Presentation

Operator

Welcome to the Microsoft 2008 fourth quarter and fiscal year-end conference call. (Operator Instructions) I would now like to turn the meeting over to Ms. Colleen Healy, General Manager, Investor Relations. Madam, you may begin.

Colleen Healy

Good afternoon, everyone, and thank you for joining us today. This afternoon I am joined by: Chris Liddell, Senior Vice President and Chief Financial Officer; Frank Brod, Corporate Vice President and Chief Accounting Officer; and John [Setok], Deputy General Counsel.

Today's call will start with Chris providing some key takeaways for the fourth quarter of fiscal year 2008 and an overview of expectations for fiscal year '09. I will then provide details around our fourth quarter results and then hand it back to Chris for a more detailed discussion of our guidance for the full year and first quarter of fiscal 2009. After that, we'll take your questions.

Our earnings release includes and addendum of financial highlights, which contains more detailed information about revenue, operating expenses, and other items. We also posted our quarterly financial summary slide deck, which is intended to follow the flow of our prepared remarks in order to assist you. The slide deck offers highlights from the quarter, outlines our guidance, and provides a reconciliation of differences between GAAP and non-GAAP financial measures [inaudible].

You can find the earnings release, the financial highlights, and the quarterly financial summary slide deck on the investor relations website at www.microsoft.com/msft.

Today's call will be recorded. Please be aware that if you decide to ask a question, it will be included in both our live transmission as well as any future use of the recording. As always, shareholders and analysts can listen to a live webcast of today's call at the Microsoft investor relations website. A replay of the call will be available at the same site through the close of business on July 25, 2009.

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We will be making statements during this call that are forward-looking. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially because of factors discussed in today's earnings press release, in the comments made during this conference call, and in our most recent Form 10-K, subsequent quarterly reports on Form 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.

With that, let me now turn it over to Chris.

Christopher P. Liddell

Thanks, Colleen, and good afternoon, everyone. I will start today's call with a few highlights from the year and then give you an overview of our expectations for fiscal year 2009.

Quarter four results capped off an outstanding year for the company in terms of both operating and financial performance. All three of our key financial measures met or exceeded the guidance we provided entering the year, despite a challenging economic environment. For the year, revenue, operating income, and earnings per share increased 18%, 21%, and 32% respectively.

Furthermore, the 18% revenue growth represents our first annual revenue growth in almost a decade. These results demonstrate the breadth of our business model, revenue growth being fueled by strong customer demand for our products and services across all of our businesses.

Our core businesses of client, Microsoft business division, and server and tools turned in fantastic results, growing revenue a combined 15% in the year. The online services business grew revenue 32%, while entertainment and devices division was up 34% for the year.

Looking at the fiscal year results from a geographic perspective, revenue in the U.S. increased approximately 15%. Other mature markets were up 16% and emerging markets grew a tremendous 35%.

Now for a couple of key points on our outlook for fiscal 2009, with our planning and budgeting process [in place]. Our revenue and operating income [growth trends] remain relatively consistent with what we told you in April. Specifically, we expect revenue growth of 11% to 13%, operating income growth of 17% to 20%, and earnings per share growth of [13% to 17%].

Since we last gave you guidance, we've increased investments in three ways. First, we've continued to make a number of important inorganic acquisitions. We're taking the view that the current environment is in fact a positive one to acquire companies if you are in the fortunate position of having a strong balance sheet and a willingness to take a long-term view.

Second, we've increased organic investments in operating expenses, driven in particular by a deliberate decision to invest more aggressively in our online services strategy.

Last, we remain committed to investing in ourselves through our ongoing share repurchases. For the year, we repurchased over $12 billion of our stock, with $5 billion of that amount occurring in the fourth quarter.

One final comment before we get into the details; clearly we're disappointed that our strong financial results are not reflected in our share price because of general market turbulence combined with Microsoft specific issues, including the uncertainty over the outcome of Yahoo! discussions.

In this environment, we remain focused on driving the factors inside our control. In particular, from my perspective, improving long-term earnings per share. I'm satisfied that despite difficult economic conditions, should we achieve the middle of our guidance for fiscal year '09, we will have increased our earnings per share from $1.42 to $2.15 in two years, an increase of 50% over that period.

With those high level themes for 2008 and 2009, I'm going to turn the call over to Colleen now for more details on how we closed out last year.

Colleen Healy

Thanks, Chris. The fourth quarter was a solid finish to an outstanding year. For the quarter we met our top and bottom line guidance, driven by 18% revenue growth. Let me provide you with the details of our financial performance, starting with revenue. I will discuss top line financial and business momentum points and then follow with revenue performance for each of the business units. Then I'll review the rest of the income statement.

All growth comparisons relate to the comparable quarter of last year unless otherwise specified.

Revenue grew 18% to $15.8 billion, with every business growing in the mid-teens or higher. Our annuity sales mix, which is approximately 40% of our billing revenue, continued to grow on both a year-over-year and sequential basis, with enterprise agreement renewal rates in line with historical trends.

The remainder of our product billings for the quarter was approximately 25% from OEM, around 15% from license only sales, and the balance from our other businesses.

Our unearned revenue grew 21% to $15.3 billion, over $600 million above our high-end guidance. Our contracted not billed balance increased both sequentially and year over year to over $13 billion, about $3 billion above where we started the fiscal year. When taken together with reported revenue, total bookings for the company grew 23%, driven by over 20% bookings growth for our core businesses of server and tools, client, and the Microsoft business division.

Overall, changes in foreign exchange rates added about four percentage points to our revenue growth.

Now I will provide revenue highlights by business segment, starting with client and its biggest driver, the PC market. We estimate that the PC unit growth rates for the quarter returned to the 12% to 14% range that we experienced in the first half of the fiscal year. This is about three points above our forecast, due to improvements in mature markets, including in the United States. This helps to drive client revenue growth of 15% to $4.4 billion, which was over $150 million above our high-end guidance.

During the quarter, our OEM license units increased by 22%, about nine points faster than the overall hardware market. OEM unit growth outpaced that of the PC market, primarily driven by a couple of factors: one, our OEM partners always have channel fluctuations. With this quarter, we estimate were a combination of replenishing the channel from lower Q3 levels as well as buying [hit some] pricing tiers during the quarter; and two, we returned to the trend of making gains on piracy, including in Asia.

OEM revenue increased by 13%. The difference between OEM revenue and unit growth is due to three trends, which you are already well familiar: one, volume mix shift towards emerging markets, which generally have lower ASPs; two, channel mix shift towards large OEMs with volume pricing; and three, premium mix shift toward consumer premium offerings. Specifically, while business and consumer premium units were up year-on-year and the overall OEM premium mix remained unchanged from the prior year at 72%, the premium mix composition shifted down four points of business premium and up four points of consumer premium.

The remaining roughly 20% of client revenue comes from commercial and retail licensing. This portion of the business grew over 20%, driven by continued strength in client annuity licensing as business customers continued to demand our enterprise offerings, including those that help them more efficiently manage their desktop infrastructure.

During the quarter, we surpassed the 180 million for Windows Vista licenses sold to date and Windows Vista had driven client revenue to an average growth rate of 16% since it became generally available.

Moving to server and tools, revenue was $3.7 billion, growing an outstanding 21% on top of the string of Q4 double-digit growth quarters. And this quarter marks the group's 24th consecutive quarter of double-digit growth.

[inaudible] for annuity contracts, covering our [server and tools] offerings continued during the quarter, driving server and tools unearned revenues increased 37% from the beginning of the year. This customer commitment to annuity contracts demonstrates the increasingly critical role our server products perform in information technology infrastructure, as well as an increasing interest in the value offered in our long-term product roadmap.

Demand for our consulting and support services remains strong, driving associated revenue growth of 30%.

On the product side during the quarter, we released our eagerly anticipated virtualization feature, Hyper-V, two months ahead of schedule. We also made significant progress on SQL Server 2008, which is targeted for release during this, the first quarter of fiscal year 2009.

Online services business grew revenue 24% to $838 million. Online advertising grew 18%, including $33 million of ad revenue from aQuantive. While both search queries and page views were up and in line with expectations, monetization lagged, driven by tightening advertising budgets combined with a more competitive display pricing environment. We continued to attract users to our properties with live IDs hitting 460 million, up 80 million from last year. And we grew the number of advertisers utilizing our advertising platform by 28% during the year.

We closed the acquisitions of FairCast, which offers technology to aid in the purchase of online tickets at the lowest price, and Navic Networks, which develops tools to deliver targeted ads to television set-top boxes.

In May, we announced the beta launch of Live Search Cashback. Since then, we have 680 merchants participating in the program with about 200,000 registered users.

Microsoft business division revenue was up 14% to $5.3 billion. The business element of MBD revenue grew almost $700 million, or 19% on both strong enterprise agreement signings and license only sales.

Consumer revenue declined $66 million, down 7%. This reflects both a difficult comparison to last year's quarter following the Office 2007 launch, and a continuation of a shift towards our lower price consumer SKUs.

Our emerging business product momentum continues, with SharePoint revenue up over 30% and unified communications revenue up over 20%. During the quarter, we completed the acquisition of Fast Search & Transfer, expanding our spectrum of enterprise search solutions for customers.

Our Dynamics business also had a good quarter, with customer billings growth of 22% and two product releases, Dynamics AX2009 and Dynamics CRM Online. Dynamics CRM continues to deliver the function and flexibility customers want, evidenced by over 120,000 CRM seats being sold in the quarter.

Entertainment and devices division grew revenues 37% to $1.6 billion. We sold 1.3 million Xbox 360 consoles, representing 88% growth over the prior year and passing the milestone of 20 million consoles sold life to date. In May, we announced that Xbox Live reached 12 million members, roughly doubling in membership for each of the last two years. Software attach rate continued to lead the industry at 7.7 software titles per console.

As was evident at E3 earlier this week, the interactive entertainment business was extremely busy during the quarter, securing industry-leading media content providers such as Netflix, NBC, Universal, Constantine, MGM International, as well as developing innovative new gaming and social experiences that will continue to expand our audiences.

The mobility business within the entertainment and devices division completed the acquisition of Danger and released System Center Mobile Device Manager 2008, which has created the opportunity for our sales force to partner with customers' IT departments, helping them manage their mobile device assets with capabilities similar to those already used to manage PCs.

And Microsoft Surface moved into early commercial deployment in AT&T stores and [inaudible], [as you know.]

Now for the rest of the income statement: adjusting last year for the impact of the $1.1 billion charge related to the expansion of the Xbox 360 warranty policy, cost of revenue as a percent of sales increased one point to 18%, driven by increasing Xbox 360 console sales, costs associated with the growth of our consulting and support services, as well as data center equipment and online content expenses in our online services business.

Operating expenses increased $1.1 billion, or 19%, driven primarily by headcount related costs, acquisition related expenses, and marketing related expenses. Expenses came in $500 million higher than our guidance, split rather evenly between cost of revenue and operating expenses.

First, cost of revenue; we sold more Xbox 360 consoles than our guidance had reflected. In server and tools, the higher revenue growth in our consulting and support services carries higher associated costs than does software revenue. In our online services business, we were able to bring servers in our data centers online faster than expected and we invested in premium online content, which is [higher creative and agency fees associated with it].

Moving on to operating expenses, we took advantage of the economic environment out there to attract top talent for the company, yielding higher close rates and filling headcount openings. Also, across a number of our businesses, we spent more on product development and efforts to ready marketing campaigns, and foreign currency rates presented some headwind.

Operating income was $5.7 billion, up 42% or 13% after adjusting for the impacts of the warranty related charge in the year-ago period. Investment income and other totaled $284 million, as the Microsoft treasury team continues to successfully navigate a challenging capital market environment.

Our effective tax rate for the quarter was 28%, a couple points lower than expected, driven by an earnings mix increase in lower tax jurisdictions.

During the quarter, we repurchased 171 million shares, or almost $5 billion of company stock, and paid out about $1 billion in dividends to shareholders.

Diluted shares outstanding were $9.4 billion, down 3% from the prior year, as a result of share repurchases. Earnings per share were $0.46, in line with our guidance and growing 48%, or 18% after adjusting for the warranty related charge in the prior year.

So in summary, we had our fastest growing fourth quarter revenue since 1999. Adjusting of the year-ago Xbox warranty charge, operating income and EPS grew 13% and 18% respectively.

With that, let me turn it back to Chris who will provide you with our first quarter and full year guidance for fiscal 2009.

Christopher P. Liddell

Thanks, Colleen. I’m going to spend my remaining time on the call talking about what we see coming for the full year and for the first quarter. Let me begin by outlining some of our key assumptions around the economy and general demand in the industry. The forecast generally assumes a continuation of the economic conditions and demand we experienced in the fourth quarter to continue into the first half of fiscal year ’09, with some improvement over the second half of the year.

We expect PC unit to remain healthy with growth rates similar to those in 2008. Specifically, we expect PC unit growth in fiscal 2009 to be 12% to 14% for the year and between 10% to 12% for the first quarter. We estimate that growth rates will continue to be driven by roughly 20% growth in emerging markets, with high-single-digit growth in mature markets.

Now let me go through our detailed guidance; for the full year, we expect our revenue to come in between $67.3 billion to $68.1 billion, growing 11% to 13%. For the first quarter, we expect revenue of $14.7 billion to $14.9 billion, which represents an increase of 7% to 8%.

With that, revenue guidance by business group is as follows: for client, we expect full year growth to be 9% to 10% and Q1 growth to be 6% to 7%. The PC market growth will outpace that of client revenue because of a continuation of the underlying PC market dynamic, namely emerging market PC growth outpacing mature markets, consumer growth exceeding business growth, and the shift in the system build channel to large OEM.

Server and tools revenue should be up 18% to 19% for the year and 19% to 20% for the first quarter. Coming off another impressive year of growth in fiscal year ’08, the server and tools business is expected to continue to show double-digit growth across the breadth of our server platform products and services, driven by strong customer demand for the recently refreshed Windows Server and Digital Studio offerings, and the soon-to-be-available SQL Server 2008.

We forecast revenue in the online services business to increase 18% to 20% for the year, and 7% to 11% for the first quarter. The advertising component of revenue is expected to grow at approximately 25% for the year and 15% for the quarter.

Our Q1 guidance assumes the continuation of the challenging online advertising market experienced in the fourth quarter. We expect revenue growth will accelerate through the year as we begin seeing returns from the additional investments we are making in the business.

Our business division revenue should be up 14% to 15% for the year and 15% to 16% in the first quarter. We should continue to see business demand for Microsoft Office 2007, SharePoint, and Dynamic products. Combined with growth in our emerging unified communication and business intelligence offering, this will drive another year of very strong growth.

Fiscal 2009 also represents an important year in delivering on our software for services strategy, with the upcoming releases of Exchange Online, SharePoint Online, and Office Communications Online later this calendar year.

For the entertainment and devices division, we expect revenue to be down 4% to flat for the full year, and down 23% to 26% in Q1. The strong customer demand for Halo 3 following its launch in fiscal 2008 makes for challenging year-over-year comparisons in the entertainment and devices division. But having said that, we remain committed to a profitable performance in fiscal year ’09.

Turning back to company wide performance, operating income for the year is expected to be between $26.3 billion and $26.9 billion, increasing 17% to 20%, or 10% to 12% excluding certain tax and legal charges in fiscal 2008. For the first quarter, we expect operating income to be between $5.9 billion and $6 billion.

Q1 operating income includes the impact of increased spending associated with our online services business, costs associated with a number of new acquisitions, and investments in a new Windows consumer marketing campaign.

I would like to address the overall level of -- the impact of the overall level of spending on the company margin. To do so, as I’ve told you before, we need to look at the three individual parts of the company that have distinct margin structures. The core businesses of client, server and tools, and Microsoft business division collectively will have an operating margin in fiscal 2009 that’s essentially flat. This performance is obviously very good, given that we are making a number of investments to drive the overall health of the business and absorbing a number of acquisitions we’ve made this year and growing revenue in mid-teens.

The margin for entertainment and devices should also remain roughly the same year-on-year in fiscal year ’09, even without a first party game release of Halo 3’s magnitude.

So taken together, our businesses representing over 90% of our revenue will grow double-digits next year with the margin structure intact.

Clearly the online services business has a totally different dynamic and is in a period of significant investment. We do not make these investments lightly, as the loss in this division will be a drag on an otherwise exceptionally good performance.

However, we believe that the additional investments of several hundreds of millions of dollars is worth the short-term cost, given the opportunity to participate in a market where the opportunity is measured in the tens of billions of dollars.

So I wanted on the call to take a few minutes to frame our reasoning behind the additional online service business investments. I will start with an overview of our broad strategy and then provide details into the additional investments.

With the online ad spending expected to reach $80 billion by 2012, this area represents one of the largest growth opportunities for the company. We segment the market for online advertising in four distinct categories -- search, advertising platforms, information content, and communication and social networking.

For search, we’re focused on driving query share improvements and business model innovation, specifically in the area of high value commercial search. Our recent release of Cashback is a good example of executing on our strategy, which combines innovation in the shopping experience with a shift in the distribution of advertiser economic towards the end users.

Additionally, we also [seek to win] targeted distribution through OEMs, ISPs, ISVs, and retailers. The recently announced deal with HP in the U.S. is an example of [this].

Turning to the ad platform, our strategy can be summarized as consolidate [when in] display, and there we are focused on integrating our advertising assets into a single comprehensive system that can deliver our publishing partners' industry leading yields and our advertisers optimal return on their ad spend.

In the area of communication and social networking, which includes our mail, messenger, and social networking assets, such as Spaces, we'll deliver the leading end-to-end experiences across the PC, phone, and web.

And finally, in the category of information content, we plan to invigorate our MSN portal experience with improvements in user experience, social media consumption, and premium content.

As well as overall advertising revenue, which is clearly the overall measure of success, we have aggressive growth targets in each of the above areas over the next five to 10 years. These targets can be broken down in terms of the percentage of share of worldwide page views, percentage of share of Internet [inaudible], the percentage share of search queries, and percentage of the growth of the online advertising dollars that pass through our platform.

Clearly the Yahoo! transaction, which I'll make some more comments on later, would have accelerated our progress towards these goals. However, during the quarter, a transaction became increasingly unlikely. Further, as you know, during the quarter Yahoo! signed a search outsourcing agreement with Google. Given that environment, we made some decisions to accelerate our online services' organic growth strategy. Mainly we decided to increase our investment in the high-margin scalable areas of search and ad platforms.

So about two-thirds of the incremental spend that we are planning is related to investments to drive usage of our search offering. We're dialing up our search distribution initiatives with targeted OEM toolbar [alt] search deals, scaling search globally with investments in localized engineering and data centers, pursuing acquisitions and partnerships to build vertical content to support our commercial strategy, accelerating the rollout of our Cashback program, and increasing marketing in the business to grow awareness and drive traffic.

Second, we are upping the investments in our ad platform and increasing the number of advertisers and high quality inventory on that platform. Specifically, these investments are in the area of accelerating the integration of our ad platform assets, expanding our sales and service capabilities, small acquisitions to enhance the platform technology, and investments in strategic partnerships to increase third-party inventory available to advertisers on our ad platform.

So turning to EPS, our diluted earnings per share for the year are expected to come in at $2.12 to $2.18, representing growth of 13% to 17%, two to four points faster than revenue.

To put this performance in context, as I mentioned at the front of the call, if we achieve the middle of our guidance, we'll have increased earnings per share from $1.42 to $2.15 in two years, an increase of 50%. But first quarter we expect earnings per share of $0.47 to $0.48, and these earnings assume an effective tax rate of 28%.

From a balance sheet perspective, we expect total unearned revenue to finish fiscal 2009 up 8% to 9%. [Contracts not filled] should also finish 2009 up from current levels.

When thinking about sequential changes in unearned revenue from Q4 fiscal year '08 to Q1 fiscal year '09, we expect a sequential decrease from Q4 to Q1 to exceed the rate of decline we experienced the last few years.

As always, when thinking about the guidance we provide, you should also consider the risks. These include competitors, legal, execution and general market risks such as foreign exchange rate movements, fluctuations in PC and server hardware growth rates, IT spending, changes in the piracy rate, and customer acceptance of our new and existing products. Additionally, changes in the mix of our billings between annuity and license only can have an impact on revenue, operating income, and EPS by delaying revenue recognition into future periods.

So in closing, the strong results of fiscal year ’08 were the outcome of both business and engineering execution. In addition to the financial out-performance, we delivered the final phase in our multi-year product refresh cycle with the availability of Windows Server 2008 and Visual Studio 2008, and are well-positioned to continue that momentum into fiscal 2009.

The next fiscal year will be an important year, driving mass adoption across the portfolio of products. With our breadth of products and global diversification, we are confident in our ability to continue to deliver double-digit revenue increases even off our base of over $60 billion, and we will continue to use our strong cash flow to invest in our organic growth, inorganic growth through acquisitions, and in ourselves through buy-backs.

Before I hand the call back to Colleen, I want to take a moment to clarify the terms of our recent proposal for a search transaction with Yahoo!. Given the upcoming Yahoo! shareholder meeting, I won’t be taking any questions on this topic in the Q&A section that will follow this presentation and we won’t be providing any additional comments on matters we’ve already discussed. But with that, let me outline for you the key elements of our proposal.

Firstly, we are providing significant revenue guarantees. Microsoft proposed a 10-year minimum revenue guarantee totaling between $19.5 billion and $26.5 billion. For the first five years, the guarantee is $2.3 billion per year. There afterwards, both Yahoo! and Microsoft have the option to extend the agreement for an additional five-year period. If Yahoo! unilaterally chooses to extend the agreement, the guarantee would be for $1.6 billion per year after the extension. Conversely, if Microsoft unilaterally chooses to extend the agreement, the guarantee to Yahoo! would be $3 billion per year after the extension. These guarantees are not conditional on Yahoo!’s search queries, but rather the guarantees are tied to Yahoo!’s homepage performance.

Our proposal includes an 85% TAC rate for the first three years of the agreement and 70% there afterwards. Microsoft would pay Yahoo! $1 billion for its search assets, provide $2.8 billion of senior debt to Yahoo! on favorable terms, and make a significant equity investment in Yahoo! through the purchase of $3.9 billion of Yahoo! stock at $19.50 per share, reflecting our view of the value of the company as a result of our proposed transaction and the distribution of cash and the Yahoo! Asian investments by Yahoo! to its stockholders.

I should also note that Microsoft’s proposal did not and does not include changes to Yahoo!’s governance. We clearly continue to believe that our proposal is a compelling one.

With that, I am going to hand the call back to Colleen so we can get started taking your questions, and I clearly look forward to seeing a number of you at our financial analyst meeting, which is next Thursday.

Colleen Healy
Thanks, Chris. Let’s now proceed to questions. We want to accommodate questions from as many people as possible, so please avoid multi-part questions and limit yourselves to just one question. Operator, will you please repeat your instructions?

Question and Answer

Operator

(Operator Instructions) The first question comes from Sara Friar with Goldman Sachs.

Sara Friar
Goldman Sachs

Good afternoon, everyone. Thanks for taking my question. Chris, just firstly, could you give us a little bit of your overview on the macro environment and how that's changed when you think back to giving earnings three months ago? And then, just on your cash flow, it came in a little weaker than we were anticipating. DSOs were up higher than we have seen in perhaps ever for Microsoft. Was there a collections issue, more back-end loading? If you could perhaps talk to the weakness there.

Christopher P. Liddell

Sure. Okay, taking those in turn, in terms of the macro environment, it's broadly speaking the same as what we were expecting in April. Clearly people are getting concerned now about the length of softness here in the U.S., but as you've seen for revenue, we've taken it up slightly since April, so in terms of the visibility into our products, we are actually feeling very good about our position, not only here in the U.S. but outside the U.S.

I mentioned in my comments, if you look at the company overall, our sales in the U.S. in the year that we just completed were up 15%. The company overall is up 18% so clearly we grew faster outside the U.S. than we did inside the U.S., but at 15%, given it's been a difficult environment for a number of companies, growing at 15% off our base was very good.

So going into next year, we are clearly cautious like everyone is about the impact of the environment but for our products overall, we are feeling very good. I'd say the one proviso to that is in the online advertising space, where we are seeing a direct impact. It was weak in the fourth quarter and I think you are seeing from results of other companies as to the weakness in that general space. So there is a direct impact and we are not immune to that in the online space and we'll probably see that continuing certainly for the next quarter. But overall in terms of our core business growth, it feels very good.

In terms of your other questions on cash flow, the biggest thing in the cash flow that was probably a negative was the payment of the fine to the E.U., which was over $1 billion, so -- $1.5 billion, so that was clearly a big negative from a cash flow point of view. Other than that, there really wasn't anything remarkable from a cash flow point of view. In fact, it was quite a strong quarter, given the results overall.

Colleen Healy

And on a DSO standpoint, Q4 seasonally does tend to be a little higher than some of the other quarters. We do close a lot of business in our fiscal Q4 as the sale force is out there closing deals. But we didn't see anything unusual from a DSO standpoint.

Christopher P. Liddell

But overall, I'd say revenue growth of 18% last year, guiding to revenue growth of 11% to 13%, so you combine those and so that's 30% broadly for the two years that cover what was hopefully the worst of the economic condition, so we're feeling good about it.

Sara Friar
Goldman Sachs

Okay. And there were -- okay, thanks.

Colleen Healy

Okay, thanks, Sara. Next question, please.

Operator

The next question comes from Heather Bellini with UBS.

Heather Bellini
UBS

Good afternoon. I was just wondering, Chris, if you could talk a little bit about the OSB business. Given how far behind you guys are, if you're unsuccessful in getting all or even a part of Yahoo!, can you walk us through how you are going to be able to compete with Google? And also, are we in a critical period here in this segment where if you continue to go down the path of going it alone that we are going to be seeing this accelerating spending from current levels so that it's going to adversely impact overall op-margin, so we're actually not going to see op-margins expand for the next few years? Thanks.

Christopher P. Liddell

Sure. Okay, overall, clearly regardless of what happens with Yahoo!, it's a space that we're committed to. I said that in the prepared remarks and it's one that we're committed to on a long-term basis. I would split the market, as I did in my prepared remarks, into four areas, of which search is only one -- ad platform, communications, central networking, and information content being the other ones, and clearly we have a very good position in information content and communications in an ad platform with the acquisition of aQuantive. So we feel very good about our relative position in those areas and a number of our investments are going into that.

In the search area, clearly that's the one where, relatively speaking, we are the most behind and that's why we're taking a different approach, which again I mentioned in the prepared remarks where we are focusing in particular on the areas of search where there's a strong commercial intent, our verticals like retail, travel, real estate, local. We're looking at different approaches where we might potentially take a disruptive and innovative business model, for example, Cashback, and then looking at winning distribution deals.

Now in the short-term, that isn't going to make the division profitable and I think clearly from our guidance, that's not the case. So as I said in the remarks, if you look at the operating margin structure of the company, you really have to look at the three distinct businesses. We feel good about the margin structure for our core businesses in particular growing double-digit revenue on. Entertainment and devices will be broadly flat but online is going to be negative --

Heather Bellini
UBS

Chris, yeah, I totally get what you are saying. I guess the question that I'm getting asked a lot is how long are you going to spend -- you are obviously performing well on the top line but your spending the upside so that people aren't getting margin expansion. I guess the question that I'm getting asked is how long should we expect that to continue?

Christopher P. Liddell

We're not going to make -- certainly on this call we're not going to give guidance for fiscal year '10 and '11. Some of these investments that we are making will be multi-year, so it will depend to a large extent on our revenue growth as to when that division becomes profitable. So it will need to continue to grow relatively substantially in order to cover the level of investments that we are making, but it is going to be, and I think we've made this point on previous calls, it is going to be an investment [in the] area, in particular things like the ad platform, where we see it converging to two natural players over time, of which we clearly would expect to be one, and that's an area where spending in particular on infrastructure is likely to be high.

So I can't promise you that you are going to see a massive turnaround in the short-term, and certainly in fiscal year '09, which is the year that we are guiding to today, it is going to be a continuation of an investment. But again, put it in the context of what we would describe as the overall opportunity and the size of the company overall.

Heather Bellini
UBS

Thank you.

Colleen Healy

Thanks, Heather. Next question, please.

Operator

The next question comes from Charles Di Bona with Sanford Bernstein.

Charles Di Bona
Sanford C. Bernstein

I would like to circle back to the Q4 results and really particularly the margins here -- I think the Xbox issue is fairly straightforward but in something like five of the last eight Q4s, you guys have had an issue about being disappointing on margins, and maybe you can give us some color and comfort on what sort of looks to be a fairly persistent control issue in Q4, and in some cases it looks like you might be pulling some of the expenses forward. Are we going to see that in the fiscal '09 numbers?

Christopher P. Liddell

I always distinguish, Charlie, between the costs, which were, if you like, a function of the revenue, a function of decisions that we made, and functions of unexpected low quality spend, if you like. But I can give you some comfort -- it's the areas that we spent more of in the fourth quarter were more [inaudible] in the first two. For example, on the revenue side, we sold more Xboxes, so we had more COGS. That's good news, okay? We don't make any money from those but overall in terms of long-term health of the business, the more consoles we sell, the better.

In server and tools, the higher enterprise services revenue carries higher COGS with it -- again, that's just a factor of it. So the mix inside server and tools might not be as strong as you would like from a revenue point of view, but that's just a natural consequence.

In terms of decisions that we made, we have budgeted headcount and people hired to their budgeted levels. That's a good thing in the sense that we actually hired people that we want to hire and we were particularly successful. I think that's a reflection to a large extent of the economic environment and the fact that if anything at the moment, we are an even more attractive company than we have been to people.

So again, that hits us from an expense point of view, but I'd describe it in one of the categories, you know, it's a conscious decision to hire people.

In terms of things that were outside our control, FX was a factor. FX has been our friend pretty much throughout the year in terms of driving more revenue upside than more expense, net net it's been a positive, clearly because we have more revenue outside the U.S. than we do expenses. In the fourth quarter, it was an unusual quarter in that we hired a lot of people outside the U.S. and the mix of expenses was such that the FX impact was higher on OpEx than it was on revenue. If you look across the year, that's not the case but in the quarter, it was.

So I'm comfortable that there's not any lack of control over spending. Most of the decisions I've talked about were either conscious ones or were a reflection of better revenue performance in certain areas.

Colleen Healy

Great, thanks, Charlie. Next question, please.

Operator

The next question comes from Kash Rangan with Merrill Lynch.

Kash Rangan
Merrill Lynch

Thank you very much. It looks like stepping up investments in the online services business seems like the right thing to do. I'm just curious, Chris, what -- I would have expected that to be accompanied by an increase to the revenue guidance, yet when you look back over the last 12 months, if I exclude aQuantive, I still come up with much faster revenue growth in the online services business. So my question is, is the return on these investments going to take more than one year sort of a lag to show up in the financials, or is there some conservatism in how you are budgeting for the revenue productivity as a result of these investments? Is there a longer lag to these OpEx investments?

And also, maybe three of our seconds of your thoughts on client guidance. I know Colleen didn't want multi-part questions, but I couldn't resist this; the 6% to 7% growth absent currency looks to be very low on the 2% to 3%, so I'm just curious what was the thought process that went into that guidance as well. Thanks.

Christopher P. Liddell

Okay, sure. Kash, you went blank through the start of your question, so if I don't cover it exactly, please come back to me. We missed just the first few words of your question, but in terms of online spending, is it likely to be more of a fiscal year '10 impact on revenue? The answer is yes, and that's not only because of the nature of some of the investments that we are making. Things like marketing Cashback, that's going to take time in terms of seeing the real impact from that.

But also, just because -- as I mentioned I think to Sara's question, the online advertising area is probably the part of the business certainly in the short-term which we think is most challenging. From an economic environment point of view, we have actually done remarkably well in our commercial businesses and overall for PCs, getting through difficult and choppy economic waters. The online advertising area is very difficult at the moment and I think that's across the board. That's not just us, so I don't want to promise -- you know, we might see benefits, for example, in share but I'm not sure that share is necessarily [in best display] in the search area. Again, it translates in the -- certainly in the first six months and possibly across the year to significant revenue growth but I think you could expect to see us make progress in the areas that I talked about, which is the underlying dynamics, the driver of the -- percentage minutes, percentage share, et cetera. That's really how we are going to have to measure ourselves over the next year.

I think the second half of your question was client-specific, is that right?

Kash Rangan
Merrill Lynch

That's correct, yes.

Christopher P. Liddell

In the 6% to 7%, yeah, that is relatively light. To some extent, it's because of the very high, strong quarter one that we had last year. If you'll recall, we had a very strong quarter one piracy performance in last year. It's also part of the strong Q4 performance from this year, which Colleen mentioned in the prepared remarks, was some channel inventory. We -- if you like, it was a very strong unit growth in quarter four fiscal year '08. Some of that was because of a weak Q3. You'll recall our Q3 call, we talked about some of the inventory issues there and that was one of the reasons why Q3 of last year was weak. So it feels like a bit of a borrowing from Q3 into Q4, and also we think a little bit of some of our customers may have bought forward from Q1 into Q4 as well, so that's one of the reasons.

The other is we've got 10% to 12% PC unit growth expectation, which relative to the year of 12% to 14%, we're just seeing that quarter as being one of the low points. So you combine all of those factors and we think that's going to be the lowest revenue growth quarter for client in the year.

Colleen Healy

Great, thanks a lot, Kash. Next question, please.

Operator

The next question comes from Brent Thill with Citigroup.

Brent Thill
Citigroup

Thanks. Chris, the overall buy-back for ’08 was more than cut in half from ’07. Obviously that’s understandable considering the acquisition strategy, but I guess as it relates to the overall plan, you only have $3 billion left on the current $36 billion plan. How aggressive at 25 and change will you be with the stock here?

Christopher P. Liddell

Okay, yeah -- going backwards and then going forwards, backwards -- yes, you are right, it was lower than the previous year. One of the reasons for that is we were getting down to a level of cash that we feel more comfortable with, so there was some accelerated buying in the previous year. The other impact was we see that the aQuantive acquisition, which was relatively expensive this year, and the last factor is when we announced the Yahoo! acquisition earlier this year, we went out of the market but from a sensitivity point of view, and clearly at that stage we’re envisaging having to use a large part of that cash for the acquisition. Subsequent to May when it was clear that the overall transaction wasn’t going to happen, we went back into the market and we have been buying at levels that are more like historic levels. So those are the reasons why we’ve been less in the year. It was $5 billion I believe for the quarter, so it was a reasonably strong buy-back quarter.

Clearly at these prices, it’s incredibly attractive from a buy-back perspective. I can’t tell you, as I never do on a quarter by quarter basis exactly how much we will buy back. You’re right that we only have about $3 billion worth of our buy-back left. That’s good news in the sense that I think we gave ourselves until 2012 to complete it, so we can put it at a little ahead of schedule.

What we do here is we complete the current buy-back, and then we go back to the board for authorization of any subsequent buy-back, and that would be exactly the process that we do here and if and when we get authorization from the board to do further buy-backs, we’d clearly announce the amount at that stage. But similarly wouldn’t announce exactly the shape of what we do. But clearly the value of the company relative to the last three years is as good as it’s been.

Colleen Healy

Thanks a lot, Brent. Next question, please.

Operator

The next question comes from Adam Holt from Morgan Stanley.

Adam Holt
Morgan Stanley

Good afternoon. I have a question about Office and MBD. Obviously Office 2007 has been a terrific product cycle, but MBD has been a little bit light relative to guidance for the last couple of quarters. Could you maybe talk about where you think we are in the Office 2007 cycle, and what gives you confidence that we’ll see a reacceleration of growth in MBD next year versus what we saw in the back half of this year?

Christopher P. Liddell

Well overall, obviously the MBD division did extremely well last year, so put that in context but you’re right in the sense that Office was slightly lighter than we might have thought, mainly to be honest in the consumer area, and that’s around lower price SKUs in retail. So we’re seeing more of a buy from the volume that we’re seeing. The volumes are very good and business sales are very good but the volumes in the retail side tend to be more in the lower priced SKUs, so that’s having an impact overall. But the overall volume and the overall adoption and reaction to Office 2007 has been extremely good, so we feel good and we've put it inside our business group, which grew at 15% to 20% last year.

Adam Holt
Morgan Stanley

So as we look at it next year, should we be thinking about dynamics and share points being the key drivers, or should we expect office to reaccelerate?

Christopher P. Liddell

I think those emerging products are certainly going to make a big difference. We're guiding 14% to 15%. That's very good. I mean, Office is unlikely to grow at 14% to 15%. It's likely to grow at more like high to single digits. But the other parts of the business will grow extremely well, and that is going to average it up to 14% to 15%, so you're right. SharePoint, Office Communications, some of the online services that we are bringing in will start to have an impact. So overall, it's now our biggest division in terms of revenue, 14% to 15% looks very good.

Adam Holt
Morgan Stanley

Terrific. Thank you.

Colleen Healy

Thanks, Adam. Our next question, please.

Operator

The next question comes from Robert Breza with RBC.

Robert Breza
RBC Capital Markets

Just looking at the $500 million in expenses that you are talking about, how should we think about that trending through the year? And then, depending on any outcome from an acquisition perspective, would you look to accelerate that investment or decelerate that investment? Thanks.

Christopher P. Liddell

It has slightly different dynamics. In terms of the consumer marketing, that's probably going to be front loaded in the year, and one of the reasons for our first quarter being relatively light compared to the other quarters would be some of the marketing spend that we see in the first quarter.

In terms of some of the online spending, that's probably going to be more progressive through the year. In terms of acquisitions, that's really going to be opportunistic. We closed a lot in the fourth quarter, and one of the things that is impacting our results is clearly the amount of non-cash amortization associated with acquisitions, and that was relatively substantial last year. It was over $300 million. We don't call that out, as some companies do, and take the benefit of adjusting our results to reflect that. We take that probably through the P&L and next year in terms of the guidance we've given you, we expect it to be more than $300 million. How much more and exactly the shape will depend on acquisitions. We have an expectation of it that we build in and -- but it will grow progressively through the year. It's all non-cash but we'll continue to take the full impact through the P&L.

Robert Breza
RBC Capital Markets

That's helpful. Thank you.

Colleen Healy

Thanks, Robert, and our last question, please, Operator.

Operator

The last question comes from Kirk Materne with Banc of America Securities.

Kirk Materne
Banc of America

Thanks very much. Chris, you talked in the guidance just on entertainment and devices about maintaining profitability. Given that there's no sort of new cycle of the hardware this year, is there any reason why profitability shouldn't start to trend up as attach rates get better? Is there anything going on in that business that's going to require say more advertising dollars or spending in that?

Christopher P. Liddell

One of the impacts obviously as we dropped prices during the course of last year, so year-on-year we have slightly difficult price comparisons. The other thing is there's more than just X-Box sitting in there. There's obviously Windows Mobile, which has got a lot of opportunities, so there are other areas that we will be spending on. We aren't in the comments of today giving any guidance on profitability. My comment was simply that it will sustainable profitability, but we're not saying whether that's going to be significantly up or down from where it was last year.

Kirk Materne
Banc of America

Okay. Thanks very much.

Colleen Healy

Thank you and thank you to everyone for your participation in today's call. If you have any further questions, please feel free to call me or my team directly. We're very much looking forward to seeing you at our financial analyst meeting next week. As I mentioned at the beginning of this call, this conference call will be available on replay at our investor website through close of business July 17, 2009. In addition, you can hear the replay by dialing 866-515-1618, or for international calls, dial 203-369-2027. The dial-in replay will be available through the close of business July 25, 2008. Thanks again for joining us today.

Operator
That concludes today's call. Please disconnect your line at this time.