**MSFT Earnings Conference Call**

**Bill Koefoed, Peter Klein**

**Thursday, April 19, 2012**

(Operator Direction.)

**BILL KOEFOED:** Thank you, Carol.

And thank you, everyone, for joining us this afternoon. As usual with me today are Peter Klein, Chief Financial Officer; Frank Brod, Chief Accounting Officer; and John Seethoff, Deputy General Counsel.

Our financial summary slide deck is on our website, Microsoft.com/investor, and is intended to follow our prepared remarks, and provide the reconciliation of differences between GAAP and non-GAAP financial measures.

As a reminder, we will post today's prepared remarks to our website immediately following the call until the complete transcript is available. Note that all growth comparisons we make on the call today will relate to the corresponding period of last year unless we specify otherwise. Today's call is being webcast live and recorded. If you ask a question, it will be included in our live transmission, in the transcript, and any future use of the recording. You can replay the call and view the transcript at the Microsoft Investor Relations website until April 19, 2013.

During this call, we will be making forward-looking statements, which are predictions, projections, or other statements about future events. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could materially differ because of factors discussed in today's earnings press release, in comments made during this conference call, and in the risk factor section of our Form 10-K, Forms 10-Q, and other reports and filings with the Securities and Exchange Commission. We do not undertake any duty to update any forward-looking statement.

Okay. And, with that, I'll turn the call over to Peter.

**PETER KLEIN:** Thanks, Bill.

And thanks everyone for joining us. I'm pleased with our performance, as we delivered another quarter of solid financial results. Our robust portfolio of enterprise products and services drove revenue growth of 6 percent to a third quarter record $17.4 billion. Combined with our ongoing operating expense discipline, even as we prepare for one of our biggest launch years, we delivered operating income growth of 12%.

Let me provide more color on the business.

Our business desktop offerings remain a top priority for CIOs. This quarter businesses continued to refresh their hardware, and as a result we saw healthy growth in business PCs around the world. As they purchase new PCs, businesses are also deploying Windows 7 and Office 2010 to increase productivity and manageability while reducing their total cost of ownership. Today, approximately 40 percent of enterprise desktops worldwide are on Windows 7. And we see continued momentum as the remaining desktops upgrade from Windows XP over the next two years.

As CIOs look to address the needs of a more social and mobile workforce, our productivity services, such as Office 365, have become an important solution. Our communication and collaboration offerings, such as Exchange, SharePoint, and Lync, all grew revenue double digits, and are well positioned in this growing market.

On the infrastructure side, the Server and Tools business delivered double-digit revenue growth with SQL Server leading the way. We've now launched System Center 2012 and SQL Server 2012, and the new versions of Windows Server and Visual Studio are on the horizon. Our product roadmap and vision are driving new customer wins, and strong enterprise agreement renewal. We are confident that we are uniquely positioned to address the needs of CIOs as they strive to efficiently manage private and public cloud.

Establishing a vibrant Windows Phone ecosystem is a priority for us, and we are working with our partners, including Nokia, to enable more features, markets, and devices. We are pleased with our Nokia partnership, and the pace of innovation across devices, including the Lumia 900, which recently launched on AT&T's 4G LTE network.

In gaming and entertainment, while industry console sales were softer than our expectations, we continue to maintain our share leadership position. With Xbox Live, we are adding more content and partners as we expand the entertainment experience, and build on our leading position in the living room.

And in search, we are focused on addressing RPS and operating performance. We are seeing our hard work pay off with year over year improvements in both areas.

In summary, solid revenue growth, and our ongoing commitment to fiscal discipline delivered strong financial results. We are enthusiastic about the market reception to our products and services as we continue to execute well heading into our launch wave.

With that, I'm going to hand it back to Bill to provide more details on this quarter's results, then I'll come back and provide some thoughts on our outlook for our fourth quarter, and the next fiscal year.

**BILL KOEFOED:**

Thanks Peter. First, I'm going to review our overall results, and then I'll move on to the details by business segment.

Revenue for the quarter was $17.4 billion, up 6%, or roughly $1 billion. Operating income was up 12% to $6.4 billion, cash flow from operations was a record $9.6 billion and earnings per share was $0.60. Remember, in Q3 last year we had a $461 million, or $0.05 per share benefit related to a partial tax settlement with the IRS, and if you exclude that EPS grew 7% for the quarter.

Foreign exchange did not materially impact our net income this quarter.

From a geographic perspective, developed markets remained healthy and we saw strong double-digit growth in emerging markets.

Businesses continue to make long-term investments in the Microsoft platform and as a result, multi-year licensing as a percentage of our total revenue grew to approximately 40%. This quarter we saw strong enterprise agreement growth in both new business and renewals. At the end of the quarter, unearned revenue was $15.2 billion, up 17%, and our contracted not billed balance was over $19 billion.

Moving on to the PC market, we estimate the worldwide PC market grew 2 to 4 percent this quarter. Business PCs grew 8 percent as businesses continued to upgrade their hardware and software to Windows 7. When excluding netbooks, consumer PCs grew 6 percent. We are pleased with the early demand for ultrabooks as they reinvigorate personal computing with innovative design, high performance, and enhanced battery life.

Now, I'll move on to the results for the Windows and Windows Live Division, where revenue was up 4 percent. As in past quarters, you'll find the OEM revenue bridge in our earnings slide deck. Overall, Windows revenue slightly outgrew the underlying PC market due to the strength of the business refresh and attach gain in several geographic regions.

In late February, we made the Windows 8 consumer preview available. It is important to note that the development of Windows 8 on both Intel and ARM is proceeding on our schedule.

Now I'll move on to the Microsoft Business Division, where revenue grew 9 percent. Consumer revenue increased 2 percent, while business transactional revenue grew 5 percent, again, outperforming our historical trend. Multi-year licensing revenue grew 13 percent as customers continued their commitment to our productivity services.

As businesses embrace social enterprise scenarios, they are turning to the combined power of Exchange, SharePoint, and Lync to enable their presence, collaboration, and communication needs. This quarter Exchange and SharePoint both grew double digits while Lync revenue growth accelerated to over 35 percent.

During the quarter, we launched the technical preview of the next version of Office, code named ‘Office 15’, with public beta coming later this summer.

Our Dynamics business continued its momentum, and revenue grew double digits. Dynamics CRM revenue grew over 30 percent with more than to more than 2.25 million users, and 33,000 customers who leverage Dynamics CRM every day.

Now let's move to Server and Tools which posted another solid quarter with 14 percent revenue growth, and over 20 percent bookings growth. Transactional revenue grew low single digits, roughly in line with the underlying server hardware market growth. Multi-year licensing revenue was up high teens, and enterprise services, once again, grew more than 20 percent.

Our growth in market success this quarter demonstrates that our customers really value our unique ability to deliver a solution, which spans the private and public cloud.

In the private cloud, Windows Server Premium revenue grew high teens, and System Center grew more than 20 percent. We launched the beta version of Windows Server 2012, and announced the general availability of System Center 2012, which will help customers progress beyond virtualization to build efficient and secure hybrid cloud.

In the public cloud, we recently announced strategic partnerships with leading service providers Accenture and Hitachi to offer enterprise-ready cloud solutions on our Windows Azure Platform to accelerate application deployment and migration.

We are the only company which can deliver a common identity, virtualization, management and development platform to our customers, across both private and public clouds.

In our data platform business, SQL Server revenue grew high-teens while SQL premium revenue grew more than 30% as customers increasingly selected the premium edition to power their business intelligence and mission critical workload needs.

In early April, we announced general availability of SQL Server 2012 which now enables businesses to scale on demand and create flexible hybrid deployments. Hundreds of global, industry-leading customers, such as Mitsui, Volvo, Revlon, and LG Chemical have already deployed SQL Server 2012 for production use to leverage its enhanced performance, reliability and high availability features.

We also recently announced the second preview of Hadoop-based services with customers, such as Webtrends, using it to glean simple, actionable insights from complex data sets hosted in the cloud. Hadoop integration along with the powerful analytical capabilities in SQL Server 2012 position us well to capture the full potential of Big Data growth.

With major releases in each of our server product offerings we continue to strengthen our enterprise portfolio and empower businesses to be both more agile and efficient.

Moving on to the Online Services Division, revenue grew 6% and operating performance improved by $300 million. This quarter, online advertising revenue was up 9% driven by volume and rate improvements in our search business.

In the Entertainment & Devices Division revenue declined 16% reflecting the soft gaming console market. Xbox maintained its share leadership in the U.S. this quarter and we continue to expand the content available in Xbox LIVE, with the release of three new major entertainment applications– Comcast XFINITY TV, HBO GO and MLB.TV, all with Kinect integration.

We are working to bring Windows Phone to more people. Our progress can be seen with the April launch of 4G LTE phones through AT&T, our launch in China with multiple OEM’s, and the enabling of sub $200 phones with more silicon support. With this work, and the building enthusiasm around Windows Phones, we have seen the number of apps published in the marketplace increase by 50% over the past 3 months.

Turning to Skype, we continue to be pleased with both the pace of the integration, and the rapid growth of the business. This quarter, Skype users made over 100 billion minutes of calls over the Skype network, an increase of 40% from the prior year.

I will now cover the remainder of the income statement.

Cost of goods sold increased 1% reflecting changes in the mix of products and services sold.

Operating expenses were $7.1 billion, an increase of 4 percent mainly due to higher people cost.

Operating income increased 12% to $6.4 billion.

And this quarter we returned $2.7 billion to shareholders in buybacks and dividends.

To summarize, we saw a strong enterprise uptake for our Server and Office products and continued business demand for PCs leading to healthy topline growth. Along with our revenue growth we were able to drive margin expansion with our strong focus on cost management. And with that I will hand it back to Peter, who’s going to discuss our business outlook.

**PETER KLEIN:**

Thanks, Bill. For the remainder of the call, I will discuss our expectations for the fourth quarter with some high level themes as we begin to think about Fiscal 2013.

Let me start with the fourth quarter.

Within the PC market, we expect growth in business PCs to outpace consumer PCs and growth in emerging markets to outpace developed markets.

In the Microsoft Business Division, multi-year licensing revenue, which is approximately 60% of the division’s total, should grow low double-digits. Transactional revenue, which is the remaining revenue in the division, should lag the overall PC market reflecting a higher mix of PC shipments to emerging markets.

Within Server and Tools, approximately 30% of the division’s revenue comes from transactional licensing, 50% from multi-year licensing, and 20% from enterprise services. We expect transactional revenue to generally track with the server hardware market, and multi-year licensing and Enterprise Services revenue to both grow high-teens.

In the Online Services Division, we will continue to focus on RPS improvements as well as operating efficiencies.

For our entertainment and devices divisions, we expect revenue to grow low double digits. We expect COGS to grow 8 to 12 percent for the fourth quarter, as has been the case in prior quarters, the mix of revenues will continue to impact this number. We are revising our operating expense guidance downward to $28.3 to $28.7 billion for fiscal 2012.

We expect our effective tax rate to be 19 to 21 percent for the fourth quarter and we continue to expect capital expenditures for the full fiscal year to be about 2.5 billion.

Unearned revenue will roughly follow historical sequential growth patterns.

Now, I would like to spend a few minutes looking ahead to Fiscal 2013, which will include an unprecedented refresh of our major products.

* With Windows 8 and its availability on both X86 and ARM, we believe the ecosystem will capitalize on the new range of capabilities and scenarios Windows 8 enables.
* In the enterprise the addition of Windows Server 2012, combined with the momentum of SQL Server and System Center, position us to take share as businesses increasingly look to cloud optimize their IT infrastructure.
* And in productivity we believe ‘Office 15’ will help people work, collaborate and communicate smarter and faster than before, driving growth in the Office business.
* Consumers will see ongoing innovations in Xbox, Skype, Windows Phone, and Bing.

So as you can see, there is a lot to look forward to next year.

We expect Fiscal 2013 operating expenses to be $30.3 to $30.9 billion, which represents growth of 6 to 8 percent from the mid-point of our updated Fiscal 2012 guidance, as we continue to prioritize our spending and manage our expenses against the backdrop of a big product release year.

In closing our product portfolio is stronger than it has ever been, and customer satisfaction with our products and services is high. And with our latest wave of innovation, paired with ongoing operating expense discipline, we are well positioned to continue delivering value to shareholders.

And with that, I'll turn the call over to Bill who will take some questions.

**BILL KOEFOED:** Thanks, Peter. We want to get to questions from as many of you as possible, so please stick to just one question and avoid long, or multi-part questions.

Operator, can you please go ahead and repeat your instructions.

(Operator Direction.)

**ADAM HOLT, Morgan Stanley:** Thank you, nice quarter, guys. My question is about the enterprise upgrade cycle. The clock is ticking on XP obviously, but you are only at 40% of the enterprises upgraded. Where do you think that number goes? Do you think it's front-end loaded towards calendar '12 versus calendar '13? And how do you think about how that impacts the model, given some recovery with DLAs? Thanks.

**PETER KLEIN:** Well, the only thing I can say, Adam, is obviously it's high on the prior list for CIOs to upgrade their business desktops, and we've seen that. We've seen that in deployments, as we talked about, and it remains a high priority. Exactly how that will play out over the next couple of years, it's hard to say. The Memorandum has been great so far. It remains a top priority, so we see that momentum continuing, really, over the next couple of years.

**BILL KOEFOED:** Operator, next question please.

(Operator Direction.)

**HEATHER BELLINI, Goldman Sachs:** Thank you. I was just wondering, Peter, a few years ago, and you might not have been CFO at the time, you guys had talked about online and what your goals were five years out. And, talking about 20% organic market share and that could get you to breakeven. I mean, given what we are seeing in terms of RPS, although you are doing a very good job on the OpEx side, how would you say you're thinking about that today?

**PETER KLEIN:** Well, thanks, Heather. The same basic dynamics continue, right? We need to do two things. We need to grow our share, we need to grow our RPS, so really, improve our monetization. At the same time as managing the operating performance, which we've been doing. So, the same characteristics apply. We are making progress on both counts, as Bill indicated, we saw gains in both volume and rate, and we need to continue to do that, sort of monotonically, quarter-after-quarter and year-after-year.

**BILL KOEFOED:** Yes, I would just add on to that, and I've been reminding some investors to go back and watch the FAM presentation that Qi Lu gave back in September. We do view our search asset as a pretty strategic asset for the Company. The capabilities that it offers are leveraged across our -- we think can be leveraged across our whole product set, so I do think our strategy has evolved from whatever conversation you had a couple three years ago, because we see the opportunity to leverage the asset being even more powerful than maybe we did at that point. But, a good reminder if people haven't looked at that video, you can go back and look at it on the site.

Operator, next question please.

(Operator Direction.)

**RICK SHERLUND, Nomura:** Yes, thank you. On EDD, just sort of curious whether there is anticipation. We're not really looking for much at E3 this year. I think new console, people are thinking is maybe next year. There is Halo 4 coming. Just how you thinking about with more and more gaming going to mobile, what do you think the outlook is beyond next quarter for EDD? Do we need a new console cycle to create growth in that segment?

**PETER KLEIN:** Thanks, Rick. You know we feel really good about both our market position and our strategy. If you think about what we've done over the last couple of years, we've really staked out a unique value proposition and a unique strategy when it comes to not just the gaming console, but also the UI technology with Kinect. And importantly, Xbox Live and all the entertainment content that comes with that, which we view as a persistent long-term revenue stream, both from a subscriber perspective, as well as a transactional perspective.

And so, we feel great about our leadership position. We've been the number one console for the last 15 months or so. We feel great about our unique value proposition and the growing business we have with both Kinect and Live, and we think that's really persistent. If you look at the engagement that our subscribers have, the amount of time they spend doing entertainment, as opposed to gaming, is increasing all the time. And so, I think the strategy and the value proposition there plays out very well over the next several years.

**RICK SHERLUND:** Will Skype be a big benefit to that division going forward?

**PETER KLEIN:** Skype will be a big benefit across the company as we've talked about how it plays across all of our businesses.

**BILL KOEFOED:** Operator, next question please.

(Operator Direction.)

**WALTER PRITCHARD, Citi:** Hi, thanks. Peter, you guys had a much better enterprise performance than I think most of the peers that we've seen report that are enterprise-exposed, IBM, et cetera. And I'm wondering if you could help us out with understanding where you saw strength across your business there? Was it more small business, medium business, enterprise? Were there any trends there that might help us understand why you're outperforming some of your peers?

**PETER KLEIN:** Thanks, Walter. Yes, it was all segments. I would highlight the enterprise. And, it's really broad-based. Businesses are investing in data centers. They're investing in their desktops, because they see technology as a way to really both cut costs and improve their strategic positioning.

For a while, COI's had been saying Microsoft is a top priority. And we're really, really starting to see that, both on the infrastructure side and the desktop side. We feel great about our product lineup, particularly in Server and Tools. If you think of what we've done with Systems Center and SQL Server, and the upcoming release of Windows Server 2012, we kind of have a unique value proposition for enterprises, which is all about the hybrid, private and public cloud, which nobody else really has. We've seen growth across both of those things.

Similarly on the Business division side, we've broadened the Office business in several important ways over the last several years. One is in the experiences and workloads that people are getting in communications and collaboration, and that's been a huge growth driver. And secondly, again, is cloud services and how that expands from helping people understand our road map from where they are today to how they get to the public cloud.

I think those things taken together across the board have allowed us to take share and allowed us to grow both of those businesses, and you're really starting to see that take hold. And we're really excited about the product lineup that's coming in the next six to nine months.

**BILL KOEFOED:** I would just add on to that, I think investors sometimes put companies in a box and say you are either in private cloud or you're in public cloud. And as Peter mentioned, we are in both. I mean we have high growth rates in both.

And we are, as Peter said, really the only company that's got that breadth of offerings in the growth rate on both the private, the public, and then importantly, we've kind of coined this term of hybrid IT, where you can have a road map as you kind of want to use both to manage your IT infrastructure. So, yes, we feel really good about where we are in the share that we are taking in the market place for sure.

Next question, Operator.

(Operator Direction.)

**BRENT THILL, UBS:** Thanks. You commented that you saw strong, multi-year licensing, and I was just curious if you could just talk about how the upcoming cycle is helping influence that? And if I got this right, Bill, I think you mentioned new enterprise agreements, you also saw strength there. So, if you could just talk through the dynamics of what you are seeing on these multi-year deals?

**PETER KLEIN:** Yes, the way that the product pipeline impacts our Multi-year Licensing business is enterprises, when they invest in a multi-year licensing agreement, they're making a long-term investment in their platforms, in their infrastructure. And they are making a long-term investment in their vendors. And so, it's important to really understand the road map.

And that's where the pipeline really helps, and that's really been, I think, a big driver so far. And that applies not only to the workloads and the capabilities in the products themselves, but as Bill just mentioned, the private and public cloud road map, because people really are starting to think about long-term how do they make that transition from where they are today in their data centers to a public cloud world.

So, having that road map and having that pipeline really impacts our current period Enterprise business, and I think that's what you saw, not only in Server and Tools, but also in the Business division, as well.

**BILL KOEFOED:** Operator, next question please.

(Operator Direction.)

**MARK MOERDLER, Sanford Bernstein:** Thank you. So, we saw strong numbers on System Center growing well, as well as SQL Server, and yet we're just about to enter a product cycle. Normally, I guess, they would slow down a bit. What do you think is the driver of why this has continued to accelerate into the cycle?

**PETER KLEIN:** I'll just go back to our continued vision, our continued roadmap, the capabilities that we're offering. I mean it's a combination of the features and capabilities, particularly in System Center 2012, and SQL Server 2012. SQL Server 2012 is an amazing value proposition when you think about its scalability, when you think about business intelligence and analytics. And when you think about the roadmap to the public cloud. People are understanding not only current features in the products, but they are looking towards the future roadmaps. And I think that's what's really driving that.

**BILL KOEFOED:** Operator, next question please.

(Operator Direction.)

**PHILLIP WINSLOW, Credit Suisse:** Hi, thanks, guys, great quarter. Just have another question on the Server and Tools division. Obviously Intel is coming out with a new chip, Romley here, probably shipping to OEMs now, probably see it actually being delivered in servers late Q2, Q3 in the calendar. How do you think these chip cycles actually are going to impact your business? Thanks.

**PETER KLEIN:** We're super-excited about it, but I think about the business more broadly obviously, customers making long-term investments in their roadmap. We love what they're doing, we think that's an interesting thing, and to the extent the ecosystem technology evolved, that's always a good thing for how businesses are investing in their infrastructure.

But, I wouldn't want to overstate it. It's a much broader issue in terms of the long-term road map, but certainly, having advances in technology, whether it's in hardware or in the data center, is a great thing all up.

**BILL KOEFOED:** Operator, next question please.

(Operator Direction.)

**JOHN DIFUCCI, JP Morgan:** Thank you. Peter and Bill, I think the Windows numbers were a little stale out there, as far as consensus numbers. But, even when you adjust for the more recent PC unit shipment data and something in line with what you guys said, I think Gartner and IDC were at least in the neighborhood there.

Even when you make those adjustments the Windows business was even stronger than what we would have expected anyway. And I guess I'm just trying to get a little more color on that, or figure that out. I guess a question maybe on the OEM revenue bridge. You got plus 2 percent from attach and inventory.

Bill, I think you said that business refresh and attach was strong in some regions, but I would think anyway, that given that PC shipments are much stronger in emerging markets, even if some emerging markets were a little bit better than normal, you still wouldn't necessarily get an aggregate attach that would be stronger. So, I guess the question is, was there a meaningful move in inventory, OEM inventory, that helped a bit this quarter, because those numbers are stronger than I would have thought.

**PETER KLEIN:** Thanks. No, it's actually a couple of things. One, yes, on emerging markets, but business PCs is what really drove the Windows business. And so if you think about the Windows revenue growth being really on the high end of our estimated PC shipment range, it's really a function of, one, business PCs really doing well relative to consumers. And again, that's consistent with the theme we've seen on businesses investing in their technology.

And in addition to that, we did see some attach gains. I mean, that's just reductions in piracy, kind of broadly, not in any one place. That was a tailwind this quarter. As you know, sometimes that's not always a tailwind. In general in the long term, that tends to be on the up-tick, but this quarter that attach and inventory gain is really partially attach.

**JOHN DIFUCCI:** Thanks, Peter.

**PETER KLEIN:** Thanks, John.

**BILL KOEFOED:** Operator, next question please.

(Operator Direction.)

**KASH RANGAN, Merrill Lynch:** Hi. Thank you guys. I don't have any questions. Thank you very much.

**BILL KOEFOED:** Operator, next question, please.

(Operator Direction.)

**COLLIN GILLIS, BGB Financial:** Thank you. Can you just update us on the changes and the refresh in the marketing group, where the priorities are for the spend and any major upcoming campaigns?

**PETER KLEIN:** Yes. The marketing organization, you know, continues on. We are always making sort of tweaks and changes, and making sure we're being as efficient and effective as possible in getting all the resources where we want them. If you think more broadly about our marketing focus as a company, clearly heading into this launch wave of our major core products, like Windows, like Office, like Windows Server, you can imagine we're going to be focusing most of our marketing talent, and most of our attention on those areas.

**BILL KOEFOED:** Operator, next question, please.

(Operator Direction.)

**BRENDAN BARNICLE, Pacific Crest Securities:** Thanks so much.

Peter, should we assume that we're going to see the same Windows Upgrade rights around Windows 8 that we've seen around prior releases? And, therefore, should we be expecting to see some big swings in Windows revenue at some point in the middle of next year or some point during next year because of the deferrals like we've seen in the past?

**PETER KLEIN:** Thanks, Brendan. Obviously, we're super-excited about the launch of Windows 8, and we're heads down trying to get that released. We haven't said anything, and will not today. But we'll have more to talk about in terms of programs and promotions as we get closer to the launch date.

**BILL KOEFOED:** Okay, Operator, next question please.

(Operator Direction.)

**ED MAGUIRE, CLSA:** Hi, good afternoon. When you look through the pretty extensive product refreshes you have across the portfolio, are you thinking that there may be the possibility that customers may pause in any of your products? And as you look at seasonality, is there a likelihood that we might see a bit more pronounced seasonality leading up into some of the big launches?

**PETER KLEIN:** I think generally, particularly in the enterprise, you don't really see a seasonality impact. As you think about how large enterprises plan their information technology spend, they sort of have a long-term roadmap, they're on it. They execute against it when they do. Obviously, our long-term roadmap, as I said, impacts that. And so it's more about their long-term planning cycles than it is about sort of any product cycle, particularly in the enterprise which is where a lot of the growth is coming from, and a lot of the products are coming from.

**BILL KOEFOED:** Okay, Operator, next question, please.

(Operator Direction.)

**RAIMO LENSCHOW, Barclays:** Thanks for taking my question, and congrats on the quarter. I was having a forward-looking question on the gross margin. Remember in the last few quarters that you had a slight negative mix effect there. As I look into the new product launches into the next year, they're in all kind of high gross margin areas. Is there anything that stops that feeding through in the P&L, or should it be a straightforward one? Thank you.

**PETER KLEIN:** Well, you're correct. Mix is what drives the gross margin percentage, and obviously we saw that this quarter. And so, you're right in the math of that, if there's good growth, better growth in higher margin products that will have a positive impact on gross margin.

**BILL KOEFOED:** Operator, next question, please.

(Operator Direction.)

**GREGG MOSKOWITZ, Cowan:** Okay, thank you. This past quarter both Gartner and IDC saw a better than expected PC up-tick in the European corporate market, and your reported Windows revenues certainly support that. I know broadly speaking the business refresh was healthy. I just was wondering if there is anything you would add that might have contributed to an up-tick in Europe PC growth? Thanks.

**PETER KLEIN:** Nothing specific to add to that. As we talked about, we saw broad based growth geographically in business in particular, and so there's nothing unusual or specific in Europe about that.

**BILL KOEFOED:** Okay. Operator, last question, please.

(Operator Direction.)

**JASON MAYNARD, Wells Fargo:** Good afternoon, guys. I had a question on the Fiscal '13 OPEX guidance, which is a couple of points, looks like, if you use the midpoint, ahead of the Fiscal '12 growth rate. And I'm just curious, the delta obviously I would assume would come to some of the product launches. But the question broader is, do you think you have enough spend baked into that model to account for the big push you're going to need to make around perhaps on the smartphone side given that that's an area where you're coming from behind, given all the other products that you're going to be releasing, and obviously consumer push, and some of the new enterprise products? Thanks.

**PETER KLEIN:** Thanks, Jason. Obviously, over the last several years and even longer, we've really been focused on making sure we're prioritizing our spend to the highest value areas. And so you ask a good question, and our approach is exactly the same like we've done the last couple of years. We're really looking at next year and saying, how can we move effectively and most efficiently allocate the resources to the areas that drive the best long-term results.

And we think we've got a good balance there, as we've had in the past. We've tried to be transparent and consistent in that, and really predictably execute against that. I think what we've got next year is a good balance between the exciting launches that we have that really drive both short and long-term growth as well as hopefully a good financial result.

**BILL KOEFOED:** Okay, so that will wrap-up our Q&A portion of today's earnings call. We look forward to seeing many of you at the numerous conferences in which we will be participating this quarter. For those of you unable to attend in person, you will be able to follow our comments at Microsoft.com/investor. Please contact us if you have any additional questions or need additional details. Thanks again for joining us today. Really appreciate it, and take care.

Bye-bye.

END