Presentation

Operator

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

Chris Suh
General Manager of Cloud & Enterprise Finance

Thank you, operator. 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 in 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 July 18, 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-Q 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 Amy, I'd like to remind you 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 recognitions related to the Office and Windows Upgrade Offers, the $900 million charge for inventory adjustment, primarily related to the new Surface RT pricing we announced earlier this week, and the goodwill impairment charge from last year. You can find the details of the adjustments and reconciliation of differences between GAAP and non-GAAP financial measures in our financial summary slide deck. And with that, I'll turn the call over to Amy.

Amy E. Hood
Executive VP & CFO

Thanks, Chris, and good afternoon, everyone. Thanks for joining us today. In many ways, our fourth quarter results reflect the trends we saw developing throughout the fiscal year. The consumer x86 PC market declined as users continued to prioritize devices to touch and mobility. At the same time, we saw continued strength in our enterprise products and cloud solutions and increased adoption of our consumer services.

This quarter, our Windows business declined as the device market continued to evolve beyond the traditional PC. We are working to transition the business into this modern era of computing, taking advantage of the new scenarios enabled by Windows 8. As we've said before, given the complexity of the ecosystem, this journey will take time, but we continue to make incremental progress.

In June, we released the public preview of Windows 8.1. It blends the desktop and modern experience and has new features and improvements in areas such as personalization, search, built-in apps and cloud connectivity. Windows 8.1 will be a free update to existing Windows 8 users and will be made available to OEMs in August, less than 1 year since launch.

To increase and improve retail distribution, we entered into a strategic partnership with Best Buy to create a Windows store in over 600 Best Buy locations. These store-within-a-store locations provide a large-scale, hands-on consumer experience that showcases Microsoft devices and services.

The percentage and breadth of touch devices available at retail continues to improve. The first 8-inch Windows tablet came available at retail a few weeks ago. It has legacy application compatibility, includes Microsoft Office and retails for less than $400. We expect additional compelling small-screen devices to be available in the coming months.

Less than a year ago, we launched Surface RT and Surface Pro, each with a unique value proposition. Surface is one part of our journey to bring innovative, compelling Windows devices to market in the modern era of computing. With each step, we analyze our progress and fine-tune our action plan as needed.

Here's what we did this quarter. We reduced the price of Surface RT by $150 to $349 per device. As a result of this price change, as well as inventory adjustments for related parts and accessories, we recorded a $900 million charge to our income statement. While this resulted in a negative $0.07 impact on earnings, we believe this pricing adjustment will accelerate Surface RT adoption and position us better for long-term success.

We also increased retail distribution in the quarter. Surface is now available in 29 markets and 10,000 retail locations. We expanded availability of Surface to our business and institutional customers. Through our new channel expansion program, commercial customers are able to purchase Surface devices from authorized resellers in the U.S. Over the next few months, we will authorize commercial distributors and resellers in more countries.

So in summary on Windows, we are working hard with our partners to gain share in the evolving and growing device market. I want to be very clear, we know we have to do better, and that's one reason we made the strategic and organizational changes we made last week. With over 1.5 billion Windows users around the world, a transition of this magnitude takes time. We are confident we are moving in the right direction.

Now on to our Enterprise business, which continues to be strong. We closed out the year with record unearned revenue of $22.4 billion as businesses continue to make long-term commitments to the Microsoft platform.

Within our Server & Tools Business, we continue to make significant improvements in performance, reliability and scalability with SQL Server. As a result, customers are increasingly moving mission-critical and BI workloads to the platform.

While SQL Server has been the unit share leader in the market for some time, it has consistently outgrown the market over the past 12 months and is now the second largest database in revenue share. We recently announced the next versions of Windows Server and System Center, which will continue to deliver on our Cloud OS vision. With new features and enhancements in virtualization, storage and networking, we are empowering our customers to more efficiently manage their application services and their private, hosted and public cloud infrastructures.

In Windows Azure, we continue to innovate and broaden our cloud platform offering. We recently announced an important enterprise partnership with Oracle that will enable customers to run Oracle software on Hyper-V and in Windows Azure.

In June, we announced the public preview of Windows Azure in China, operated by 21Vianet, making Microsoft the first multinational organization to offer public cloud services in China. As a result of the greater choice and flexibility, we are seeing increased customer traction, both in terms of an increase in enterprise customers, but also the average deal size.

Our productivity solutions continue to be a top priority for CIOs. As enterprise customers look to modernize their productivity infrastructures, they are increasingly turning to Office 365.

We recently announced the expansion of commercial availability into several new markets, making Office 365 available in over 125 markets worldwide. I'm pleased to share that momentum is accelerating, and Office 365 is now on a $1.5 billion annual revenue run rate.

During the quarter, we saw ongoing momentum for our consumer services, such as Office 365 Home Premium, SkyDrive, Xbox LIVE, Skype and Outlook.com. By giving consumers rich, high-value experiences across productivity, communications and entertainment, these services can help give our products and our overall ecosystem a strategic advantage in today's marketplace, where the line between home and work is blurring for many customers.

Our unified communication offering of Skype and Lync are great examples of what customer enterprise products can be mutually reinforcing and create more opportunity for Microsoft.

In summary, the fourth quarter continued many of the trends we saw developing throughout the fiscal year. We continued to make important strides toward our strategy, to create a family of devices and services for individuals and businesses, to empower them for the activities they value the most.

Some of our investments are already paying off, while others reinforce the foundation that positions us for future growth and profitability. With that, I'll hand it over to Chris to give more details about this quarter, before I come back to share thoughts on the first quarter of fiscal 2014.

Chris Suh
General Manager of Cloud & Enterprise Finance

Thanks, Amy. First, I'm going to review our overall results and then I'll move on to the details by business segment. Revenue was up 3% to $19.2 billion, and operating income declined 11% to $6.2 billion. Earnings per share declined 19% to $0.59. Foreign exchange had a $257 million or 1 percentage point negative impact to revenue this quarter and a $177 million or 3 percentage point negative impact to net income.

From a geographic perspective, revenue in the U.S. was strong relative to other regions. Annuity revenue continued to be strong, growing 13%. We had record unearned revenue of $22.4 billion and our contracted not billed balance was approximately $21 billion.

Now to the results for the Windows Division, where revenue declined 5% this quarter. The x86 PC market continued to decline. While business PC showed modest growth, we estimate consumer PCs declined more than 20%. As a result, OEM revenue declined 15%. OEM revenue lagged the PC market, primarily due to market dynamics in China and lower ASPs, reflecting the introduction of our small-screen touch offering and current period incentive program.

Non-OEM revenue grew 22%, driven by sales of Surface and continued double-digit growth in volume licensing, as businesses across all areas and segments continued to value the Windows platform.

This quarter, we saw continued progress in the transition from Windows XP. And today, almost 3/4 of enterprise desktops are running Windows 7. Volume licensing of Windows delivered more than $4 billion in revenue this year.

Next I'll walk through our Server & Tools business, which posted another solid quarter with 9% revenue growth and double-digit bookings growth. Product revenue grew 9%, driven primarily by growth in premium versions of Windows Server and SQL Server.

Our cloud momentum continues with strong customer adoption, upsell to higher-level services and increased innovation. We released a number of Azure services, including mobility, media and website services, and a growing number of customers are already using multiple services for their cloud platform needs. We added 25% more enterprise customers this quarter, and now over 50% of the Fortune 500 are using Windows Azure.

In the Data Center, System Center revenue grew 14%, and the premium version of Windows Server continued to see significant revenue growth. Hyper-V, our virtualization product, continued to gain market share over the past year. Companies such as Aston Martin and Grant Thornton continue to look to Hyper-V and System Center to deliver their critical business applications.

In the Data Platform business, SQL Server revenue grew 16% and again outpaced the broader market. Last month, we announced SQL Server 2014, the next version of our Data Platform, which has in-memory capabilities built right into the core database. We also announced Power BI for Office 365, a cloud-based BI solution that combines the power of SQL Server with the familiarity of Office.

Now I'll move on to the Microsoft Business Division, where revenue grew 2%. Within that, business revenue grew 7%, driven by 10% growth in annuity revenue. Consumer revenue declined 27%. Results in our consumer business were driven by declines in the consumer x86 PC market and the shift to subscription, offset in part by attached games.

As our customers transition to this new subscription model, there's a short-term impact to revenue due to the changes in the timing of revenue recognition. But over time, we expect our revenue to grow and become more recurring and predictable.

With the subscription model, we are providing greater value to our customers, through frequent product updates, new cloud services and attractive pricing. We saw strong early adoption of the subscription offering and now have more than 1 million Office 365 Home Premium subscribers. It's been a big year for Office 365, and as Amy said, it's now on a $1.5 billion annual revenue run rate. This was our strongest quarter ever with more net seat adds in the quarter than all of fiscal 2012.

We're seeing strong upsell, with 1 and 3 Office 365 seats now running premium workloads.

In terms of our productivity offerings, we continued to see strength with Exchange, SharePoint and Lync, each growing double digits. Lync revenue grew over 30%, driving our enterprise communication business to deliver more than $1 billion revenue this fiscal year. Additionally, we met a key milestone in the Lync and Skype integration, and users can now seamlessly communicate in voice and IM across the 2 services.

Next, I'll move on to the Online Services Division, where revenue grew 9% and operating performance improved by $107 million or 22%. Online advertising revenue was up 11%, driven by both rate and volume improvements in our Search business.

In the Entertainment and Devices Division, revenue grew 8%. Xbox LIVE transaction revenue grew nearly 20% and is providing economic opportunities for publishers in the soft console market. This quarter, we announced our next generation gaming and entertainment console, Xbox One, and at E3, we showcased an impressive line of games that will be coming to the new platform.

Progress with Windows Phone continues as our partners, including Nokia, Samsung, Huawei and HTC, are delivering new phones at a broader range of price points. Telefonica also recently announced an enhanced marketing effort to promote Windows Phone 8 devices. And with the recent Sprint announcement, Windows Phone 8 devices will now be available on all major U.S. operators.

Now I'll cover the remainder of the income statement. Cost of goods sold increased 14%, principally driven by Surface and growth in cloud infrastructure. Operating expenses grew 9%, primarily related to sales and marketing for Surface and Windows 8.

This quarter, our CapEx increased as we continue to invest in our cloud infrastructure and expand our geographic footprint to support the growth in our online businesses. And finally, we returned $2.9 billion to shareholders in buybacks and dividends.

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

Amy E. Hood
Executive VP & CFO

Thanks, Chris. Before I discuss our expectations for the first quarter, I'd like to spend a few minutes discussing last week's announcement on One Microsoft. If you haven't already done so, I encourage you to read our strategy memo and Steve Ballmer's email to employees.

Microsoft is rallying behind a single strategy. As a part of this, we implemented a new organizational structure that will allow us to advance our strategy more quickly and more efficiently. We are currently in the process of determining what changes, if any, will be made to our reporting segment.

In late September, we will host an analyst event here in Redmond, at which point we will discuss our strategy, our new organizational structure and any changes to our reporting segment. We will also give more thoughts on our full year outlook at that time. Please look for additional details from Chris over the coming weeks.

Now moving on to our expectations for the first quarter. In Windows, we expect revenue to continue to be negatively impacted by the decline in the consumer x86 PC market. Excluding the impact of the Windows Upgrade Offer in the prior year, OEM revenue should account for approximately 65% of the division's revenue and should decline mid-teens.

Non-OEM revenue should account for approximately 35% of the division's revenue, primarily reflecting revenue from volume licensing and Surface, including Surface RT at new price points. When updating your models, please keep in mind that in the first quarter of fiscal 2013, prior to the launch of Surface, OEM accounted for 75% of the division's total revenue.

Within Server & Tools, product revenue, including transactional and multiyear licensing, is about 80% of the division's total, while Enterprise Services is the remaining 20%. We expect both product and Enterprise Services revenue to grow high single-digits.

In the Microsoft Business Division, we expect business revenue to account for approximately 85% of the division's total, while consumer revenue should account for the remaining 15%. Business revenue should grow mid-single-digits, reflecting low double-digit growth in annuity and the shift from transaction licensing to cloud services.

With the ongoing shift to subscription, consumer revenue will lag the x86 consumer PC market by approximately 5 percentage points, even as attach continues to grow. This excludes the impact of the Office Upgrade Offer in the prior year. As a reminder, business revenue accounted for 80% of total revenue in the prior year.

In the Online Services Division, we expect revenue to grow low double-digits, reflecting growth in service revenue, partially offset by lower display revenue.

With the Entertainment and Devices Division, we expect revenue to decline low single-digits as the industry awaits the next-generation consoles.

For the first quarter, cost of goods sold will reflect Surface, as well as the impact of the capital expenditures we made in fiscal 2013. As a result, COGS should grow over 20%.

Other income and expense includes dividends 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.

For the first quarter, regarding CapEx, we expect continued growth in our investments in our global data centers. Excluding the impact of the Windows and Office Upgrade Offers, unearned revenue should roughly follow historical seasonal patterns.

Now turning briefly to the full fiscal year. We are reducing our operating expense guidance. We now expect fiscal year 2014 operating expenses to be $31.3 billion to $31.9 billion, with growth in the low teens for the first quarter. We expect our tax rate to be between 18% and 21% for the full fiscal year.

In summary, as we look back on the year, fiscal 2013 was a pivotal time for Microsoft. With Windows 8, we increased our addressable market. Our OEM partners have started capitalizing on the new opportunities, delivering a wide range of new Windows hardware, from phones to tablets to new PCs.

We extended our first-party devices through Surface and the announcement of Xbox One. We modernized productivity with Office 365, changing our business model. For the first time, both businesses and consumers can now access Office through subscription.

We took share from key competitors in key enterprise markets. We added several new features, including Infrastructure-as-a-Service capabilities for Windows Azure. With Azure, we are fundamentally changing the way businesses manage their IT infrastructure, and we continued the expansion of our data center footprint, which enables us to deliver high-value services and experiences globally.

As we look to fiscal 2014, we're focused on a single strategy. With our new organizational structure, we believe we'll be able to execute more quickly and more efficiently, driving long-term growth, profitability and shareholder value.

With that, I'll turn it back to Chris, and we'll take some questions.

Chris Suh
General Manager of Cloud & Enterprise Finance
Thanks, Amy. [Operator Instructions] Operator, please go ahead and repeat your instructions.

Question and Answer

Operator

[Operator Instructions] And we do have a first question from Walter Pritchard with Citigroup.

Walter H Pritchard
Citigroup Inc, Research Division

Amy, I'm wondering if you could talk a little bit about -- you talked about COGS in Q1, and you don't mention COGS for the rest of the year, obviously, you have Xbox One launching in the second quarter. Could you give us some guidance about how we should think about that product having an impact on margins, maybe comparing it to the 360 or anything else you could do to help us directionally with the COGS impact beyond Q1?

Amy E. Hood
Executive VP & CFO

As we transition to a device and services company, I think you should keep in mind that we expect CapEx to continue to grow as we ramp our business. Specifically to Xbox One and the new generation of consoles and launches, I think you should think about that as you think about all console life cycles. And so keep that in mind as you model COGS and seasonality throughout the year.

Operator

Our next question comes from Mark Moerdler with Sanford Bernstein.

Mark L. Moerdler
Sanford C. Bernstein & Co., LLC., Research Division

Can you give us some color on the short-term revenue impact to the move to the cloud? Is it just MBD? Is it also in Server & Tools? How does the license revenue convert to cloud revenue?

Amy E. Hood
Executive VP & CFO

Mark, thanks for that question. It is primarily in MBD, where we had a higher percentage of our revenue, but that was accounted for transactionally, both on the business side and in the consumer side. So I think that's why you've seen us in our outlook for Q1 try to start to explain that transition to consumer by saying that we expect it to lag the PC market by approximately 5 percentage points while attach increases [ph].

Mark L. Moerdler
Sanford C. Bernstein & Co., LLC., Research Division

Is there a similar lag on the transactional side on the enterprise?

Amy E. Hood
Executive VP & CFO

Yes, you can see it when we gave the guidance for the business segment. We said 10% growth in the annuity, and so that would clearly say that part of that is a transactional move from recognized upfront revenue to multiyear licensing agreements.

Operator

Our next question comes from Phil Winslow with Credit Suisse.

Philip Alan Winslow
Crédit Suisse AG, Research Division

It's just a follow-up on actually both those 2. First, Amy, obviously, when you go to a subscription model, you have less upfront kind of lower billings that first year versus license. I wonder if you could give us sort of a backfill where dollar of cloud or Office 365 revenue would have been -- in that first year would've been $3 relative to license just so we can try to back fill and help with that transition. And also actually to Walter's question about Xbox COGS. Maybe you can give us a sense for if this cycle really should be any different than previous cycles when you thought about pricing relative to the cost of the console itself?

Amy E. Hood
Executive VP & CFO

Yes, I'll try to remember both those questions. Let me take the second one because it's the most recent in my mind. I would not think about this console cycle as being any different from prior cycles. So let me go back to the first question, which is can I give an example, I believe, of how to think about the transition from how we used to recognize revenue when we bought something upfront transactionally versus buying a subscription from us. I'll give an example. If you used to buy a license from us as a consumer and paid us, for example, $100, for ease of math. We recognized the $100 in the period in which it was purchased. Now if that same person went and bought Office 365 Home Premium and once it's activated, we will recognize the revenue over the period of the purchase, which is 12 months and recognize it ratably.

Operator

Our next question comes from Keith Weiss with Morgan Stanley.

Keith Weiss
Morgan Stanley, Research Division

I was wondering, focusing on the Server & Tools division, you guys came in with high single-digit growth versus the guidance of low double-digit growth. I was hoping you could walk us through some of the elements that perhaps transpired during the quarter that caused that gap, of why you came in slightly below expectations there, and to what extent was the shift toward subscriptions a part of that?

Amy E. Hood
Executive VP & CFO

Let me start by saying Server & Tools had a very good quarter. We continue to win share in virtualization, with SQL Server, and continue to grow faster than both Oracle and IBM. Revenue did grow 9%, which importantly far outpaced the underlying hardware market. And over the period of the quarter, we did see the hardware market fundamentally coming a bit lower than we had expected.

Operator

Our next question comes from Heather Bellini with Goldman Sachs.

Heather Anne Bellini
Goldman Sachs Group Inc., Research Division

Amy, I was wondering if you could talk a little bit about the incentive pricing you've been doing, not just on your own devices like Chris mentioned in his prepared remarks, but also in the OEM market. And if you haven't done incentive pricing at the OEM level, is there a chance we could see this strategy going forward as a way to help lower the price points of consumer PCs and then, hence, try and spur demand?

Amy E. Hood
Executive VP & CFO

Thanks, Heather. I think it's a great question. I do think that we should think about incentives, and all of our programs, including a small-screen touch view that we've launched, as a way to increase the breadth of our Windows devices available across all price points.

Operator

Our next question comes from Rick Sherlund with Nomura.

Richard G. Sherlund
Nomura Securities Co. Ltd., Research Division

I wonder if you have any perspective for us on, you've got Intel's Haswell chip shipping now, 8.1 coming in probably October. Are you sensing that OEMs are trying to manage inventories down for the time being and waiting cautiously? Intel suggested that maybe you're seeing some inventory liquidation. So I was wonder if you could just give us a sense for what you're hearing from the OEMs?

Amy E. Hood
Executive VP & CFO

Thanks, Rick. I think like the rest of the ecosystem, we are excited by the advances Intel has made with the fourth generation core processor. And we're also looking forward to the next add-on chip. But with launch a little less than a month ago. I think it's a little bit too early for me to say, and we'll have to wait and see how the quarter plays out.

Operator

Our next question comes to us from Brent Thill with UBS.

Brent John Thill
UBS Investment Bank, Research Division

Amy, on the expenses, you're revising next year down, and it looks like your expense growth will materially slow from what it was this year. I'm just curious if you could just help us understand where that's coming from and how you're thinking about that for next year?

Amy E. Hood
Executive VP & CFO

Well actually, I think this is -- I feel good because I think in some ways, the reorg we announced last week, along with our increased focus on our new single strategy, has allowed us to really look and say what are the things we're going to put behind and focus to improve our execution. And so I feel quite good about our ability to do that. And you've heard us say before many of the reasons we did this reorg are about doing things better and more efficiently.

Operator

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Our next question comes from Ed Maguire with CLSA.

Edward Everett Maguire
CLSA Americas, LLC, Research Division

Amy, you had discussed your increased CapEx this quarter, and I was wondering if you could address the margin profile of your cloud services. In the comments, you discussed how you have higher data center costs, and what I'd like to understand is whether this is temporary as you're ramping up this transition towards subscription business? Or whether this actually changes the gross margin profile of these revenues?

Amy E. Hood
Executive VP & CFO

Thanks, Ed. That's a good question. As we transition to a device and services company, that is a multiyear commitment to evolve our business. And you should expect the CapEx will continue to grow as we ramp that business. With the expansion of Azure service offerings and the continued momentum in Office 365, as well as our consumer services, investing in this global footprint to meet customer demand is incredibly important and quite strategic. And really, the question is our ability to scale smartly and that will create an advantage for us that we can pass along to our customers. And so I look forward to being able to move these Data Centers globally to reach more people with more services.

Operator

Our next question comes to us from John DiFucci with JPMorgan.

John Stephen DiFucci
JP Morgan Chase & Co, Research Division

Amy, your CapEx this quarter was about $700 million -- or greater than $700 million, greater than you guided just 90 days ago. Why was there such a sudden change? I know, Chris I think explained why it was high -- higher and why it's going to be higher going forward. But why was it such a sudden change so dramatically just in this quarter? And will this planned increase going forward affect your ability to do things like buy back shares?

Amy E. Hood
Executive VP & CFO

Our -- in Q4, really as we continued to add Azure services, in fact, we added over 80 this quarter, and with the increased demand of Office 365 and the $1.5 billion annual run rate, up from just $1 billion in Q3, I would think about that as our ability to increase demand and meet demand globally with our services. And so doing that in Q4 was important because you want to be ahead of demand there.

John Stephen DiFucci
JP Morgan Chase & Co, Research Division

So was that something that was unexpected, you just had higher demand in Q4?

Amy E. Hood
Executive VP & CFO

We're accelerating.

John Stephen DiFucci
JP Morgan Chase & Co, Research Division

Okay. Will this affect your ability to buy back shares going forward, this increasing CapEx?

Amy E. Hood
Executive VP & CFO

No. I mean, our cash -- we returned $2.9 billion this quarter, and over $12 billion for the year, and we'll continue to take a balanced approach to capital allocation with those investments, acquisitions where they make sense and return of capital to shareholders.

Operator

Our next question comes from Kash Rangan with Merrill Lynch.

Kasthuri Gopalan Rangan
BofA Merrill Lynch, Research Division

My question had to do with the Windows side of the business. I know that you had an impairment charge for the inventory clearance. But even if I back -- if I add that back in, it looks like the operating margins in the Windows business were sequentially lower, quite materially. I just wanted to get some insights into what drove that from the March quarter into the June quarter? And as you look further out into the operating margins for the Windows business, given that you're going to be focusing on Surface, how should we think about the margin structure? I guess you have a volume threshold to clear before you can start to make a margin, given that it's more of a product. But really 2 parts to that question, would love to get your insights.

Amy E. Hood
Executive VP & CFO

Thanks, Kash. Let me address what I think were the 2 components. The first component, so like a general question about margins this quarter for Windows. As you said, they were impacted by Surface, and the second one is by the marketing investment we continue to make in the ecosystem to move it forward. Overall, I think as you think about the Windows Division as we report it, obviously, since there's a mix between hardware and software, you should continue to expect margins to reflect that mix.

Operator

Our next question comes from Ross MacMillan with Jefferies.

Ross Stuart MacMillan
Jefferies LLC, Research Division

Amy, I just wanted to drill into the billings growth where we adjust for the unearned. And it's a lot higher for the Server & Tools business, which is obviously going through a transition towards more subscription arrangements than it -- a lot higher there than in the MBD segment. And I'm just wondering if you could compare and contrast why that might be. I understand the consumer piece in MBD. But is the other piece of this just that there are more sort of traditional licensing arrangements in MBD with enterprise customers, and so the impact from the transition is all the greater and that's why you see that more subdued billings growth rate in MBD?

Amy E. Hood
Executive VP & CFO

Ross, thank you. It's always terrific when someone answers their own question. You actually have it exactly correct.

Operator

The next question comes from Gregg Moskowitz with Cowen.

Gregg Steven Moskowitz
Cowen and Company, LLC, Research Division

Just a follow-on a bit on Kash's question. With Windows revenue coming in where it did, we're getting a few questions from investors about how Windows fared this quarter relative to PC units. If we were to exclude tablet revenues, both Surface and otherwise, just wondering, Amy, if you might be able to say roughly on a year-over-year basis how Windows PC revenue compared to the low double-digit PC unit decline cited by the IDCs and Gartner's?

Amy E. Hood
Executive VP & CFO

Chris actually covered that a bit in his comments, but let me reiterate, because I do understand the question I think, which is related to our OEM revenue 15% -- down 15%. It was related, I believe, to China, lower ASPs on the small-screen SKU that we mentioned, as well as some of the incentive programs that we had in place during the quarter.

Operator

Our next question comes from Raimo Lenschow with Barclays.

Raimo Lenschow
Barclays Bank PLC, Research Division

I had a question on the business PC side. That's sort of was [ph] an area of strength for the Windows Division and you saw some growth there. Can you talk a little bit about if that's kind of if you see that as a sustainable number or is that still driven by the end of life for Windows XP?

Amy E. Hood
Executive VP & CFO

Yes. As we mentioned, our Windows business did make incremental progress in the business side. We expect that to continue in Q1. And with the end of life of Windows XP next year, we expect continued migrations. And today in the enterprise, about 3/4 of desktops are already running Windows 7.

Operator

Our next question comes from Brendan Barnicle with Pacific Crest Securities.

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

Amy, contracted but unbilled was down sequentially from Q3, the first time we've seen that in the last 2 years. What's attributing to that shift?

Amy E. Hood
Executive VP & CFO

Thank you. Actually, I think our strong annuity growth, as well as our record unearned balance, I do believe, supports our belief that the strong performance of our multiyear license agreements is in place.

Operator

The next question is going to come from Karl Keirstead with BMO Capital Markets.

Karl Emil Keirstead
BMO Capital Markets U.S.

I just wanted to ask a question about the mix shift to multiyear licensing across Microsoft that's been a big part of the story. It's been up about 5 percentage points year-over-year each quarter in fiscal '13. Amy, I'm just wondering as we look forward to fiscal '14, can we expect it to increase at that clip or is the software assurance attach rate now getting high enough that, that mix shift should start to moderate?

Amy E. Hood
Executive VP & CFO

Yes, we've -- I continue to believe we'll have double-digit annuity growth next year, so I think that shift you've seen, especially as we continue to move people to our cloud services, will continue.

Chris Suh
General Manager of Cloud & Enterprise Finance

Okay. So that will wrap up our Q&A portion of today's earnings call. We look forward to seeing many of you in the coming months at various investor conferences and at our Financial Analyst Meeting to be held in late September, where we'll share more details about our long-term strategies, new organizational structure and outlook for the rest of the fiscal year. Thank you, again, for joining us today.

Operator
This concludes today's conference. Thank you for your participation. You may disconnect at this time.