tender back to the Company the proper number of Shares on the Tax Date.

17. *Adjustments Upon Changes in Capitalization, Dissolution, Merger or Asset Sale* .

(a) *Changes in Capitalization* . Subject to any required action by the shareholders of the Company, the number of shares of Common Stock covered by each outstanding Award and the number of shares of Common Stock which have been authorized for issuance under the Plan but as to which no Awards have yet been granted or which have been returned to the Plan upon cancellation or expiration of an Award, as well as the price per share, if any, of Common Stock covered by each such outstanding Award and the 162(m) fiscal year share issuance limits under Sections 7(a) and (b) hereof shall, shall be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the Common Stock, or any other increase or decrease in the number of issued shares of Common Stock effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration." Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into

shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock subject to an Award.

(b) *Dissolution or Liquidation* . In the event of the proposed dissolution or liquidation of the Company, all outstanding Awards will terminate immediately prior to the consummation of such proposed action, unless otherwise provided by the Administrator. The Administrator in its discretion may provide for a Participant to have the right to exercise his or her Option, SAR or Stock Purchase Right until ten (10) days prior to such transaction as to all of the Awarded Stock covered thereby, including Shares as to which the Award would not otherwise be exercisable. In addition, the Administrator may provide that any Company repurchase option or forfeiture rights applicable to any Award shall lapse 100%, and that any Award vesting shall accelerate 100%, provided the proposed dissolution or liquidation takes place at the time and in the manner contemplated. To the extent it has not been previously exercised (with respect to Options, SARs and Stock Purchase Rights) or vested (with respect to other Awards), an Award will terminate immediately prior to the consummation of such proposed action.

(c) *Merger or Asset Sale* . Unless otherwise determined by the Administrator, in the event of a merger of the Company with or into another corporation, or the sale of substantially all of the assets of the Company, each outstanding Award shall be assumed or an equivalent award substituted by the successor corporation or a Parent or Subsidiary of the successor corporation. In the event that the successor corporation refuses to assume or substitute for the Award, the Participant shall (i) fully vest in and have the right to exercise the Option, SAR or Stock Purchase Right as to all of the Awarded Stock, including Shares as to which it would not otherwise be vested or exercisable, and (ii) fully earn and receive a payout with respect to other Awards. If an Award becomes fully vested and exercisable (or earned, as applicable) in lieu of assumption or substitution in the event of a merger or sale of assets, the Administrator shall notify the Participant in writing or electronically that (i) the Option, SAR or Stock Purchase Right shall be fully vested and exercisable for a period of thirty (30) days from the date of such notice, and the Option, SAR or Stock Purchase Right shall terminate upon the expiration of such period and (ii) the other Award shall be paid out immediately prior to the merger or sale of assets. For the purposes of this paragraph, the Award shall be considered assumed if, following the merger or sale of assets, the assumed Award confers the right to purchase or receive, for each Share of Awarded Stock subject to the Award immediately prior to the merger or sale of assets, the consideration (whether stock, cash, or other securities or property) received in the merger or sale of assets by holders of Common Stock for each Share held on the effective date of the transaction (and if holders were offered a choice of consideration, the type of consideration chosen by the holders of a majority of the outstanding Shares); provided, however, that if such consideration received in the merger or sale of assets is not solely common stock of the successor corporation or its Parent, the Administrator may, with the consent of the successor corporation, provide for the consideration to be received upon the exercise (or payout or vesting, as applicable) of the Award, for each Share of Awarded Stock subject to the Award, to be solely common stock of the successor corporation or its Parent equal in fair market value to the per share consideration received by holders of Common Stock in the merger or sale of assets.

(d) *Change in Control* . In the event of a “Change in Control” of the Company, as defined in paragraph (e) below, unless otherwise determined by the Administrator prior to the occurrence of such Change in Control, the following acceleration and valuation provisions shall apply:

(i) Any Options, SARs and Stock Purchase Rights outstanding as of the date such Change in Control is determined to have occurred that are not yet exercisable and vested on such date shall become fully exercisable and vested; and

(ii) Any other Awards outstanding as of the date such Change in Control is determined to have occurred that are not yet earned on such date shall become fully earned and vested; and

(iii) The value of all outstanding Awards shall, unless otherwise determined by the Administrator at or after grant, be cashed-out. The amount at which such Options, SARs and Stock Purchase Rights shall be cashed out shall be equal to the excess of (x) the Change in Control Price (as defined below) over (y) the exercise price of the Common Stock covered by the Option, SAR or Stock Purchase Right, and the amount at which such other Awards shall be cashed out shall be equal to the Change in Control price (as defined below). The cash-out proceeds shall be paid to the Participant or, in the event of death of a Participant prior to payment, to the estate of the Participant or to a person who acquired the right to exercise the Option, SAR or Stock Purchase Right, or who acquired the right to receive the payout of the other Award, by bequest or inheritance.

(e) *Definition of "Change in Control"* . For purposes of this Section 17, a "Change in Control" means the happening of any of the following:

(i) When any "person", as such term is used in Sections 13(d) and 14(d) of the Exchange Act (other than the Company, a Subsidiary or a Company employee benefit plan, including any trustee of such plan acting as trustee) is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing fifty percent (50%) or more of the combined voting power of the Company's then outstanding securities; or

(ii) The occurrence of a transaction requiring shareholder approval, and involving the sale of all or substantially all of the assets of the Company or the merger of the Company with or into another corporation (other than the Company's reincorporation into another jurisdiction).

(f) *Change in Control Price* . For purposes of this Section 17, "Change in Control Price" shall be, as determined by the Administrator, (i) the highest Fair Market Value at any time within the 60-day period immediately preceding the date of determination of the Change in Control Price by the Administrator (the "60-Day Period"), or (ii) the highest price paid or offered, as determined by the Administrator, in any bona fide transaction or bona fide offer related to the Change in Control of the Company, at any time within the 60-Day Period.

18. *Date of Grant* . The date of grant of an Award shall be, for all purposes, the date on which the Administrator makes the determination granting such Award, or such other later date as is determined by the Administrator. Notice of the determination shall be provided to each Participant within a reasonable time after the date of such grant.

19. *Amendment and Termination of the Plan* .

(a) *Amendment and Termination* . The Board may at any time amend, alter, suspend or terminate the Plan.

(b) *Shareholder Approval* . The Company shall obtain shareholder approval of any Plan amendment to the extent necessary and desirable to comply with Applicable Laws.

(c) *Effect of Amendment or Termination* . No amendment, alteration, suspension or termination of the Plan shall impair the rights of any Participant, unless mutually agreed otherwise between the Participant and the Administrator, which agreement must be in writing and signed by the Participant and the Company. Termination of the Plan shall not affect the Administrator's ability to exercise the powers granted to it hereunder with respect to Awards granted under the Plan prior to the date of such termination.

20. *Conditions Upon Issuance of Shares* .

(a) *Legal Compliance* . Shares shall not be issued pursuant to the exercise or payout, as applicable, of an Award unless the exercise or payout, as applicable, of such Award and the issuance

and delivery of such Shares shall comply with Applicable Laws and shall be further subject to the approval of counsel for the Company with respect to such compliance.

(b) *Investment Representations* . As a condition to the exercise or payout, as applicable, of an Award, the Company may require the person exercising such Option, SAR or Stock Purchase Right, or in the case of another Award, the person receiving the payout, to represent and warrant at the time of any such exercise that the Shares are being purchased only for investment and without any present intention to sell or distribute such Shares if, in the opinion of counsel for the Company, such a representation is required.

21. *Inability to Obtain Authority* . The inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, shall relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.
22. *Reservation of Shares* . The Company, during the term of this Plan, will at all times reserve and keep available such number of Shares as shall be sufficient to satisfy the requirements of the Plan.
23. *Shareholder Approval* . The amended and restated Plan shall be subject to approval by the shareholders of the Company within twelve (12) months after February 8, 2005. Such shareholder approval shall be obtained in the manner and to the degree required under Applicable Laws.
24. *Non-U.S. Employees* . Notwithstanding anything in the Plan to the contrary, with respect to any employee who is resident outside of the United States, the Committee may, in its sole discretion, amend the terms of the Plan in order to conform such terms with the requirements of local law or to meet the objectives of the Plan. The Committee may, where appropriate, establish one or more sub-plans for this purpose.

APPLE COMPUTER, INC.

PERFORMANCE BONUS PLAN

1. *Purposes of the Plan* . The Plan is intended to increase shareholder value and the success of the Company by motivating key executives (1) to perform to the best of their abilities, and (2) to achieve the Company's objectives. The Plan's goals are to be achieved by providing such executives with incentive awards based on the achievement of goals relating to the performance of the Company or upon the achievement of objectively determinable individual performance goals. The Plan is intended to permit the payment of bonuses that may qualify as performance-based compensation under Code section 162(m).
2. *Definitions* .
 - (a) " *Annual Revenue* " means the Company's or a business unit's net sales for the Fiscal Year, determined in accordance with generally accepted accounting principles.
 - (b) " *Award* " means, with respect to each Participant, the award determined pursuant to Section 8(a) below for a Performance Period. Each Award is determined by a Payout Formula for a Performance Period, subject to the Committee's authority under Section 8(a) to eliminate or reduce the Award otherwise payable.
 - (c) " *Base Salary* " means as to any Performance Period, the Participant's annualized salary rate on the last day of the Performance Period. Such Base Salary shall be before both (a) deductions for taxes or benefits, and (b) deferrals of compensation pursuant to Company-sponsored plans.
 - (d) " *Board* " means the Board of Directors of the Company.
 - (e) " *Cash Position* " means the Company's level of cash and cash equivalents.
 - (f) " *Code* " means the Internal Revenue Code of 1986, as amended.
 - (g) " *Committee* " means the Compensation Committee of the Board, or a sub-committee of the Compensation Committee, which shall, with respect to payments hereunder intended to qualify as performance-based compensation under Code Section 162(m), consist solely of two or more members of the Board who are not employees of the Company and who otherwise qualify as "outside directors" within the meaning of Section 162(m).
 - (h) " *Company* " means Apple Computer, Inc. or any of its subsidiaries (as such term is defined in Code Section 424(f)).
 - (i) " *Determination Date* " means the latest possible date that will not jeopardize a Target Award or Award's qualification as Performance-Based Compensation.

(j) “ *Earnings Per Share* ” means as to any Fiscal Year, the Company’s or a business unit’s Net Income, divided by a weighted average number of common shares outstanding and dilutive common equivalent shares deemed outstanding, determined in accordance with generally accepted accounting principles.

(k) “ *Fiscal Year* ” means a fiscal year of the Company.

(l) “ *Individual Performance Objective* ” means any individual Company business-related objective that is objectively determinable within the meaning of Code Section 162(m) and the Treasury Regulations promulgated thereunder. Individual Performance Objectives shall include, but not be limited to, improvement in customer satisfaction, opening of additional retail stores, and similar

objectively determinable performance objectives related to the Participant's job responsibilities with the Company.

(m) "*Maximum Award*" means as to any Participant for any Performance Period, \$5 million.

(n) "*Net Income*" means as to any Fiscal Year, the income after taxes of the Company for the Fiscal Year determined in accordance with generally accepted accounting principles.

(o) "*Operating Cash Flow*" means the Company's or a business unit's sum of Net Income plus depreciation and amortization less capital expenditures plus changes in working capital comprised of accounts receivable, inventories, other current assets, trade accounts payable, accrued expenses, product warranty, advance payments from customers and long-term accrued expenses, determined in accordance with generally accepted accounting principles.

(p) "*Operating Income*" means the Company's or a business unit's income from operations determined in accordance with generally accepted accounting principles.

(q) "*Participant*" means an eligible executive or key employee of the Company participating in the Plan for a Performance Period.

(r) "*Payout Formula*" means as to any Performance Period, the formula or payout matrix established by the Committee pursuant to Section 7 in order to determine the Awards (if any) to be paid to Participants. The formula or matrix may differ from Participant to Participant.

(s) "*Performance-Based Compensation*" means compensation that is intended to qualify as "performance-based compensation" within the meaning of Section 162(m).

(t) "*Performance Goals*" means the goal(s) (or combined goal(s)) determined by the Committee (in its discretion) to be applicable to a Participant with respect to an Award. As determined by the Committee, the Performance Goals applicable to an Award may provide for a targeted level or levels of achievement using one or more of the following measures: (a) Annual Revenue, (b) Cash Position, (c) Earnings Per Share, (d) Net Income, (e) Operating Cash Flow, (f) Operating Income, (g) Return on Assets, (h) Return on Equity, (i) Return on Sales, (j) Total Stockholder Return, and (k) Individual Performance Objectives. The Performance Goals may differ from Participant to Participant and from Award to Award. The Committee shall appropriately adjust any evaluation of performance under a Performance Goal to exclude (i) any extraordinary non-recurring items as described in Accounting Principles Board Opinion No. 30 and/or in management's discussion and analysis of financial conditions and results of operations appearing in the Company's annual report to shareholders for the applicable year, or (ii) the effect of any changes in accounting principles affecting the Company's or a business units' reported results.

(u) "*Performance Period*" means any Fiscal Year or such other period longer than a Fiscal Year but not in excess of three Fiscal Years, as determined by the Committee in its sole discretion.

(v) "*Plan*" means this Performance Bonus Plan.

(w) "*Plan Year*" means the Company's fiscal year.

(x) "*Return on Assets*" means the percentage equal to the Company's or a business unit's Operating Income before incentive compensation, divided by average net Company or business unit, as applicable, assets, determined in accordance with generally accepted accounting principles.

(y) "*Return on Equity*" means the percentage equal to the Company's Net Income divided by average shareholder's equity, determined in accordance with generally accepted accounting principles.

(z) "*Return on Sales*" means the percentage equal to the Company's or a business unit's Operating Income before incentive compensation, divided by the Company's or the business unit's, as applicable, revenue, determined in accordance with generally accepted accounting principles.

(aa) “ *Section 162(m)* ” means Section 162(m) of the Code, or any successor to Section 162(m), as that Section may be interpreted from time to time by the Internal Revenue Service, whether by regulation, notice or otherwise.

(bb) “ *Target Award* ” means the target award payable under the Plan to a Participant for the Performance Period, expressed as a percentage of his or her Base Salary or a specific dollar amount, as determined by the Committee in accordance with Section 6.

(cc) “ *Total Stockholder Return* ” means the total return (change in share price plus reinvestment of any dividends) of a share of the Company’s common stock.

3. *Plan Administration* .

(a) The Committee shall be responsible for the general administration and interpretation of the Plan and for carrying out its provisions. Subject to the requirements for qualifying compensation as Performance-Based Compensation, the Committee may delegate specific administrative tasks to Company employees or others as appropriate for proper administration of the Plan. Subject to the limitations on Committee discretion imposed under Section 162(m), the Committee shall have such powers as may be necessary to discharge its duties hereunder, including, but not by way of limitation, the following powers and duties, but subject to the terms of the Plan:

(i) discretionary authority to construe and interpret the terms of the Plan, and to determine eligibility, Awards and the amount, manner and time of payment of any Awards hereunder;

(ii) to prescribe forms and procedures for purposes of Plan participation and distribution of Awards; and

(iii) to adopt rules, regulations and bylaws and to take such actions as it deems necessary or desirable for the proper administration of the Plan.

(b) Any rule or decision by the Committee that is not inconsistent with the provisions of the Plan shall be conclusive and binding on all persons, and shall be given the maximum deference permitted by law.

4. *Eligibility*. The employees eligible to participate in the Plan for a given Performance Period shall be executive officers and other key employees of the Company who are designated by the Committee in its sole discretion. No person shall be automatically entitled to participate in the Plan.
5. *Performance Goal Determination* . The Committee, in its sole discretion, shall establish the Performance Goals for each Participant for the Performance Period. Such Performance Goals shall be set forth in writing prior to the Determination Date.
6. *Target Award Determination* . The Committee, in its sole discretion, shall establish a Target Award for each Participant. Each Participant’s Target Award shall be determined by the Committee in its sole discretion, and each Target Award shall be set forth in writing prior to the Determination Date.
7. *Determination of Payout Formula or Formulae* . On or prior to the Determination Date, the Committee, in its sole discretion, shall establish a Payout Formula or Formulae for purposes of determining the Award (if any) payable to each Participant. Each Payout Formula shall (a) be set forth in writing prior to the Determination Date, (b) be based on a comparison of actual performance to the Performance Goals, (c) provide for the payment of a Participant’s Target Award if the Performance Goals for the Performance Period are achieved, and (d) provide for an Award greater than or less than the Participant’s Target Award, depending upon the extent to which actual performance exceeds or falls below the Performance Goals. Notwithstanding the preceding, in no event shall a Participant’s Award for any Performance Period exceed the Maximum Award.

8. *Determination of Awards; Award Payment* .

(a) *Determination and Certification* . After the end of each Performance Period, the Committee shall certify in writing (which may be by approval of the minutes in which the certification was made) the extent to which the Performance Goals applicable to each Participant for the Performance Period were achieved or exceeded. The Award for each Participant shall be determined by applying the Payout Formula to the level of actual performance that has been certified by the Committee. Notwithstanding any contrary provision of the Plan, the Committee, in its sole discretion, may eliminate or reduce the Award payable to any Participant below that which otherwise would be payable under the Payout Formula.

(b) *Right to Receive Payment* . Each Award under the Plan shall be paid solely from the general assets of the Company. Nothing in this Plan shall be construed to create a trust or to establish or evidence any Participant's claim of any right to payment of an Award other than as an unsecured general creditor with respect to any payment to which he or she may be entitled.

(c) *Form of Distributions* . The Company shall distribute all Awards to the Participant in cash.

(d) *Timing of Distributions* . Subject to Section 8(e) below, the Company shall distribute amounts payable to Participants as soon as is practicable following the determination and written certification of the Award for a Performance Period, but in no event later than 90 days after the end of the applicable Performance Period.

(e) *Deferral* . The Committee may defer payment of Awards, or any portion thereof, to Covered Employees as the Committee, in its discretion, determines to be necessary or desirable to preserve the deductibility of such amounts under Section 162(m). In addition, the Committee, in its sole discretion, may permit a Participant to defer receipt of the payment of cash that would otherwise be delivered to a Participant under the Plan. Any such deferral elections shall be subject to such rules and procedures as shall be determined by the Committee in its sole discretion.

9. *Term of Plan* . The Plan shall first apply to the Company's 2005 Plan Year. The Plan shall terminate with respect to the 2005 Plan Year and all subsequent Plan Years unless it is approved at the 2005 annual meeting of the Company's shareholders. Once approved by the Company's shareholders, the Plan shall continue until terminated under Section 10 of the Plan.

10. *Amendment and Termination of the Plan* . The Committee may amend, modify, suspend or terminate the Plan, in whole or in part, at any time, including the adoption of amendments deemed necessary or desirable to correct any defect or to supply omitted data or to reconcile any inconsistency in the Plan or in any Award granted hereunder; provided, however, that no amendment, alteration, suspension or discontinuation shall be made which would (i) impair any payments to Participants made prior to such amendment, modification, suspension or termination, unless the Committee has made a determination that such amendment or modification is in the best interests of all persons to whom Awards have theretofore been granted; provided further, however, that in no event may such an amendment or modification result in an increase in the amount of compensation payable pursuant to such Award or (ii) cause compensation that is, or may become, payable hereunder to fail to qualify as Performance-Based Compensation. To the extent necessary or advisable under applicable law, including Section 162(m), Plan amendments shall be subject to shareholder approval. At no time before the actual distribution of funds to Participants under the Plan shall any Participant accrue any vested interest or right whatsoever under the Plan except as otherwise stated in this Plan.

11. *Withholding* . Distributions pursuant to this Plan shall be subject to all applicable federal and state tax and withholding requirements.

12. *At-Will Employment* . No statement in this Plan should be construed to grant any employee an employment contract of fixed duration or any other contractual rights, nor should this Plan be

interpreted as creating an implied or an expressed contract of employment or any other contractual rights between the Company and its employees. The employment relationship between the Company and its employees is terminable at-will. This means that an employee or the Company may terminate the employment relationship at any time and for any reason or no reason.

13. *Successors* . All obligations of the Company under the Plan, with respect to awards granted hereunder, shall be binding on any successor to the Company, whether the existence of such successor is the result of a direct or indirect purchase, merger, consolidation, or otherwise, of all or substantially all of the business or assets of the Company.
14. *Indemnification* . Each person who is or shall have been a member of the Committee, or of the Board, shall be indemnified and held harmless by the Company against and from (a) any loss, cost, liability, or expense that may be imposed upon or reasonably incurred by him or her in connection with or resulting from any claim, action, suit, or proceeding to which he or she may be a party or in which he or she may be involved by reason of any action taken or failure to act under the Plan or any award, and (b) from any and all amounts paid by him or her in settlement thereof, with the Company's approval, or paid by him or her in satisfaction of any judgment in any such claim, action, suit, or proceeding against him or her, provided he or she shall give the Company an opportunity, at its own expense, to handle and defend the same before he or she undertakes to handle and defend it on his or her own behalf. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such persons may be entitled under the Company's Certificate of Incorporation or Bylaws, by contract, as a matter of law, or otherwise, or under any power that the Company may have to indemnify them or hold them harmless.
15. *Nonassignment* . The rights of a Participant under this Plan shall not be assignable or transferable by the Participant except by will or the laws of intestacy.
16. *Governing Law* . The Plan shall be governed by the laws of the State of California.

CERTIFICATIONS

I, Steven P. Jobs, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Apple Computer, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 4, 2005

By: /s/ Steven P. Jobs
Steven P. Jobs
Chief Executive Officer

Exhibit 31.2

CERTIFICATIONS

I, Peter Oppenheimer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Apple Computer, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 4, 2005

By: /s/ Peter Oppenheimer
Peter Oppenheimer
Senior Vice President and Chief Financial Officer

Exhibit 32.1

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Steven P. Jobs, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Apple Computer, Inc. on Form 10-Q for the period ended March 26, 2005 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Form 10-Q fairly presents in all material respects the financial condition and results of operations of Apple Computer, Inc.

By: /s/ Steven P. Jobs
Steven P. Jobs
Chief Executive Officer

I, Peter Oppenheimer, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Apple Computer, Inc. on Form 10-Q for the period ended March 26, 2005 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Form 10-Q fairly presents in all material respects the financial condition and results of operations of Apple Computer, Inc.

By: /s/ Peter Oppenheimer
Peter Oppenheimer
Senior Vice President and Chief Financial
Officer

End of Filing

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