

Who: Charles Di Bona, General Manager, Server and Tools

When: Wednesday, May 11, 2011

Where: Jefferies Global Technology, Internet, Media & Telecom Conference

MODERATOR: Charlie is going to make a few introductory remarks, and then we'll go straight some questions.

CHARLES DI BONA: I just want to, first of all, I will be possibly making some forward-looking statements, so I would refer you to the Safe Harbor Statement and risk sections of our public filing.

I do want to just sort of preemptively say here that I would not be able to say much more than what's been publicly said about the Skype acquisition. So, I can field questions, but you'll hear the exact same answer that you heard yesterday on the public disclosures from Peter and from Steve.

Look, I'm excited to talk about Server and Tools. I think we are sort of one of the hidden gems in Microsoft. I think everyone sort of appreciates that we continue to perform and execute very well, continue to show solid top line growth, solid operating margin expansion and growth of our operating income, but I think it sort of under-appreciated. The opportunity we have as a sort of a swing vote in Microsoft, the ability to leverage our business as we move into the cloud to drive profit growth, profit dollar growth for Microsoft that's probably under-appreciated as a delta for what is expected in the company.

So, I'm excited to present those opportunities to you guys, and talk to you about your questions about Server and Tools.

MODERATOR: Great. So maybe I can just start. Obviously there are a lot of products in the Server and Tools business, Server OS, virtualization, database, and so forth. Let's talk a little bit about enterprise and their prioritizations of spend right now. What do you see enterprises clamoring after, where do they want to spend their dollars?

CHARLES DI BONA: Well, look, we're seeing sort of broad-based growth in our product offering. So, there isn't sort of one piston that's firing and sort of pulling everything along. We're seeing growth pretty much across our product offerings.

The places where we're probably -- if I were going to sort of call out a couple of areas where we're seeing growth, there's obviously some focus on virtualization. There is more meaningfully for us in terms of revenue dollars a focus around business intelligence, and management. Management is related, obviously, to the virtualization efforts as well.

But both of those two areas, business intelligence for us is not a singular product. It's a collection of pieces, some of which are not even within Server and Tools, or within the MBD, but to expose business intelligence to sort of the information worker in a more accessible and dynamic way. And, on the back-end, that's driving premium SKUs in our SQL offering, and we're seeing the monetization of higher level SKUs within our SQL offering in particular as a big driver of our growth. It's now collectively within Microsoft sort of a billion dollar plus business spread out, not called out as a singular product.

But, management likewise, as we get into these heterogeneous environments, we are seeing and managing virtualization in heterogeneous environments, we're seeing very, very

solid uptake of System Center, which, again, is another billion plus business that is kind of skimming along underneath the covers. But it's a very, very positive growth for us. Both of those are double -- solid double-digit growers for us, and continue to be, I think, for the future.

MODERATOR: Great. So, you mentioned it in your opening remarks, the cloud, and let's talk a little bit about Azure. Where are we today, and what's the momentum, and is there anything that you can share with us to help us understand the pace at which it's being adopted?

CHARLES DI BONA: Look, relative to the entire portfolio of Server and Tools, Azure is relatively small. We don't break it out yet, so I can't really talk about specific numbers, but we are seeing good up tick, and really what I would look at as sort of the near-term indications of what we're doing with Azure would be more anecdotal evidence. So, I would call out particularly last quarter the Toyota deal as sort of emblematic of where we're taking Azure.

Toyota is using both our Azure back-end, and also some of the embedded stuff on the front end in the cars to drive some telematics and product offerings as they sort of roll them out in Asia and in the U.S. It's an opportunity for them to use our cloud offerings to deliver, on a global scale, things that they simply couldn't have done with a traditional product offering from anybody. And it's those kind of new use case scenarios that we think are going to drive Azure in particular in the future.

We are really looking for these great test cases where -- look, Toyota is not really concerned about software per se, or services per se. What they're concerned about is improving the driving experience for their customers, and making driving more the whole act of driving in the cars, the Toyota cars that you do that in, sort of more consumable, and more pleasant for their customers. And Azure services, Azure-backed services that they build on top of Azure, and which then communicate on the front end with these very diversely distributed cars throughout the globe will allow them to do that in ways that are really sort of unique, and creative. And so we're excited about that opportunity, and ones like that. But in the near-term, I would say that these sort of anecdotal evidences, as we roll these things out and talk about them, will be the best sort of proof points of Azure.

MODERATOR: Are you seeing your developer community, your .NET community, that traditionally worked on top of your traditional servers and tools, are you starting to see the sandbox stuff being done in Azure? Is that really one of the early ways you're seeing the adoption?

CHARLES DI BONA: Yes. I mean, clearly we are an open framework. So we will support non-.NET environments, non-.NET frameworks. But the .NET community is obviously a natural place for us to move to Azure. And we are seeing early adoption of that. There is some education that needs to go into that, because to really utilize Azure, it is much more holistic than simply moving an instance of virtualizing things out onto AWS, or something. To really use Azure, you need to think architecturally a little bit different. So, it takes a little bit more time to get people accustomed to thinking about that sort of platform as a service offering as opposed to sort of an infrastructure as a service offering.

I would say anecdotally, related to that, not anecdotally, but you saw within MCS that we had good growth with the consulting services. Part of that is a conscious effort for us to have those people make those early adopters successful. And so there's going to be some investment in people to make that happen in the context of us still growing margins across

the board, but we will be using consulting services to ensure the success, and to educate people in the channel how to do that.

MODERATOR: So, we should think about Azure as it continues to evolve as more in that platform as a service rather than I've been using SQL database, and I'm going to basically keep that workload and throw it onto a SQL database in the cloud.

CHARLES DI BONA: Right. Azure is a built from the ground up platform as a service offering. Now, we can do IAS, and we can do the other stuff, and we're sort of building up the capabilities to do that. But we believe that the future is around platform as a service, and those sort of higher-level services that you can then build on top of that. And that is the direction we're headed. We're not trying to retrofit platform as a service onto an infrastructure as a service offering. We're going platform as a service as a holistic, built from the ground up, cohesive whole. And, frankly, we think our mousetrap is better than the best in the business.

MODERATOR: I've always thought that one of your big advantages is your, and I mentioned it, .NET developer community, it's large. What other advantages do you think that Microsoft has around this platform?

CHARLES DI BONA: Well, I think the Windows Server install base and SQL Server install base, particularly Windows Server, as we think about the platform, are huge advantages. We have relationships across the board. And we think that we have an opportunity to sort of tie together more of a hybrid IT environment in a way that none of our competitors can do, where you can be on premise, where Windows Server and Hyper-V are sort of very big players. Windows Server is dominant in many respects, it's a huge share. And then we have the sort of public cloud offering. And the combination of sort of a server-based private cloud/public cloud offering is something that we think, and we are big participants across the board there, and where we can create a development framework around .NET, but also identity frameworks, management frameworks that span across those three sort of legs of the stool as a unique value proposition that is really hard to compete with because there's no one else who is in all three camps.

MODERATOR: How much of this transformation that is actually Microsoft internally doing today? Are you guys running along this path internally quickly?

CHARLES DI BONA: We're running along the path. But, I can't talk about exactly what we're doing, but we're clearly -- we, within Server and Tools, know that Azure is our future in the long run. It's not the near-term future, the near-term future is still servers, right, that's where we monetize.

But, in the very, very long run, Azure is the next instantiation of Server and Tools.

MODERATOR: So, let's talk about that, it's going to take time at the business model transformation. You've got about 30 percent of your product revenue in Server and Tools today, which is transactional, and the rest is multi-year licensing, excluding the services piece right now. So, what happens, if you will, to the model as more customers start to adopt Azure? Is it as simple as thinking about that transactional piece becoming effectively subscription, or is it more complicated than that?

CHARLES DI BONA: Hopefully it's more complicated, or I'll be unemployed. It's a little more complicated. I think from what we would -- from what you'll see from the outside it will look like a bigger and bigger part of subscription style revenues. Now managing that

transition in how people consume our products, the people who are already consuming on SA, which is the equivalent of maintenance, essentially, is already large, and those people, it will be a more natural transition for them to think about continuing to subscribe. The transactional business, I don't think the transactional business is going to go to zero. I don't think anyone thinks that. That's part of why we think we have some advantages, is that there's still going to be servers in the world. And that business is not going to completely disappear, at least not within a reasonable timeframe, right.

So, we will continue to have some transactional business, and that does tend to be sort of more the small and medium enterprise as it is, there's some across the board, but the bigger customers, they are enterprise customers, are moving towards SA more aggressively, and we see very good adoption of SA and good renewals of SA, which is a commitment to our roadmap. And we think that's a commitment to our roadmap, both in terms of the product offering, right, and it's a commitment to our roadmap in terms of customers, and particularly enterprises, acceptance that we are going to get them to the cloud, both in terms of technology and business model. So, we're very enthused by the uptake of SA, and the renewals of SA at this point.

MODERATOR: You talked about management tools. It seems that in these mixed environments, you could really almost reinvent management tools to work across on-premise, private and public type cloud. Is that a big advantage, is that a potential big revenue opportunity, if you will?

CHARLES DI BONA: I can't talk about sort of product roadmaps that we haven't really openly discussed, but yes, you would think about managing your IT environment holistically, as something that IT professionals want to do. And our ability to do that, our ability, because we are in all of those environments, we think we have some natural advantages in supporting those scenarios.

MODERATOR: We could take some questions.

QUESTION: What kind of X86 server unit growth are you building your business plan against?

CHARLES DI BONA: You know I can't -- I really can't discuss what we do, versus what the market is doing. I think I would leave it to you to sort of make your assessment about what the server growth is. Look, we think that servers are not going to zero. People still use servers, servers are the backend of what's in the cloud. So, people still sell servers. You've seen our guidance that's related to server unit growth, but I can't break that out for you, unfortunately.

MODERATOR: Any other questions? Here's one here.

QUESTION: Could you comment on the recent alliance with Nokia, in the mobility area?

CHARLES DI BONA: Well, it's actually not my group. I don't know what -- I really, probably would refer you to what's been publicly disclosed on that. I think there's not much more to say at this point.

QUESTION: What are you hearing in terms of push back from guys who are looking at Azure? I guess, can you detail some of the negatives that you're hearing?

CHARLES DI BONA: On Azure adoption? I think while we have -- we tried to make it as simple as possible, it does take some sort of architectural shift to really code to Azure. And so there's -- there's a learning curve there. It's easier to sort of -- if you want to go to the cloud the cloud is one of those words that has a million definitions. But, to sort of throw your VM up on AWS, and say, I'm done. So, there's a little bit of education that we need to do, and that's the role of the evangelists in our group to do. I'd say that's probably initially where the first push back is from the developer community.

There is -- it's a service that's in evolution, right. I mean it's in the early -- we went public a year ago February, right. So, there's still some services that occasionally there's, "I want this capability," and we're still building it, or we have a roadmap that we're building these things to. So, there will be certain instances where there's something, a feature that's missing and we're rapidly moving that direction. We have a very aggressive roadmap for building out the service. I'd say those would be the two -- first line of opposition or disruption.

QUESTION: Could you speak about the high availability and disaster recovery market, hardware versus software, what you're seeing in the competitive landscape, where you see that industry going?

CHARLES DI BONA: For high availability that's covered by our higher end SKUs. And we are seeing uptake of that, and some of it is related to people wanting high availability. We think there is sort of an interesting dynamic that's happening around disaster recovery, particularly related to the cloud, about how people are pushing storage and such into the cloud for DR reasons. And then that starts to be a natural anchor. One of our best partners in the valley is a company called Store Simple that's running on Azure, that's partnering up with Azure. And the idea is that they put the storage out in the cloud and then once people's storage is out in the cloud they go, hey, that's interesting. Now, we're sort of -- we are partly Azure. And that makes the next adoption of Azure for compute, and for sort of more transactional stuff easier.

So, it's an interesting thing to see DR going into the cloud as a sort of first step for people, for CIOs thinking about moving their whole -- getting them comfortable with moving bigger parts of their infrastructure out there. Does that address your --

QUESTION: (Off mike.)

CHARLES DI BONA: Obviously our customers, we like the cheaper software solution, but there's going to be some self-selection in who we talk to.

QUESTION: (Off mike.)

CHARLES DI BONA: I can't speak to anything that's not been announced or on the roadmap.

MODERATOR: Can I ask one about there's a company, VMware, I'm sure you've heard of them, they have this idea that they're going to be successful in really building a stack from the hypervisor layer, rather than the OS. And I'm curious just to kind of get your perspective on what your view is of that, and why you think the Windows Server OS is still important?

CHARLES DI BONA: The reality is that overwhelmingly running on VMware is Windows Servers, again. We think that the services that the Windows Server and the ecosystem the

Windows Server brings along with it are a natural complement to what they're doing in a lot of respects. And we think of virtualization as a feature of the operating system, not as a replacement for the operating system. So, and frankly we think that Hyper-V is a great solution for that, and we promote people to use that.

Look, I think the longer-term story for us is around, again, Azure. I'm going back to the well on this, but I think we view the long-term solution is not really just virtualization, but it's really the public cloud. And then potentially private clouds built on the same type of architecture. That is really a much better long-term solution for people looking to get those kinds of efficiencies. So, that's where we think the world is going, that the virtualization might be more of an interim situation, as opposed to the end point. But look, we think they are a great competitor, right. But, they're also a great complement to us, in terms of selling lots of Windows Server on top of their platform. We are obviously keeping an eye on them on a daily basis, because of what they would like to do.

MODERATOR: I guess that's what I was thinking, more as they try to build out their own platform as a service offering, and maybe they're more agnostic down at the kind of other infrastructure component layer, whether it be database layer, or whatever.

CHARLES DI BONA: I guess they're more agnostic, but again, overwhelmingly what they do run is Windows. So, being agnostic and saying you're agnostic, the reality on the ground is that there's a lot of Windows Server running on top of them. I'm sorry. I missed the first part of your question.

MODERATOR: No, that's really it. Can you talk about, I guess a lot of this is around enterprise customers, but this is a more general question. But, you've got -- Microsoft has a very wide channel partner network, and I'm just curious as to how you're going to bring channel partners along on this journey, I guess is a question I have. I mean are they going to be part of this as we start to migrate a bigger proportion of sales toward Azure and the cloud.

CHARLES DI BONA: Yes, I mean we certainly want to bring our channel partners. I mean they are our partners for a reason. We want to bring them along. I mean, I think sometimes there will be some nuanced changes in their role in the situation, but partners are going to be a distribution -- we think about partners building and sort of promoting higher level services on Azure, as one of the ways we're going to get people using Azure, consuming Azure. So, the partners are a vital part of our ecosystem, and our strategy going forward, how we're going to win with Azure.

MODERATOR: Can you maybe comment, as well, Azure as it impacts, you know, Microsoft's Business Division, and other parts of the business? How do you all make sure that you're singing on the same hymn sheet, and developing, if you will, concurrently, because that seems to be like another big advantage that Microsoft has, because you have so many touch points, whether it be applications or whatever.

CHARLES DI BONA: Clearly, we work together with the other divisions. You would think MBD is sort of the natural fit, in particular, because they would be sort of higher-level services, or SAS, in some respects on our tools, and on our platforms. So, there's a lot of coordination that goes on between the divisions, and internally in what we consume, in terms of our own internal IT, around what's on Azure. It's more of a coordination at the development level, and that sort of proceeds at a pace. So, there's a lot of effort, but a lot of effort does go into that, because we understand that those are really -- those are the touch points for most of the information workers, it's going to Office 365, and SharePoint,

and that's the way most people, not the IT professionals, but most people information workers, and consumers interact with Microsoft as a company is going to be through those information worker touch points. And to the extent that those are then ways to interact with Azure, we think that's a positive.

And also, frankly, that becomes a positive for the development community and ISVs to then sort of access those capabilities that we provide for the information worker, and work with those as a touch point for what they build out for other more differentiated services.

MODERATOR: And then, I'm curious, there is another big technology company out there, Oracle, who has a strategy around kind of integrated systems, appliances, and have been much less vocal around really, if you will, moving infrastructure to a platform as a service. I guess I'm curious to get your perspective on these kind of integrated appliances, and maybe the strategy that they seem to be following?

CHARLES DI BONA: I would hesitate to sort of comment on their strategy. But, look, those appliances are very interesting offerings. In some ways it's sort of presenting -- a large enterprise, obviously, where the footprint is big -- a large enterprise with a sort of cohesive package where they don't have to muck around with the inner workings, which in many ways is what the cloud does for a much broader audience.

So, it's an interesting way of sort of appealing to that sort of very high end constituency, which is sort of the sweet spot of what Oracle has done the past, with a sort of integrated offering that replicates in many ways the future of the cloud. Now, we still believe that the public cloud offers certain capabilities, and certain efficiencies that an appliance, a scaled-up appliance like Exadata is not going to offer them, and we think that that's the long-term future of where things are going. But it's an interesting way of appealing to that very high-end user now before they might feel comfortable going to the cloud.

MODERATOR: Microsoft's approach is going to be more lean on that public cloud delivery model?

CHARLES DI BONA: Well, no, we've already announced about a year ago at this point that we've started to rollout some Windows Azure Appliances, Azure Appliances. They are early stage at this point. But we think of the private cloud based on what we're doing in the public cloud, and the learnings we're getting from the public cloud, and sort of feeding that back into that appliance, which would be more of a private cloud. It has some of the same characteristics of what Oracle is doing with Exadata. So, we don't think of it as mutually exclusive, but we think that the learnings we're getting from the public cloud are different and unique in a way that they're not bringing into Exadata.

MODERATOR: Any other questions?

Maybe I can wrap just with one then. On the BI side, we had a really interesting panel here a little while ago, all about kind of next generation analytics. I know you guys have introduced at least not in your division, but PowerPivot, a new memory tool that sits kind of alongside Excel, and I know that that is integrating up in the stack with SharePoint, and SQL.

So, can we assume that you're going to be embracing some of these new technologies, and that that could sort of feedback up in the stack, if you will? I'm just curious to get your sense for kind of how BI is changing, and how you're playing in that changing market?

CHARLES DI BONA: The way we think about BI is sort of democratizing BI. We really want to make BI accessible through familiar tools, particularly Excel, to the information worker, and allow them not to have to sort of go to the high priest of BI to get their answers, so they can do it themselves.

Already, we're working on integrating that back into our existing products, but you can think about that reaching into all sorts of new forms of data. I would say that data is huge. The amount of data that is being generated is enormous. The amount of information that is being generated is relatively small compared to that, because the data is overwhelming for people. And we want to make that data accessible in a way that's useful for people through common tools, and you can think about that ultimately being all sorts of forms of data, and all the ways that it's being generated. And so, it's not just -- you can think about big data and other things ultimately being part of that consumption pipeline.

MODERATOR: Great. Well, we'll wrap it there.

Thanks very much, Charlie.

CHARLES DI BONA: Thank you.

END