Presentation

Operator

Welcome to the Microsoft Second Quarter Fiscal Year 2010 Earnings Conference Call. [Operator Instructions] I would now like to turn the call over to Mr. Bill Koefoed, General Manager, Investor Relations. Sir, you may begin.

William A. Koefoed
Former General Manager, Investor Relations

Thank you, Barb, and thanks everyone for joining us this afternoon. Let me begin by welcoming Peter Klein to his first earnings call as Microsoft's Chief Financial Officer. Also joining us today are Frank Brod, Chief Accounting Officer; and John Seethoff, Deputy General Counsel.

Today, Peter will start with takeaways from the second quarter of our 2010 fiscal year. Then I'll get into the details of the quarter before handing it back to Peter who will discuss our business outlook. After that, we'll take your questions.

We filed our Form 10-Q this afternoon. In addition, we posted our quarterly financial summary slide deck, which is intended to follow the flow of our prepared remarks, as well as provide a reconciliation of differences between GAAP and non-GAAP financial measures. You can find these documents at the Investor Relations website at www.microsoft.com/msft.

Today's call will be webcast live and recorded. If you ask a question, it will be included in our live transmission, any future use of the recording and in the transcript, which will be posted on our website. You can replay the call and view the transcript at the Microsoft Investor Relations website until January 28, 2011.

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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 materially differ because of factors discussed in today's earnings press release and the comments made during this conference call and in the Risk Factors section of our Form 10-K, 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 statements. Okay, Peter, it's all yours.

Peter S. Klein
Former Chief Financial Officer

Thanks, Bill, and good afternoon, everyone. It's a pleasure to be joining you for my first earnings call. I've met with many of you over the last two months and during my prior role with the Microsoft, and I look forward to spending time with many more of you in the months ahead.

Over the course of my career, both inside and outside of Microsoft, in good economies and bad, I have learned that there are a few constants that persistently translate to success: Working with great people and relentlessly focusing on creating value for customers, employees and shareholders. I'm delighted I have the opportunity to do that in my new role, building on our current momentum and driving future growth.

Now let me share some thoughts on our second quarter results. We reported record revenue and a record profit. These results were driven in large part by strong consumer demand for Windows 7 and PCs. While consumer demand remains healthy, we have not seen a return of enterprise-spending growth.

Meanwhile, our ongoing work in managing expenses and aligning our cost structure to the highest priorities have enabled us to drive earnings growth ahead of revenue growth. We also returned $4.8 billion of cash to investors through dividends and stock repurchases.

As we have previously discussed, we are just starting our strongest product cycle ever. This quarter was highlighted by the successful launches of Windows 7, Windows Server 2008 R2 and Exchange 2010 [Microsoft Exchange Server 2010]. We released Office 2010, the Beta, and introduced more Bing innovations this quarter. Bing has now gained market share each month since its launch.

We also announced upcoming releases of two very important and compelling offerings that will drive growth into the future: Windows Azure and Natal [Project Natal]. Azure is our cloud platform, which is providing developers, partners and our customers a smooth transition to the cloud with tools and processes they already know. Natal, which is based on our natural user interface work, will energize this generation's gaming and entertainment experience starting this coming holiday season.

So in summary, I'm very pleased with our progress this quarter. We have momentum with products and market, we have an exciting pipeline of new products and we delivered strong financial results. I'll now hand the call back to Bill to give you some additional details on the quarter, and then come back and provide some thoughts on our outlook.

William A. Koefoed
Former General Manager, Investor Relations

Thanks, Peter. I'll start with the company overview and then go through revenue performance for each of our business units. I will then review the rest of the income statement. Please keep in mind that all growth comparisons relate to the corresponding quarter of last year, unless I specify otherwise.

As Peter mentioned, we had an exceptional quarter with record revenue and profit. Overall, revenue grew 14% to just over $19 billion, primarily driven by strong Windows 7 consumer demand. Net income and earnings per share were $6.7 billion and $0.74, respectively. Excluding the $1.7 billion of revenue recognized from the Windows 7 upgrade program and Windows 7 licenses sold in advance of general availability, revenue grew 4%. Foreign exchange did not have a significant impact on revenue during the quarter. Our product billing mix in the second quarter was roughly the same as last year with 30% annuity, 30% OEM and 25% license-only with the balance coming from our other businesses.

Now let me dive deeper into the overall revenue mix. Geographically, emerging markets grew mid-teen while mature markets grew single digits. In terms of segments, consumer demands continue to be the driver of growth. While we saw a stabilization in the business segment, as Peter mentioned, we have not seen a return of enterprise-spending growth today.

Enterprise Agreement sales cycles have lengthened and multi-year annuity revenue was flat year-over-year. Unearned revenue was $12.5 billion, down slightly from last year. On a sequential basis, unearned revenue was down primarily due to this quarter's recognition of the $1.7 billion of Windows 7 revenue that I referred to earlier. Our contracted not billed balance was approximately $13 billion, down slightly from last year.

Now for the PC market. PC hardware shipments grew substantially during the quarter fueled by demand for Windows 7 and innovation from our OEM partners. The combination of Windows 7 and the unprecedented variety of hardware choices, form factors and price points makes it a terrific time for customers to get exactly the PC they want. Year-over-year, we estimate the PC market grew 15% to 17%. More specifically, we estimate consumer PCs grew more than 20% while business PCs were roughly flat. This quarter, netbooks represented about 11% of the total PC market roughly flat compared with last year and last quarter.

Now with that back drop, let's move on to revenue and business drivers by segment beginning with the Windows and Windows Live division, which I will refer to as the Windows division. All of my comments related to the Windows division are adjusted to exclude the $1.7 billion of Windows 7 revenue I referred to earlier. Keep in mind that this is a non-GAAP view and all GAAP, non-GAAP reconciliations can be found in our slide deck which is posted on website.

Overall, the Windows division had a phenomenal quarter with record quarterly revenue of $5.2 billion, growing 28% year-over-year. This growth was mainly driven by increased OEM unit sales of 22%. OEM revenue increased 21% and grew faster than PC shipments for the first time in eight quarters. As in the prior quarter, we have included a slide that bridges the difference between the PC market growth and OEM revenue growth.

Changes in segment mix represented a nine percentage point headwind to OEM revenue. This was caused by two factors: A higher mix of consumer PCs than business PCs and emerging markets outpacing mature markets. Windows Attach [VHD Attach] and Inventory [Microsoft Software Inventory Analyzer] drove 10 percentage points of OEM revenue growth. Attach accounted for about half the increase. Year-to-date, we saw solid Attach gains across all regions, channels and form factors.

Inventory, accounting for the other half of the increase was a result of OEMs rebuilding inventory to exit the quarter at normal levels as we discussed in the last quarter's call. Windows 7 up sell and Channel Dynamics [Microsoft Dynamics Channel] drove six percentage points of OEM revenue growth, reflecting consumer demand for Windows 7 Home Premium and demand for Windows 7 on netbooks. The commercial, retail and online portion of the Windows division grew 55%, primarily driven by the retail launch sales of Windows 7.

Now let me give you some additional Windows data points. Through the end of the second quarter, we sold more than 60 million Windows 7 licenses, making it the fastest-selling operating system in history. Windows is attached to more than 90% of netbooks, with Windows 7 accounting for well over half of that. Windows consumer licenses grew more than 35% year-over-year. And finally, Q2 was another record quarter, representing the highest number of Windows licenses sold in one quarter ever. In fact, Q2 beat the previous records set last quarter by 20%.

In summary, it was an exceptional quarter for the Windows division. With Windows 7, we have terrific consumer momentum and a great product for the business PC market when it recovers.

Now let's move to Server & Tools. The server hardware market was stronger than expected for the quarter, although still down slightly year-over-year. Our OEM and license-only revenue continued to outperform underlying x86 server hardware market shipments while annuity revenue grew low single digits.

This quarter, we released the Windows Server 2008 R2. Customer adoption for this and our virtualization and management offerings continue to build momentum. Revenue from our virtualization offerings, such as premium editions of Windows Server and System Center grew double digits.

At PDC [Professional Developers Conference], we provided an update on Windows Azure including the anticipated commercial availability next month. In addition, we recently announced the three-year agreement with Hewlett-Packard. This partnership offers customers' comprehensive solutions whether for data centers or public clouds. We are also very excited about the upcoming May release of SQL Server 2008 R2, which will further expand our capabilities in business intelligence and data warehousing.

Now for the Online Services division. While search revenue grew, display revenue was hampered primarily by international rate decline. We continue to be pleased with Bing's momentum to date, including seven consecutive months of share gains in the U.S. Regarding our Yahoo! partnership, we are still working through the regulatory review process and continue to be hopeful the deal will be approved early this year.

Now onto the Microsoft Business Division. In general, the conditions from last quarter remain unchanged. Revenue was down 3% as enterprise spending remains soft. Business revenue was down 6% due to weak business PC sales. The non-annuity component of business revenue was pressured in advance of the next product cycle. Annuity revenue was roughly flat as expected. Consumer revenue, which includes the OEM and retail portion to this business increased 12%. This growth was primarily due to better-than-expected consumer PC shipments although it still lags the overall PC market.

Within MBD [Microsoft Business Division], we continue to see double-digit growth of our SharePoint, Office Communications Server and Dynamics CRM products. During the quarter, we released the Beta of Office 2010, which has been downloaded over 2 million times.

In the Entertainment and Devices division, revenue was down 11%. During the quarter, we sold 5.2 million consoles, a year-over-year decline of 13%. Due to the favorable mix shift to Elite and Special Edition consoles, console ASPs were down only slightly following the Q1 price cuts. While our software Attach rate continue to grow and lead the industry at 8.8% Attach revenue declined as we faced difficult comps with the prior year.

Xbox Live continue to contribute to the quarter's performance and now has 23 million members, over 35% growth from a year ago. We also continue to make progress in the mobile space, and you will hear more about that at Mobile World Congress in February.

Now for the rest of the income statement. Cost of goods sold decreased 7% to $3.6 billion, driven primarily by lower Xbox 360 volume and console costs. These savings were partially offset by increased traffic acquisition and online costs.

Operating expenses increased 1% to $6.9 billion and included approximately $290 million of legal expenses. We continue to execute on our resource management plan, and during the quarter, eliminated an additional 800 position. Year-over-year headcount declined 8%. This quarter, cash flow from operations was $5 billion and we repurchased $3.6 billion of shares, and paid $1.2 billion of dividends.

So to wrap up, while we have yet to see a return of business spending growth, the Consumer segment performed better than expected, and we couldn't be more pleased with the reception of Windows 7 by our partners, developers, and most importantly, our customers. We continue to be excited by our momentum and believe we are well-positioned for the future. And with that, I'll hand it back over to Peter who's going to discuss our business outlook.

Peter S. Klein
Former Chief Financial Officer

Thanks, Bill. Now I'll discuss our expectations for calendar 2010.

From a macro perspective, IT spending should improve from the recessionary levels of 2009. Taking into account second quarter results, we are incrementally positive towards the PC and server hardware market. As we've been saying, we expect the business hardware refresh cycle to begin this calendar year, occurring gradually over a couple of years. When thinking about the remainder of fiscal 2010, keep in mind that our third quarter tends to be seasonally weaker than our second and fourth quarters.

Now addressing each of the divisions individually. In the third quarter, we expect Windows division revenues to be roughly in line with the overall PC market growth. Attach gains, the Inventory rebuild relative to the prior year, should offset macro trend of consumer PCs growing faster than business PCs and emerging markets growing faster than mature markets. When thinking of sequential trends in the third quarter, keep in mind Q2 included a large retail launch impact.

For the full year, we expect the Windows division revenue to grow in line with the overall PC market growth. The Microsoft Business Division's revenue in the third quarter should largely demonstrate same dynamics within the first half. Consumer and business non-annuity revenue, approximately 40% of the total, will face ongoing pressure in advance of the next product cycle, and that such should lag overall PC shipments until Office 2010 becomes generally available in June. We expect annuity revenue, representing 60% of total revenue, to be broadly flat for the full year.

The release of the Office 2010 Beta this quarter was an important milestone. We received terrific feedback from early adopters about the flexibility and powerful new ways to stay productive across the PC, browser and phone. As you think of the fourth quarter financial impact of the Office 2010 release, keep in mind the timing of the launch is late in the quarter, and the financial impact should be seen starting in FY '11.

The Server & Tools business, is most closely aligned the server hardware shipments and business IT spending. We expect server shipments to show year-over-year growth in Q3 and Q4 for the first time in several quarters. We expect non-annuity revenue, which is approximately 30% of the total, to generally in line with it. Annuity revenue should grow mid-single digit, while services should be roughly flat for the year.

For the Online Services division, the outlook for online advertising appears to be improving. Excluding the impact of our legacy Access business, we expect revenue to be roughly in line with the market to the third quarter and full year. In the Entertainment and Devices division, revenue should directionally track with the overall gaming market and we maintain our view that full year revenue should be roughly flat.

The past two quarters, we have made good progress containing our cost of goods sold, despite the upward pressures of increased traffic acquisition costs in our Search business and growth of our Online Services. As a result of our operational initiative, improved Xbox 360 console costs and an increasingly favorable revenue mix towards Windows, we now expect cost of goods sold as a percentage of revenue to be roughly flat for this fiscal year.

With regard to operating expenses, we remain focused on diligently managing our cost structure and aligning resource. In the full year, we reconfirm our guidance of $26.2 billion to $26.5 billion. This takes into account our second quarter performance, the impact of one-time costs, including the Yahoo! partnership integration expenses, and higher revenue-driven selling expenses.

We also reconfirmed that our capital spending for the year will be no more than $2 billion, and our effective tax rate should be approximately 25%. We continue to generate strong free cash flow and we'll return capital to shareholders through dividends and stock repurchases over the long run.

So in summary, we delivered very good financial results and are well-positioned for future growth. We have great momentum in the market with Windows 7, in the upcoming launches of Office 2010 and Natal.

Heading into 2010, we are encouraged by the possibility of improving market conditions, converging with the strongest wave of products in our company's history. Although the timing is uncertain, we are well-positioned to capitalize from the business spending recovery when it occurs. With that, I'll turn the call over to Bill and answer some of your question.

William A. Koefoed
Former General Manager, Investor Relations
Thanks, Peter. We want to get the questions from as many of you as possible, but please stick to one question and avoid long or multi-part questions. Barb, can you please go ahead and repeat your instructions?

Question and Answer

Operator

[Operator Instructions] And our first question comes from Adam Holt from Morgan Stanley.

Adam Holt

My question is around average selling prices. If you look at the average selling prices in the quarter, they improved sequentially and obviously, you're seeing both mix help that in the consumer side. But as we get a little bit deeper into the corporate upgrade cycle, you're going to see a lot higher dollar value. How should we be thinking about average selling prices? Should we see steady sequential improvement there, or some of the puts and takes around where you're seeing growth in the PC market going to offset that?

Peter S. Klein
Former Chief Financial Officer

Obviously, the biggest driver of the ASPs will be the business PC refresh and the growth in that. And the timing of that remains uncertain. We maintain our general view, which we've had, that, that will start to occur this year and occur gradually over the next couple of years. So what that does, that obviously has an impact on our average selling prices. What we saw this quarter, on the consumer side, with a great adoption of Home Premium, as well as Windows 7 on netbooks, which is driving that upsell that Bill talked about, for those two things combined will be the drivers and it just really depends on the macro.

Adam Holt

And do you think you saw a one-time spike there, or do you think that premium mix can remain at that high level?

Peter S. Klein
Former Chief Financial Officer

No, we think as we said in the guidance, revenues are going to be in line with PCs. There's some headwinds from emerging markets and consumers, so we'll have to offset that with the ASPs and other thing and attach.

Operator

And next is Sarah Friar from Goldman Sachs.

Sarah Friar
Goldman Sachs Group Inc., Research Division

Can I ask a question on the cost side? So there still seems to be some debate on the street as to how tighter reign you'll keep on costs, even though you guys have done a phenomenal job thus far. So I know you're not guiding for fiscal '11 on this call, but could you maybe just philosophically talk a little bit about the growth rate? I think you've messaged a low-single-digit inflation type rate. And then just on the COGS side, flat for this year is a great outcome. But for next year, as Azure and so on kicks in, I'm assuming we should assume gross margin continues to come down.

Peter S. Klein
Former Chief Financial Officer

Yes, obviously, it's too early to talk about FY '11. We're working through that planning process right now and as soon as we get through that, I'll certainly get out and talk to everybody about that. Let me hit the operating costs. We are executing against our plan very effectively. So I've been focused on, even before taking this role, working with Chris and the leadership team on that, and feel great that we've got a thoughtful plan that we've come up with and we're doing what we said in executing against that. A big part of that is prioritization in making sure the resources are allocated to the high return area. And that will be the approach that we take when we build our FY '11 plan absolutely. So that approach stays the same.

Sarah Friar
Goldman Sachs Group Inc., Research Division

And on the COGS side and assumption at Azure will continue to drive that down?

Peter S. Klein
Former Chief Financial Officer

I think the multiple dynamics on the COGS side is it's too early to get into that FY '11. There are puts and takes in the online services, traffic acquisition costs offset by improvements we make across the board whether that's Xbox 360 consoles and some of our operations as well. So we'll just have to get through the planning process on that.

Operator

And next is Brent Thill from UBS.

Brent John Thill
UBS Investment Bank, Research Division

On the Enterprise Agreements, I think Bill, you mentioned the sales cycles lengthened and your flat year-over-year. Peter, can you just elaborate in terms of what you expect for the second half of the fiscal year on Enterprise Agreements? And I would think considering the robustness of the product cycle that that would start to trend back up.

Peter S. Klein
Former Chief Financial Officer

Yes, that is the hope. Certainly of the Enterprise Agreement renewals, it is starting to take longer but we're getting them done, the sales cycle is just elongating. The good news is, we're getting them done maybe not in the quarter that they expire, but when we get them done we're not dropping products off of them. And in most cases, we're actually adding new products on to the EA [Enterprise Agreement] and so we feel great about the trajectory there. And I tend to agree with you that as the enterprise spend does pick up, given our product pipeline we feel very well positioned from an Enterprise Agreement perspective.

Operator

And next is Heather Bellini with ISI Group.

Heather Bellini
UBS

I was wondering if you could help us think about the trends in deferred revenue? Obviously that's going to be a big driver of your fiscal '11 growth. And in particular, last year was obviously a challenging year for enterprise spending and you're saying that enterprise spending isn't coming back. So would it be fair for us to think about your sequential deferred trends for the remainder of fiscal '10 being more in line with what you had in the back half of your fiscal year '09 just so we can help shape our models for the upcoming season?

Peter S. Klein
Former Chief Financial Officer

Well, it's hard to say. A lot of that's going to depend on the shape of enterprise spend and business spend. Obviously, we're...

Heather Bellini
UBS

Well, based on how you think spend is going to come out? Based on your views about enterprise spending not coming back anytime soon?

Peter S. Klein
Former Chief Financial Officer

I think it's largely -- the thing that I can say is, we have the great product pipeline. We don't have a visibility into exactly what business spend will be. So we're just going to have to work through that over the next couple of quarters. The only thing we can control as we've been saying is the product. We feel like we're executing against those and we'll keep working the Enterprise Agreements as we can.

Heather Bellini
UBS

So does that mean it would be unreasonable to assume? I mean, last year, I would imagine it was a difficult closing environment as well, so is it a measure of conservatism with kind of seasonal growth rates like you had last year and deferred the prudent in your view versus expecting an uptick?

Peter S. Klein
Former Chief Financial Officer

I would just encourage anybody to think their view, the different views of what enterprise spend is going to be. You'll just have to apply your view of that.

William A. Koefoed
Former General Manager, Investor Relations

I don't think we're going to give guidance on that, Heather. Can we move to the next question.

Operator

And next is Kash Rangan with Merrill Lynch.

Kasthuri Gopalan Rangan
BofA Merrill Lynch, Research Division

Peter, just wondering there's a lot that's been written about how you could deploy Windows 7 on the consumer side or on the business side, on existing hardware without having to upgrade. I'm just curious on the consumer side and on the business side. What are you hearing? Can you give us some anecdotal data or revenue that you're seeing from so-called shrink-wrap purchases on the consumer side and maybe on the business side as well? The threshold, you don't need to buy a brand new PC but I guess, you could deploy Windows 7 on existing hardware. What are you seeing on the business and consumer market in regards to that?

Peter S. Klein
Former Chief Financial Officer

On the consumer side, we had a very good retail quarter about $500 million, which is a little bit more than we expected. So that dynamic that you highlighted is actually happening. People are going to retail and buying shrink-wrapped Windows to put on their PCs. On the business side anecdotally, a lot of interest. Businesses are incredibly enthusiastic about deploying. And so we'll hope to see that flow through over the coming year. So in both cases, a lot of positive momentum as you indicate.

Operator

And next is Brendon Barnicle from Pacific Crest Securities.

Brendan John Barnicle
Pacific Crest Securities, Inc., Research Division

Following up on the consumer question, a year ago netbooks were a huge concern. And it sounds like on the year-over-year basis, they didn't really change as a percentage and maybe there was some pricing changes on Windows 7. Is the dilutive impact of netbooks stabilized or start to change anyway?

Peter S. Klein
Former Chief Financial Officer

Yes. I would definitely say it's stabilized. The mix has stayed stable, our attach [attach rate] is very high over 90%, and as Bill said, over 50% percentage of that is Windows 7. And so what we're finding is, people want Windows 7 on all devices and all form factors. And that's really what's been driving the quarter and the success of Windows 7. And we've worked closely with all of our OEM partners to deliver the broadest range of devices, PCs, notebooks, whatever you have. Whether it's netbook or a laptop or notebook or a desktop, Windows 7 is on them. So that's very positive for us.

Operator

And next is Brad Reback with Oppenheimer.

Brad Robert Reback
Oppenheimer & Co. Inc., Research Division

Peter, a couple of weeks ago, you guys announced a bit of a reorg [reorganization] in the E&D [Entertainment and Devices] segment. Could you maybe help us understand how some of those moves can help you close the gap in those businesses, especially in the mobile side in some of the devices going forward?

Peter S. Klein
Former Chief Financial Officer

Yes, they don't change the strategy that we have in both those businesses. And in E&D, if you need to separate mobile from the entertainment side of the Xbox side. The Xbox is in a very good position right now. We've got a great installed base of engaged users. We've got the Xbox Live asset, we've got Natal coming out, we're working through the profitability on the console costs. So a ton of momentum and a really exciting year coming up. On the Mobile side, our strategy remains the same. As we've been saying from a product perspective, we're working very hard on the next version of Windows Mobile, as Bill indicated, we'll be talking more about that in Barcelona in a few weeks. But I wouldn't think of the organization changes that's fundamentally changing the strategy. It just puts us in a better position to continue to execute against what we're doing.

Operator

And next is Phil Winslow with Crédit Suisse.

Philip Alan Winslow
Crédit Suisse AG, Research Division

Just on the operating expense side, if I back into sort of just the midpoint of your guidance, it basically implies that a year-over-year increase in OpEx in the second half of about 10.9%, give or take, versus the obviously the decline in the first half. And I understand that we're starting to anniversary some of the headcount reductions. But I just want to give a sense for what's driving that increase, sort of what line items or initiatives?

Peter S. Klein
Former Chief Financial Officer

Yes, so the biggest ones are the ones that I've talked about. There's the Yahoo! integration expenses which is a one-time new expense that we didn't have last year. And then given the increase to the revenues that we'll see over the recessionary levels that we saw last time, there's just some variable sales costs to go along with that and those drive year-over-year increases and those are the two biggest things.

And obviously, we've been aware of those that's been included in our plan and our guidance that we've had for the last several quarters.

Operator

And next is John DiFucci with JPMorgan.

John Stephen DiFucci
JP Morgan Chase & Co, Research Division

Peter, it looks like the OEM license unit growth on the OS is about 5% to 7% greater than the PC unit growth. With the launch of this, is that Delta [Microsoft Delta] was like 8% to 10%. And I'm just curious because there was some decent reviews on Vista when it came out, but there's really -- there were some questions at that point and in the end, it really looks like Windows 7 is going to be much greater success for you. I'm just curious if you think you can see some more, I guess, I know there's a lot of things that affect that, but inventory build in the launch of a new OS seems to have a big effect. And where the inventories are today, do you think you can see even more benefit in the following quarter?

Peter S. Klein
Former Chief Financial Officer

Well, two things. Inventories, they are about a normal level. So we feel pretty good in all the checks we've done on sell-through, inventories at normal level. In terms of the comparison to Vista, it's a different world now, right? We have some headwinds that we may not have had then in terms of the mix, the sort of segment mix that Bill talked about in terms of consumer and emerging market which is really some headwind. And so if you break it out that granularly, and you look at the attach in inventory gains of 10%, half of that being attached, that's a good result. And as I mentioned before, for us to continue to grow in line with the PC market given those headwinds of the segment mix, we're going to continue to have do better on attach and inventory and some of the upsell as well.

Operator

And next is Sandeep Aggarwal from Collins Stewart.

Sandeep Aggarwal
Collins Stewart LLC, Research Division

Peter, by when can we expect market share gain by being also translating into revenue growth acceleration? And any update on the timing of regulative approval for Microsoft-Yahoo! deal?

Peter S. Klein
Former Chief Financial Officer

No update. We're still waiting for regulatory approval and we're still hopeful we will close that deal early this year. It's a long-term process. We're continuing to gain share. What we really need to do is get the Yahoo! deal done, get that integrated, start to get the benefits of scale. So this is something you would expect to see in 2011 and beyond.

Operator

And next is Todd Raker with Deutsche Bank.

Todd Raker
Deutsche Bank AG, Research Division

Just turning to the enterprise adoption cycle around Win 7 [Windows 7], can you give us any sense in terms of what you're seeing when you talk to corporates out there? I know you guys don't want to pre-announce Service Pack 1, but any kind of visibility in terms of how you think the adoption cycle might play out over the course of this year would be useful.

Peter S. Klein
Former Chief Financial Officer

Yes, it's hard to say exactly how we will plan. I will tell you that the activity and the conversation, there's nothing about waiting for Service Packs for sure. Everybody is really super excited about Windows 7 right now, so there's a ton of activity. How that will play out in deployment cycles remains to be seen and people are working through that. But I would say there's way more business activity now than in previous launches.

Operator

And next is Katherine Egbert from Jefferies.

Katherine R. Egbert
Jefferies LLC, Research Division

It looks like you bought back almost $4 billion in stock this quarter, is that right? And then Peter, can you just tell us what your philosophy is going forward on repurchases and dividends.

Peter S. Klein
Former Chief Financial Officer

Yes, it was about $3.6 billion, so you're about -- my philosophy over the long term can be very consistent with what we've been doing. We had a target amount of cash, the appropriate cash, that we think we need to have. And then, the operating cash flow after capital and acquisitions will be, over the long term, distributed back to shareholders in the form of dividends and share repurchases. So exactly same consistent philosophy we've had over the last several years.

Operator

And our last question comes from Tim Klasell from Thomas Weisel Partners.

Timothy Elmer Klasell
Thomas Weisel Partners Equity Research

The guidance on the Entertainment and Devices division is roughly flat. Can you walk us through some of the puts and takes, particularly as we get into later stages of the product cycle and the macro of them?

Peter S. Klein
Former Chief Financial Officer

Yes, so the puts and takes are -- you should think about there's some whole generation of gaming. We've got Natal coming out this year, so you should think of it beyond the rest of the fiscal year. And then, how we go up and down depends on timing of software titles. We have industry-leading attach, there's a big difference on timing when we have first-party titles versus third-party titles. So I would consider what we're doing excellent growth and then it gets sort of reenergized with Natal as we head to holiday next year.

Timothy Elmer Klasell
Thomas Weisel Partners Equity Research

So maybe roughly flat for the calendar year or roughly flat for the fiscal year?

Peter S. Klein
Former Chief Financial Officer

That was the fiscal year, we haven't talked about FY '11 yet.

William A. Koefoed
Former General Manager, Investor Relations

So that will wrap up the Q&A portion of today's earnings call. Remember that you can access this call on the Microsoft Investor Relations website at microsoft.com/msft. Please keep in mind that we will be at a number of conferences in the next couple of months, including Mobile World Congress in February. In addition, Bob Muglia, President of Server & Tools, will present at the Goldman Sachs Conference in

February; and Peter will deliver a keynote speech at the Morgan Stanley Conference in March. Please contact us if you need additional details. We hope to see you there. Thanks again for joining us today.

Operator

And that concludes today's call. Please disconnect your lines at this time.