Summary of Quarterly Results – Third Quarter Fiscal Year 2014

This document provides additional details on quarterly performance to supplement our earnings conference call, held Thursday, April 24, 2014 at 2:30 pm PDT (5:30 pm EDT). This summary will not be read on the call. To access the live conference call (webcast), please visit the Investor Relations section of Microsoft’s website at [www.microsoft.com/investor](http://www.microsoft.com/investor).

All growth comparisons relate to the corresponding period of last fiscal year. Unless otherwise specified, all impacted numbers have been adjusted for the cumulative effect of last year’s revenue deferrals and recognition related to the Windows Upgrade Offer, the Office Deferral, the Video Game Deferral, and the expense related to the non-tax deductible European Commission Fine. In our segment reporting structure, we have consolidated revenue adjustments of this nature into Corporate and Other to provide better comparability of operating results. The details of the adjustments and reconciliations of differences between GAAP and non-GAAP financial measures can be found in our [financial summary slide deck](http://www.microsoft.com/global/Investor/RenderingAssets/Downloads/FY14/Q3/SlidesFY14Q3.pptx).

**Third Quarter Fiscal Year 2014 Overview**

Total revenue was $20.4 billion, up 8%, driven by total Devices and Consumer revenue growth of 12% and total Commercial Revenue growth of 7%. Foreign exchange had a $224 million or 1% negative impact on revenue.

Cost of revenue increased 24%, primarily due to increased Xbox and Surface volumes, and higher data center expenses as our online services continue to grow. Even with the changing revenue mix, gross margin increased 3% to $14.5 billion.

**Segment Performance**

Devices and Consumer

Total Devices and Consumer revenue increased 12% to $8.30 billion, and gross margin decreased 1% to $4.71 billion.

*Devices and Consumer Licensing* revenue grew 1% to $4.38 billion, driven primarily by Windows OEM and Office Consumer revenue. Gross margin decreased 1% to $3.91 billion.

Windows OEM revenue grew 4% with Windows Pro revenue increasing 19% and Windows non-Pro revenue decreasing 15%. Excluding China, where we continue to face attach challenges, Windows non-Pro revenue declined 9%.

At our Build 2014 developer conference in early April, we announced product updates for Windows and Windows Phone, enhancements to our developer platform, and changes to OEM system requirements and licensing models. These announcements and changes are intended to both improve usability and stimulate share growth.

* Windows 8.1 Update provides a familiar experience across touch, keyboard, and mouse, while enabling partners to build a broader range of devices
* Windows Phone 8.1 introduces Cortana, our digital assistant, plus other platform improvements, such as Word Flow, that lets you quickly glide over the keys to type
* Our universal app development platform is a big step towards enabling developers to engage users across PCs, tablets, and phones with a common set of APIs
* Zero dollar licensing for sub 9-inch devices helps grow share and creates new opportunities to deliver our services, with minimal short term revenue impact

Office Consumer revenue increased 15% due to higher attach and strong sales in Japan, where we saw customers accelerate some purchases ahead of a national sales tax increase. Excluding that estimated impact, Office still outpaced the underlying consumer PC market.

*Devices and Consumer Hardware* revenue grew 41% to $1.97 billion, driven by growth in our Xbox and Surface devices. Gross margin decreased 34% to $258 million, due to higher Xbox console sales and early lifecycle economics of Xbox One which launched in November.

Xbox One sold in 1.2 million consoles, and Xbox 360 sold in 0.8 million consoles, driving Xbox platform revenue growth of 45%. Titanfall, an Xbox exclusive, was the number one selling game in the U.S. for March per NPD.

Surface revenue grew over 50% to approximately $500 million.

*Devices and Consumer Other* revenue grew 18% to $1.95 billion, driven by search advertising and our Office 365 Home service. Search revenue grew 38%, offset by display revenue which declined 24% this quarter. Gross margin grew 26% to $541 million.

The combined revenue from Office 365 Home and Office Consumer, reported in the Devices & Consumer Licensing segment, grew 28%. On March 27th, we announced Office for iPad, providing additional value to Office 365 subscribers.

Commercial

All up Commercial revenue, across both on-premise and cloud services, grew 7% to $12.23 billion, and gross margin grew 6% to $9.91 billion.

* *Commercial Licensing* revenue grew 3% to $10.32 billion, with increased revenue from our server products and Windows volume licensing
* *Commercial Other* revenue grew 31%, to $1.90 billion, driven by Commercial Cloud revenue which exceeded our guidance as customers transitioned to our cloud solutions faster than expected; Gross margin increased 80% as we realized margin expansion through engineering efficiencies and continued scale benefits; Enterprise services revenue grew 8%

This quarter we continued our rapid cadence of innovation and announced a range of new services and features in three key areas - data, cloud, and mobility. SQL Server 2014 helps improve overall performance, and with Power BI, provides an end-to-end solution from data to analytics. Microsoft Azure preview portal provides a fully integrated cloud experience. The Enterprise Mobility Suite provides IT with a comprehensive cloud solution to support bring-your-own-device scenarios. These offerings help businesses convert big data into ambient intelligence, developers more efficiently build and run cloud solutions, and IT manage enterprise mobility with ease.

Server product revenue grew 10%, driven by demand for our data platform, infrastructure and management offerings, and Azure.

* SQL Server revenue grew more than 15%, and continued to outpace the data platform market; we continue to gain share in mission critical workloads
* Windows Server Premium and System Center revenue showed continued strength from increased virtualization share and demand for hybrid infrastructure

Office Commercial revenue was up 6%, driven by Office 365 as customers transitioned to our cloud productivity services. Office 365 revenue grew over 100%, and seats nearly doubled as well. Our productivity server offerings continue to perform well, with Lync, SharePoint, and Exchange, collectively growing double-digits.

Windows volume licensing revenue increased 11%, driven by annuity and non-annuity growth. Business customers continue to make Windows their platform of choice, with almost 90% of Enterprise desktops worldwide now on Windows 7 or Windows 8.

**Operating Expenses**

Operating expenses increased 2%, as we continue to drive efficiencies and prioritize spend across the organization. Increased investments in product development and sales resources were partially offset by lower advertising spend. Lower legal settlements (excluding the European Commission Fine) and business taxes in the prior year impacted the current quarter growth rate for general and administrative expenses.

**Income Taxes**

Our effective tax rate was approximately 19% for the quarter.

**Balance Sheet and Cash Flow**

Cash flow from operations was up 4% to $10.1 billion. Cash returned to shareholders in buybacks and dividends increased to $4.1 billion. Capital expenditures were $1.2 billion, supporting the global expansion of our cloud services.

**Unearned Revenue, Contracted Not Billed, and Bookings**

Unearned revenue was up 14% year-over-year and flat sequentially, exceeding our guidance and above historical seasonality as annuity mix was higher as customers chose subscriptions and multi-year agreements. Our contracted not billed balance exceeded $22.0 billion, up over $1 billion from a year ago, and total bookings increased 6%. We saw healthy renewals of expiring multi-year agreements as customers continue to make long-term commitments to our products and services.

Please join us for the live earnings conference call (webcast) on Thursday, April 24, 2014 at 2:30 pm PDT (5:30 pm EDT), available on the Investor Relations section of Microsoft’s website at [www.microsoft.com/investor](http://www.microsoft.com/investor). We will post prepared remarks from our CEO and CFO to our website immediately following the call, and will post the complete transcript, including questions and answers, when available. You can replay the call and view the transcript at the Microsoft Investor Relations website until April 24, 2015.