

Presentation

Operator

Welcome to the Microsoft Fiscal Year 2013 Second Quarter Earnings Conference Call. [Operator Instructions] Today's call is being recorded. If anyone has any objections, you may disconnect at this time. I would now like to turn the call over to Chris Suh, General Manager of Investor Relations. Chris, you may begin.

Chris Suh

Thanks, operator, and thanks, everyone, for joining us this afternoon. This does feel like a bit of a homecoming. Some of you may remember I was in IR a number of years ago. I'm excited to be back and looking forward to working with all of you.

With me today are Peter Klein, Chief Financial Officer; Frank Brod, Chief Accounting Officer; and John Seethoff, Deputy General Counsel. On our website, microsoft.com/investor, is our financial summary slide deck, which is intended to follow our prepared remarks and provides a reconciliation of differences between GAAP and non-GAAP financial measures.

As a reminder, we will post today's prepared remarks to our website immediately following the call until the complete transcript is available. Today's call is being webcast live and recorded. If you ask a question, it will be included on our live transmission, in the transcript and any future use of the recording. You can replay the call and view the transcript at the Microsoft Investor Relations website until January 24, 2014.

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

Before I hand the call over to Peter, I'd like to remind you all that all growth comparisons we make on the call today will relate to the corresponding period of last year. Also, unless specified otherwise, all impacted numbers for the current quarter have been adjusted for the cumulative effect of the revenue deferrals and recognition related to Windows, Office and Xbox video games, and the details of the adjustments can be found in our financial summary slide deck and press release. And with that, I'll turn it over to Peter.

Peter S. Klein

Former Chief Financial Officer

Thanks, everyone, for joining us. I'm pleased to welcome Chris as the new head of Investor Relations. Chris has been with Microsoft for over 16 years and has been in diverse finance roles, which gives him a good background for this role. I also want to thank Bill for all he has accomplished over the past 4 years and congratulate him with his new role as the CFO of the Skype division.

This quarter, we had record revenue of \$22 billion and record earnings per share of \$0.81. It has been an exciting quarter with the launch of Windows 8 and Windows Phone 8. In enterprise, we continue to see solid demand for our business products and services with particularly strong growth in multiyear licensing. Multiyear licensing revenues benefited from healthy renewals of enterprise agreements as customers continued to make long-term commitments to the Microsoft platform.

Our robust portfolio of enterprise products and services enable CIOs to build efficient infrastructure, unlock business insight, improve productivity and support bring-your-own-device. In the data center, recent releases of Windows Server 2012 and System Center 2012 are driving customer wins and strong renewals. Our Cloud OS road map uniquely positions us to support the hybrid infrastructure needs of CIOs by providing one consistent platform that can span their own data center, a partner's data center or Windows Azure with ultimate flexibility, portability and scale.

On the data platform, we are growing our revenue share as enterprises continue to move mission-critical workloads to SQL Server and deploy it for their business intelligence solutions. In productivity, we are excited about the upcoming launch of the new Office and how it redefines user experience with mobility, social and cloud features. The new Office features a fast, fluid design that takes full advantage of the new Windows interface. With Skype and Yammer integration, it unlocks new experiences for communication and collaboration and brings social directly into productivity scenarios.

With Windows 8, businesses will now be able to give their employees thin and light devices without compromising on security or manageability. Windows 7 momentum in the enterprise continues. And today, over 60% of enterprise desktops worldwide are in Windows 7.

We've talked about Windows 8 as Windows reimaged, from the chipset to the user experience. As we undergo this transformation, it is important for us to bring the entire ecosystem along with us. With the launch in October, we collectively took the first of many steps in changing the way people use technology at work and in play. Since then, the number of Windows 8-certified systems has nearly doubled. The number of apps in the Windows Store has quadrupled, and Windows users have downloaded over 100 million apps. To date, we have sold over 60 million licenses of Windows 8.

Our partners, including OEM hardware manufacturers, app developers and retailers, have worked hard to get us to where we are today. It's early days, and an ambitious endeavor like this takes time. Together with our partners, we remain focused on fully delivering the promise of Windows 8.

As part of our work to advance the ecosystem, we launched Surface Windows RT last quarter. Surface is one part of the overall Windows 8 story. With tight integration across hardware and software, Surface highlights the unique innovations enabled by Windows 8. We launched it exclusively in our stores and in select geographies and are expanding our retail and geographic footprint.

As we look forward, we strive to deliver seamless experiences across hardware, software and services. Windows 8, Windows Phone 8 and Xbox 360 provide a similar look and feel to users. This consistency, complemented with our cloud services like Bing, SkyDrive, Xbox LIVE and SmartGlass, unifies the consumer experience.

In the enterprise, we continue to design and deliver world-class cloud solutions that allow our customers to move to the cloud on their own terms. Compelling experiences we deliver across our devices and services, as well as our large partner and customer base, uniquely positions us for sustained future growth.

In summary, this quarter, the strength of our product portfolio delivered record revenue and earnings per share. As we enter calendar year 2013, there's tremendous opportunity for our partners, developers and customers to leverage the capabilities and scenarios our significant product releases have enabled. With that, I'm going to hand it back to Chris to provide more details on our results.

Chris Suh

Thanks, Peter. First, I'm going to review our overall results and then I'll move on to the details by business segment. Revenue for the quarter was up 5% to \$22 billion. Operating income was \$8.3 billion, up 4%, and earnings per share was \$0.81, also up 4%. Foreign exchange had a \$200 million or 1 percentage point negative impact to revenue this quarter and a \$154 million or 2 percentage point negative impact to net income. From a geographic perspective, we saw growth return in developed markets and saw mid-teens growth in emerging markets.

Bookings were strong, growing 11% as we continued to see customers making long-term commitments to our products. You see the results in the following metrics: multiyear licensing revenue grew 15%; unearned revenue grew 13% to \$17.4 billion; and our contracted not build balance was over \$21 billion.

Moving to Windows. This quarter, total revenue grew 11%. Within that, OEM revenue outperformed the underlying x86 PC market, reflecting increased demand in our distribution channel. While inventory levels ended the quarter at slightly higher levels than the prior year, we believe them to be in a healthy

range given the recent launch. Non-OEM revenue grew over 40% driven by Windows 8 upgrades, sales of Surface and double-digit growth in volume licensing.

Within the x86 PC market, we saw similar trends to prior quarters with emerging markets outperforming developed markets and business outperforming consumer. The consumer segment was the most impacted by the ecosystem transition as demand exceeded the limited assortment of touch devices available.

Next, I'll walk through our Server & Tools Business, which posted another solid quarter with 9% revenue growth. Product revenue grew 9%, and within that, multiyear licensing revenue grew at 17%. On the strength of both new and existing customers, bookings grew a solid 15%.

For the modern data center, we continue to be on the forefront of innovation with our Cloud OS road map, which provides a flexible platform for CIOs to manage their infrastructure, applications and data. With the launch of Windows Server 2012 in September, we delivered a cloud-optimized operating system and have continued to gain share in virtualization.

To further strengthen our cloud OS platform, we have introduced a steady stream of innovation in Windows Azure, including virtual machine, media services, website services and mobile services. Our management product, System Center, continues its momentum and delivered 18% revenue growth.

In our Data Platform business, SQL Server revenue grew 16% driven by strength in SQL Server Premium. Revenue growth continues to outpace the market as customers increasingly use SQL Server for their mission-critical application and business intelligence needs, making it the most pervasive data platform.

On the BI side, we're delivering on our strategy to enable analysis of all types of data while also accelerating time to insight. We're empowering organizations to realize the power of big data as Hadoop is now compatible on Windows Server and Windows Azure. With SQL Server 2012, we took the next step forward in advancing in-memory capabilities and see tremendous opportunities ahead.

Now I'll move on to the Microsoft Business Division where revenue grew 3%. Consumer revenue declined 2% with x86 PC market dynamics being partially offset by gains in attach.

Businesses are choosing Microsoft as their productivity platform for the future. This is evidenced by the healthy 18% bookings growth and near-historical high renewal rates for Office. Business revenue grew 4%, and within that, multiyear licensing revenue grew 10%.

Our productivity server offerings continued to perform well, and again this quarter, Exchange, SharePoint and Lync collectively grew double digits. Lync revenue grew at an impressive rate of 35% as customers continued to be drawn to both the enhanced productivity that it enables and also the economic benefits of our solution.

Next, I'll move on to the Online Services Division where revenue grew 11%. Online advertising revenue was up 15% driven by significant search rate improvements, offset in part by a decline in display revenue. With revenue growth and ongoing expense management, we delivered another quarter of operating performance improvement.

In the Entertainment & Devices Division, revenue declined 2%. In the important holiday season, Xbox continued its leadership position in the U.S. console market. Halo 4 launched in November and has already become the best-selling title of the critically-acclaimed gaming franchise. We did defer \$380 million this quarter for games where the buyer has rights to receive content in the future. The video game deferral was included in the Q2 guidance, and we expect it to be recognized in Q3. We also continued to expand the content available in Xbox LIVE, further solidifying Xbox LIVE as the premier entertainment service in the family room.

Windows Phone saw strong growth both in phone and patent licensing revenue. In November, we launched Windows Phone 8 with our strongest lineup of both carriers and devices. Windows Phone sales were over 4x higher than they were last year. And at CES this year, more partners were announced as the Windows Phone ecosystem continues to grow.

Skype had 138 billion minutes of calls on its network this quarter, which was up 59%.

Now I'll cover the rest -- remainder of the income statement. Cost of goods sold increased 1% due to the full quarter of Nokia platform payments, Surface and growth in cloud infrastructure, partially offset by declines in Xbox console. Operating expenses grew 10% to \$8 billion, primarily related to marketing for product launches. This quarter, our tax rate was approximately 18%. And finally, we returned \$3.5 billion to shareholders in buyback and dividends.

Now I'll turn the call back over to Peter for our outlook.

Peter S. Klein

Former Chief Financial Officer

Thanks, Chris. For the remainder of the call, I'll discuss our expectations for the third quarter and full fiscal year 2013.

Looking ahead with Windows, we know that our growth depends on our ability to give customers the exciting hardware they want at the price points they demand and a wider range of apps and services to meet their diverse needs. We are hard at work with our partners to meet these goals.

One of our biggest partners, Intel, not only delivered the Clover Trail chip this year, they said they will deliver their next-generation chip, Haswell in 2013, which will enable even more advances in the device market. This is just one example of the innovation we are seeing from our chip partners.

We also need to continue to work with our hardware partners as they create thin and lightweight devices on both x86 and ARM chipsets that offer compelling touch experiences that bring Windows 8 to life. We started to see the next wave of Windows devices at CES. And collectively, we will work to ensure that we have the most compelling devices and the right mix of devices in the marketplace.

During the quarter, we launched the first device in our Surface family of products. We recently increased production and expanded distribution to third-party retail partners. Next month, we will make Surface Windows RT available in 14 additional countries. At the same time, we will also launch Surface Windows 8 Pro, which provides the power and performance of a laptop in a tablet package. With the broadening of the Surface lineup, we will continue to highlight the power of Windows 8 tightly integrated with fantastic hardware.

On the app front, we are deepening our engagement with developers. While the number of apps in the Windows Store has quadrupled since launch, we clearly have more work to do. We need more rich, immersive [ph] apps that give users access to content that informs, entertains and inspires.

While there is a lot of work ahead of us, we are incredibly excited by the opportunities to both broaden and enrich the Windows ecosystem. With the launch of Windows 8 and Windows RT, we are positioned for growth across a massive addressable market, from tablets to laptops and Ultrabooks to all-in-ones. We will continue to work closely with our partners through this transformation as we collectively reimagine Windows.

As you update your models, remember that the Windows Upgrade Offer expires at the end of February. At that time, we will recognize \$1.1 billion, which is all of the remaining deferred revenue related to the upgrade offer.

Within Server & Tools, product revenue, including transactional and multiyear licensing, is about 80% of the division's total revenues, and Enterprise Services is the remaining 20%. We expect product revenue to grow low teens for the third quarter and low double digits for the full fiscal year. And we expect Enterprise Services to grow mid-teens in the third quarter and the full fiscal year.

In the Microsoft Business Division, multiyear licensing revenue, which is approximately 60% of the division's total, should grow low double digits for both the third quarter and full fiscal year. Excluding the Office deferral, transactional revenue, which is the remaining revenue in the division, should outperform the x86 PC market in the third quarter and for the full fiscal year.

As a reminder, when updating your Q3 models, we expect to recognize between \$250 million and \$300 million of revenue related to pre-sales into the channel and the Office Offer. We expect most of the

remainder of the deferral to be recognized at the expiration of the program in the fourth quarter of fiscal year 2013.

In the Online Services Division, we look to build upon improvements in share and search monetization. Through the third quarter and full fiscal year, we expect revenue growth to be consistent with the dynamics seen in the second quarter, with Search revenue growth partially offset by lower display revenue.

Moving on to the Entertainment & Devices Division. In the third quarter, we expect to recognize \$380 million related to the video game deferral. Excluding recognition of deferrals, we expect revenue to grow high teens in the third quarter and low single digits for the full fiscal year.

Switching to overall cost of goods sold for the company. COGS growth will continue to be impacted by the change in mix of revenue, as we have seen in the past few quarters. As we look forward, excluding Surface, we expect COGS to grow high single digits for the full fiscal year.

We are reaffirming our full fiscal year guidance for operating expenses of \$30.3 billion to \$30.9 billion. Other income and expense includes dividend and interest income, offset by interest expense and the net cost of hedging. In the current low interest rate environment, we expect these items to generally offset one another for the remainder of the year.

We expect our effective tax rate to be 17% to 20% for the full fiscal year, and we expect capital expenditures to be about \$3.5 billion for the full fiscal year.

Through the third quarter, excluding the impact of deferrals, unearned revenue should roughly follow historical seasonal patterns.

In summary, we delivered solid financial results for the second quarter. We have good product momentum in the market and are excited about the opportunity to help our customers take advantage of the advancing trends in technology. With that, I'll turn the call over to Chris and we'll take some questions.

Chris Suh

Thanks, Peter. [Operator Instructions] Operator, please go ahead and repeat your instructions.

Question and Answer

Operator

[Operator Instructions] And our first question comes from Philip Winslow with Credit Suisse.

Philip Alan Winslow

Crédit Suisse AG, Research Division

I just want to spend a moment on Surface. Obviously, you talked about ramping up production and distribution of that. Just what are some of your goals as you look at Surface, RT and Pro for this year? And within that context, how should we think about the profitability of the Surfaces?

Peter S. Klein

Former Chief Financial Officer

Thanks, Phil, as we said, we think of Surface as one part of the overall Windows 8 story. Certainly this quarter, it was a contributing factor to the revenue growth in the Windows business. And what it does is it sort of highlights some interesting innovation that can happen to sort of demonstrate the power of Windows 8 when tightly integrated with hardware and software and some new categories of devices and we're -- obviously had some limited distribution this quarter in our stores. And as you know, we're excited about expanding that. And so our goal is to continue to build that business, to highlight the incredible power of Windows 8 in an interesting set of devices. We're going to expand geographically. We're going to expand the product lineup. We're going to expand retail distribution and capacity. So we look forward to sort of continuing the growth of that business.

Operator

And our next question comes from Walter Pritchard with Citigroup.

Walter H Pritchard

Citigroup Inc, Research Division

Just wondering, Peter, if you could talk about -- obviously, one of the big differences here between newer devices in the market and some of the competing devices, I think, is price point of touch machines. Windows devices are much higher. And I'm wondering if you could just talk about what you've learned here in the first 3 or 4 months of the Windows launch, how important price is to the customer base in terms of driving units, and what do you think the outlook is in terms of getting price points down on the devices in aggregate in order to potentially drive some demand.

Peter S. Klein

Former Chief Financial Officer

Yes, and thanks, Walter. We learned a lot this quarter. We learned a lot about the types of experiences with scenarios and, to some extent, the price points customers are looking for from their devices. We saw some really great demand for some of the touch devices that we brought to market. In some cases, we didn't have the supply that we needed to satisfy that demand. I think from a price point, we learned I think what we've always suspected, which is there's segmentation and differentiation. There's -- one of the powers in the Windows ecosystem, obviously, is the variety of devices and form factors and experiences at a variety of price points, and I think we learned that, that continues to be important. And as I said, we're working very closely with both our chip partners as well as the OEMs to bring the right mix of devices, which means, to your point, the right set of touch devices at the right price point depending on the unique needs of the individual. I think we learned a lot about that, and one of the things you'll see is a greater variety of devices at a bigger variety of price points that kind of meet the sort of differentiated needs of our consumers.

Operator

And our next question comes from Rick Sherlund with Nomura.

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Richard G. Sherlund

Nomura Securities Co. Ltd., Research Division

And Chris, welcome back to IR.

Chris Suh

Thanks, Rick.

Richard G. Sherlund

Nomura Securities Co. Ltd., Research Division

MBD, I just want some clarification because the revenue growth is a little slower than I would have thought, but it looks what we're seeing is a transition in the business. It looks like it's more instead of business transactional, it's more like multiyear licensing. And the bookings growth would suggest that, that business is changing to be more revenue over time versus upfront. I just wanted clarification if I'm thinking about that correctly.

Peter S. Klein

Former Chief Financial Officer

Yes, thanks, Richard, I mean, you got it absolutely correctly. We've seen big increases in multiyear annuity business. Bookings growth was very strong. And so you are seeing a transition to sort of a long-term commitment to the business. Secondly, this quarter, obviously, a prelaunch quarter. Cyclically, you tend to see a slowdown in the transactional business as well, but that was secondary to this longer-term trend of transition to a multiyear commitment.

Operator

Our next question comes from Adam Holt with Morgan Stanley.

Adam Hathaway Holt

Morgan Stanley, Research Division

Sorry to ask a model question. My question is about cash flow and I guess 2 factors around cash flow. But could you just drill in a little bit into the delta between bookings growth and billings growth in the quarter? And then could you also just touch on in the inventory in the quarter? It looked like it was a little above what it normally is.

Peter S. Klein

Former Chief Financial Officer

Well, as always, the sort of difference between bookings growth and billings growth is going to be a function of the mix of long-term agreements, right, because our multiyear licensing agreements are 3-year agreements. And so bookings will include all of the revenue from those agreements. And then typically, those are billed a year at a time so the billings growth will be sort of that one year of billings. And so to the extent we see this sort of growth in the multiyear licensing business, you're going to see a buildup of bookings growth that's going to be fast. You're going to see a buildup of the deferred revenue, and that will then sort of enter billings and then the recognitions in the income statement over time. So to the extent that we continue to see this transition to long-term commitments, you'll expect to see that trend to continue. Your second question is on inventory. When you say inventory, you mean on balance sheet?

Adam Hathaway Holt

Morgan Stanley, Research Division

Yes.

Peter S. Klein

Former Chief Financial Officer

Yes. The inventory is a function of kind of, well, what's happening in the Xbox business and Surface. There are sort of offsetting sort of impacts this quarter. Some of it is from Surface and then some of it is from the Xbox business.

Operator

And our next question comes from Heather Bellini with Goldman Sachs.

Heather Anne Bellini

Goldman Sachs Group Inc., Research Division

Great. I had a question about Peter, you mentioned the renewal rates in MBD can be -- I guess they are at a record and continue to move higher. I'm just wondering if you could share with us what's driving the increase in the renewal rates and how much runway do you have left there. And then actually, I had a follow-up on Adam's question about inventory because it usually goes down in the December quarter. Obviously, you have Surface now, so it jumped up. But did we see the traditional Xbox's work-down of inventory that we normally see? So should we be looking at the fact that the delta between the drawdown that you normally see and the fact that I think it went up or was roughly flat this quarter was the result of Surface?

Peter S. Klein

Former Chief Financial Officer

Okay, I'll start with your first question, which was MBD annuity.

Unknown Executive

Renewal.

Unknown Executive

Renewal.

Heather Anne Bellini

Goldman Sachs Group Inc., Research Division

Renewal rates.

Peter S. Klein

Former Chief Financial Officer

Sorry, Heather. Yes, I think it's a combination of things. Heather, as you know, over time, we've been broadening the notion of how we think about productivity. And so I think it's a combination of a couple of things. One is just the product set. Lync is a big driver, SharePoint, Exchange. So the connection between the collaboration and communications technology and the enhancements to just the productivity applications themselves. I think Office 365 and the road map to the cloud is really exciting to customers. And part of the reason they're making a long-term commitment to MBD and to the Office and related products is because they really -- the -- our road map to the cloud really resonates with them and how they get there over time and how that works. And I think also, our road map from a capability perspective and what's coming in the new Office with the social, again, well, advances in the cloud is really driving sort of a road map that's compelling to customers. And so that's why they're making the long-term commitments to the platform. So that's great to see. And in inventory, yes, you're thinking about it right. I think we saw the normal sort of drawdown from the Xbox business, and any offsetting increase there was related to Surface.

Operator

Kash Rangan with Bank of America Merrill Lynch.

Kasthuri Gopalan Rangan

BofA Merrill Lynch, Research Division

But what I was wondering was in the holiday season post a launch from Microsoft, typically you get a big effect with the PC industry. It's happened every cycle. And I guess we had some competition from tablets. We didn't quite see that kind of "whiz" bang effect with a typical Windows launch. I'm curious to get your take on what is it that the media and the industry seems to have gotten it wrong? What are the misperceptions about Windows 8? And how do you think the year is going to play out as far as Windows 8 receptivity in the consumer market and business market?

Peter S. Klein

Former Chief Financial Officer

Yes, thanks, Kash. Windows 8, I talked about Windows 8 is a sort of big, bold reimagining of Windows across the whole ecosystem. And I think this was the start of that process. I think we all collectively learned a lot about from the user interface to the touch devices. And as I tried to give context on the call, there's a lot of things we're working on with our partners that I think could continue to drive this process forward over the next several quarters, whether it's the chipset, whether it's with developers or the kinds of applications that people want and certainly for the kinds of touch devices at the right price points that consumers want. I think all of that is continuously improving, we're continuously learning and happens over time. But this is a big, ambitious reimagining of Windows, and this quarter was the first step in that process.

Kasthuri Gopalan Rangan

BofA Merrill Lynch, Research Division

Got it. So the traction, the ramp, should get better over time? And so you should not be judging the cycle of the December quarter necessarily?

Peter S. Klein

Former Chief Financial Officer

I highlighted the things that drive that, exactly.

Operator

Brent Thill with UBS.

Brent John Thill

UBS Investment Bank, Research Division

Peter, just on the gross margins, they've been under pressure in the last several years, and there's a lot of components that go in that you get to see but certainly we don't get to see. Can you give us just the puts and takes of perhaps is there any change later in the year where you start to see some of the components of the COGS start to -- the expenses start to come off or not?

Peter S. Klein

Former Chief Financial Officer

Well, COGS is always going to be a function of the mix of the types of revenue, and so it's really going to depend on what your underlying assumptions are about the different components of the revenue, whether that's hardware-related revenue in Xbox and now in Surface, whether it's multiyear licensing business in consumers and what's -- I'm sorry, enterprises and what's -- Online Services. And so at any point in time, it's really going to depend on that mix of revenue, which is just going to cycle over time. So we try to give you some sense for the rest of the year how we see that playing out in total Microsoft. And again, that's going to be a function of the mix we see between the various components.

Chris Suh

And to -- reiterating Peter's guidance, excluding Surface. I think Peter just high single digits COGS practically in Surface.

Peter S. Klein

Former Chief Financial Officer

That's right.

Operator

John DiFucci with JPMC.

John Stephen DiFucci

JP Morgan Chase & Co, Research Division

Peter, so the Windows OEM revenue outperformed the x86 PC market. And your comments imply some Windows inventory build in the channel, which I believe you normally see during a quarter. With a Windows launch, OEMs build inventory in preparation for launch. Would it be accurate to assume that the Windows out-performance was primarily -- I mean, relative to the PC market was primarily due to the inventory build? Or was there something else there happening? Was there anything else -- you used to give us that bridge, which you haven't for a while now, but I just wonder if any of those other factors had a big influence?

Peter S. Klein

Former Chief Financial Officer

Yes, the 3 biggest components of the 11% total revenue growth -- and that 11% adjusted for the recognition of the deferrals -- in the Windows business were the retail upgrades, the sales of Surface and then multiyear licensing agreements within enterprises. To your point, there was some tailwind from inventory, which was normally, as you highlight, kind of what we see in a launch quarter. And as Chris said, it's within sort of the healthy range that we typically see, but that was some tailwind. But the 3 big impacts all up in Windows revenue were the retail upgrades, sale of Surface and the enterprise annuity business, which continues to grow double digits.

John Stephen DiFucci

JP Morgan Chase & Co, Research Division

Any detection of any piracy effects or changes?

Peter S. Klein

Former Chief Financial Officer

I mean, we're on the same long-term trend on piracy that we've always been. There's -- I wouldn't highlight anything sort of specific this quarter. But as always, we're fighting piracy across all the dimensions and the long-term trend should be good. But that will cycle up and down in any given quarter there.

Operator

Colin Gillis with BGC Financial.

Colin William Gillis

BGC Partners, Inc., Research Division

Peter, the trend in OSD in terms of the smaller losses, is that a run rate that we can think about going into the March quarter? And also, I mean, you talked about the improvement in revenue per search. Is there any more color or quantification you can put around that?

Peter S. Klein

Former Chief Financial Officer

I wouldn't -- on the first question, the guidance we gave on the revenue, we continue to work hard on the cost structure. But certainly, as we highlighted, the dynamics on revenue will be relatively consistent to what you see this quarter. In terms of the monetization, it's what we've been very focused on. It's partly just the work we've done with our partnership with Yahoo!, and part of it is the quality of the searches that we've been doing. It's sort of the realization of all the work we've been doing on both the search engine as well as the ad platform to make sure it's finally tuned to deliver the best economic results. And

that's what we've been -- and we've been talking about this for, gosh, 1.5, 2 years. We've been really focused on that with our best talent. And you'll start to see that paying off, and that's what's driving monetization.

Operator

Brendan Barnicle with Pacific Crest Securities.

Brendan John Barnicle

Pacific Crest Securities, Inc., Research Division

Peter, you highlighted the market share gains you guys are seeing in SQL Server. And specifically, you talked about BI and mission-critical applications. I was wondering if you can us any more color on the use cases and applications where you guys are particularly seeing the biggest gains and any impacts that pricing might be having on that.

Peter S. Klein

Former Chief Financial Officer

Yes, the biggest impact is the capabilities that we deliver with SQL Server 2012. And in terms of the use cases, there's a couple of things that sort of fall into that -- those buckets, the mission-critical and BI. In terms of mission-critical, we're seeing large enterprise customers sort of re-platforming on SQL for any number of things, underneath their ERP, underneath what other kind of major sort of LOB apps they have that sort of drive their business. And that's really an emerging trend with 2012 in what that does, and that's really advanced. And I would add that, that's been one of the drivers of our transition to multiyear licensing because now we're seeing customers commit more and more to SQL as part of their multiyear enterprise agreements as well. On the BI side, the combination of SQL as well as SharePoint and Excel is really compelling to customers in terms of the business insights they can generate from their line of business application systems. And I think really, the combination of the types of what you see front end on Excel on top of the SQL database has really been a powerful driver for both businesses, frankly. And that's a lot of what's driving the multiyear licensing business up for both MBD and STB.

Operator

Gregg Moskowitz with Cowen and Company.

Gregg Steven Moskowitz

Cowen and Company, LLC, Research Division

You had mentioned that over 60% of enterprise desktops now are running on Windows 7. Looking forward, how do you expect the cadence of migration activity to unfold from now until the termination of XP support in early to mid-2014? Does it continue at a similar pace for a while? And at what point do we probably see this moderate?

Peter S. Klein

Former Chief Financial Officer

Well, the one thing I would say is not only over 60% on Windows 7 but about 90% have expressed -- they have a plan to do that. And so I expect to see sort of a steady drumbeat between now and the end-of-life XP support in April 2014 for that to continue because the incentive is there and the expressed desire to do that has been expressed by our customers. So I would expect to see that continue over the next year or 1.25 years.

Operator

Our next question comes from Raimo Lenschow with Barclays.

Raimo Lenschow

Barclays Bank PLC, Research Division

Just to follow on, on that one. You had one quarter of Windows 8 now. What was the feedback that you had from the enterprise so far? I mean, obviously, they're still in the middle of their Windows 7 upgrade as well, but what's the point that they liked about Windows 8?

Peter S. Klein

Former Chief Financial Officer

Yes, there's a couple of things. They like the ability to get thin, lightweight devices with the kind of security and manageability that they're used to, to manage their businesses. And also, there's early interest in new applications being developed with the Windows 8 interface, which is a new way for their users to interact with their business applications. So I think you'll see those 2 things are early information in driving sort of business interest in Windows 8.

Operator

Yes, your last question comes from Ed Maguire with CLSA.

Edward Everett Maguire

CLSA Americas, LLC, Research Division

I wanted to follow up on Rick's question about the transition from the transactional to multiyear deals. How much...

Chris Suh

I think we lost the question, Peter.

[Technical Difficulty]

Operator

[Operator Instructions]

Edward Everett Maguire

CLSA Americas, LLC, Research Division

How much of your -- I was just going back to Rick's question. Regarding the transition of transactional to multiyear revenues, what in your business reflects the transition and purchasing of on-premise to hosted or cloud offerings like from Office to Office 365 or Server to Azure and other similar transitions?

Peter S. Klein

Former Chief Financial Officer

Well, the -- a cloud purchase will sort of mirror a multiyear annuity purchase. It's a very similar way to accomplish the same thing. You're making a long-term commitment, the revenue is going to be recognized in a similar fashion. Today, we see a hybrid, where customers are buying the multiyear enterprise agreements. They'll also add on some cloud services with that. But you'll feel it'll manifest itself in our financial results in a very similar way.

Chris Suh

Okay. So that will wrap up our Q&A portion of today's earnings call. We look forward to seeing many of you at the numerous events and conferences which we'll be participating in this quarter. For those of you unable to attend in person, these events will generally be webcast, and you'll be able to follow our comments at microsoft.com/investor. Please contact us if you have any additional questions or details. Thanks again for joining us. Take care.

Operator

Thank you for your participation on today's call. The call has concluded. You may disconnect at this time. Thank you.