Microsoft Corporate Conference Call to Discuss the New Reporting Segments

Company Participants

- Chris Suh, General Manager IR
- Frank Brod, Corporate VP & CAO

Other Participants

- Brent Thill, Analyst, UBS
- Gregg Moskowitz, Analyst, Cowen and Company
- Kash Rangan, Analyst, BofA Merrill Lynch
- Keith Weiss, Analyst, Morgan Stanley
- Mark Moerdler, Analyst, Sanford C. Bernstein & Company, Inc.
- Rick Sherlund, Analyst, Nomura Asset Management
- Walter Pritchard, Analyst, Citigroup

Presentation

Operator

Greetings and welcome to the Microsoft conference call.

(Operator Instructions)

As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Chris Suh, General Manager Investor Relations for Microsoft. Thank you, Chris. You may now begin.

Chris Suh {BIO 17955231 <GO>}

Good morning, everyone. And thanks for joining us on the conference call today. With me are Frank Brod, Corporate Vice President and Chief Accounting Officer. And John Seethoff, Vice President and Deputy General Counsel. 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 September 26, 2014.

During this call, we may make forward-looking statements which 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 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.

Last week, at our financial analyst meeting, our Chief Financial Officer, Amy Hood, shared with you our new reporting segments. Today, we will review these segments in more detail and we will provide the recasted fiscal 2012 and fiscal 2013 segment information. We will also discuss the key performance indicators, or KPIs, that we will be providing at our next earnings release in October. We are sharing these metrics today so that you will have a better understanding of the information that you will have available starting with this quarter-end.

On our website, Microsoft.com/investor, is our slide deck, which is intended to follow our prepared remarks. You can also find the related 8-K filing and our recast historical quarterly segment results on our webcast -- website. We will not be discussing quarter results or any topics other than segments and KPIs today. Our First Quarter fiscal 2014 earnings call is scheduled for October 24. And we'll provide the results for the quarter at that time. Thanks again for joining us today. And with that, I'm going to turn the call over to Frank.

Frank Brod {BIO 3446588 <GO>}

Thank you, Chris. Good morning everyone. We announced last week that we are changing our financial reporting segments, effective for fiscal year 2014. The new segments reflect the organizational structure announced in July and the view used by Management to analyze results and allocate resources. We had several objectives in mind as we thought through this new segment reporting structure. Our goals were to provide insight into our business model, transition and economics, to show progress against our devices and services strategy. And to deliver increased accountability on gross margins. Our new segments have been aggregated with similar product and service activities and gross margin profiles. For example, all hardware is now reported together in the hardware segment. This will enable us to better monitor and manage our businesses.

The accounting and disclosure rules also require that Microsoft report its results in the new segment presentation, beginning with the first period in which the business is managed on a new basis. So beginning in the First Quarter of fiscal year 2014, we are monitoring performance internally at a business group level that results in five new reporting segments plus corporate. On slide 5, for those of you who are following along, the five segments roll up into two broad groupings, devices and consumer. And commercial. Under devices and consumer, we have the hardware, licensing. And other segments.

And under commercial, we have the licensing and other segments. We will also have a corporate and other line, we will reflect one-time revenue deferrals and recognition here, including things like tech guarantees and presales prior to general availability of our new products. We will also continue to record corporate-level expenses that are not attributable to a segment here. We will report revenue and gross margin for each of these five segments. We will report operating expense and operating income for the devices and consumer group and the commercial group.

Moving to slide 6, from a reporting segment perspective, we have changed from a product view to one that is based on business model and customer segments. As you would expect, our accounting methodology has not changed. The revenue and cost of revenue, we will continue to directly attribute to the segments. Chris will walk you through the revenue product mapping in just a few minutes. For operating expenses, sales and marketing was previously directly attributed or allocated across the segments. These expenses will now be recorded directly or by identified customer segments.

In the past, the majority of our research and development expense was mapped by product, with some shared across segments. Now R&D will be primarily shared, with others mapped directly to the segment grouping. An example of direct expenses would be our Xbox First Party games. The value of that expense only accrues to devices and consumers. So it is appropriate that that expense is reported there.

The reason for sharing operating expenses across segments is that these expenses drive value across the platform as we seek to deliver seamless experiences across devices, whether on premise or in the cloud. In many ways, it is similar to our new organization, which is now aligned functionally rather than by product. The new financial reporting structure will provide our Company with more transparency, greater accountability. And better execution, not only for today. But also for the long term. So now, I will turn the call back over to Chris, who will provide further details.

Chris Suh {BIO 17955231 <GO>}

Thanks, Frank. In order to help you update your model from the old reporting segments to the new, we will now walk through the product mapping in detail. To help facilitate this discussion, I will leverage numbers we have previously disclosed, Unless otherwise noted, I will be referencing the Fourth Quarter of fiscal 2013. While the framework uses last Q4, you should be able to leverage the mapping to extrapolate to other periods.

So let's start with the Windows division here on slide 7. Last quarter, we reported that OEM revenue accounted for approximately 65% of the division's total revenue. And non-OEM accounted for the remaining 35%. All of the Windows OEM revenue is now reported in the devices and consumer licensing segment. Non-OEM revenue included surface devices and accessories, Windows volume licensing, hardware such as keyboards and mice, retail Windows. And Windows services. Surface and hardware are now shown in the devices and consumer hardware segment. Windows volume licensing is primarily reported in commercial licensing.

There is a small portion related to academic or students, which will be included in devices and consumer licensing. For retail Windows, approximately 90% of it will be reflected in devices and consumer licensing. The remainder that is reported in devices and consumer other is related to the retail versions of Windows sold in retail stores. And finally, Windows services is 100% reported in devices and consumer other.

Okay, now let's move to slide eight to discuss Server and Tools. This one is a little bit easier. As we've discussed previously, product revenue, including transactional and multi-year licensing, was about 80% of the division's total, while enterprise services was the remaining 20%. Going forward, all of our traditional licensing, including server and CAL, will be mapped to commercial licensing. Enterprise services and Azure will be reported in commercial other. Okay, moving to slide 9. For the Online Services Division, Bing and MSN will now be 100% reported in devices and consumer other.

Slide 10. In the Microsoft business division, business revenue accounted for approximately 85% of the division's total, with about 70% related to annuity sales and 15% being transactional. For annuity revenue, most of this revenue is now reported in commercial licensing, with the exception of Office 365 and Dynamics CRM Online, which will be reported in commercial other. All of the non-annuity or transactional sales go to commercial licensing. For consumer revenue, which accounted for roughly 15% of the total, is largely mapped to devices and consumer licensing. The portion related to Office 365 Home Premium. And retail stores, are now in devices and consumer other. As you look at prior periods, keep in mind that the strength we have seen in our business annuity revenue in recent quarters has resulted in business revenue becoming an even greater percentage of the revenue within that segment.

For our Entertainment and Devices Division, Xbox revenue now lands in two segments, console revenues, Xbox LIVE subscription. And second and third party games are all recognized in the devices and consumer hardware segment. We do include the Xbox LIVE and games revenue together with the console, as these businesses are inherently linked to the Xbox console itself. First party games and marketplaces, such as Xbox LIVE transactions, are reported in the devices and consumer other segment. Windows Phone and IP licensing are mapped to devices and consumer licensing. Skype will be reported in the commercial licensing segment, consistent with the opportunity that we see within the commercial business as we bring the technology and products of Lync and Skype together.

Okay. So that's the detailed mapping of the old to new product mapping. Starting with the old segment first, on slide 12, we bring it all together, now organized into a new segment view. We think this is a helpful view that shows both the movement in the numbers across a single table. And the underlying logic also becomes evident in this matrix view as well.

Okay, I'm going to move now to slide 13. We want to provide you with a preview of our updated KPIs. The best starting point for a thorough KPI discussion is to put them in the right context. With each quarterly earnings release, we share our results in a variety of ways. Our earnings press release, a slide deck of quarterly results, our earnings conference call. And in the MD&A section of our quarterly filings. Across these various components, we provide our actual financial results, as well the material drivers of business during the quarter.

The KPIs are intended to be metrics that supplement the information we provide in the earnings release and MD&A. The goal is to provide additional insight that helps you understand our results. And also to gauge the progress we're making as our business continues to evolve. We believe that in total, the information shared across our earnings results, the MD&A, supported by KPIs. And combined now with the addition of gross margin reported by segment, provide for a fairly comprehensive and meaningfully improved way to understand how our business is doing.

So let's get into the details by starting with slide 14. I'd like to spend the next few slides talking you through what is changing in the rationale. To ease an understanding of the changes, these slides have been structured to start with the old KPIs structure in the old segments. And then show you what has changed and what has not. On this first slide are the KPIs that are consolidated across Microsoft. At the all-Microsoft level, we have historically shared with you bookings, unearned revenue by segment. And the contracted not billed amount. For FY '14, we plan to keep all of these KPIs. The bookings and unearned revenue are good representations of the health of our business beyond the current quarter.

The contracted not billed balance, as you know, is the amount associated with multi-year (technical difficulty). These KPIs together, we believe, are helpful, especially to understand how much of our business continues to shift toward annuity and subscription billings and recurring revenue streams.

Now let's go to slide 15, which, along with slide 16, are the segment-based KPIs. For Windows, we are providing the following additional KPIs. First, within OEM revenue, which is now reported in devices and consumer licensing, we'll share with you the growth of Windows Pro and Windows non-Pro revenue. Second, in the commercial licensing segment, we will provide you with the Windows volume licensing revenue growth. These KPIs together will give you a fairly comprehensive way to gauge the health of the Windows business. Also, starting in Q1, we will report quarterly the revenue derived from our Surface products and related accessories as well.

For the Microsoft business division, we remain largely unchanged from the current disclosures of consumer and business office and Microsoft business solutions revenue. However, we are adding two important new KPIs, both related to our fast-growing Office 365 business. First is the Office 365 Home Premium subscriber growth. At our analyst meeting, Amy announced that we had reached the 2 million subscriber mark for our consumer offering. The second is Office 365 commercial seat growth. These are primarily sold as part of a multi-year licensing agreement different from the consumer subscription. And hence we thought it was valuable to provide this separately. For server and tools, we continue to provide you -- we will continue to provide you both product and enterprise services revenue growth metrics.

Now let's turn to slide 16. For entertainment and device (technical difficulty), we will continue to report Xbox console unit sales volume. Xbox LIVE and Skype are both big services with many millions of members and users. And as such, we will continue to provide updates for the user account as part of our earnings release materials when we achieve notable milestone levels. Finally, online services. We will enhance the current KPIs with the addition of our search share in the US.

Okay. So that's a lot of detail to walk through. Let's look at slide 17, where we put it all back together in the new segment taxonomy. And this is what it looks like. The blue items represent items that are new or materially changed. And we do think it is a good step function improvement versus our current KPIs. And it does supplement the rest of the earnings disclosures in a way that is both helpful and meaningful.

Finally, let's move to slide 18, which is our final slide before taking questions. We are now less than one month away from our Q1 earnings release, earnings release date October 24. On that date, we will report our results of the new segments, including all filings, commentary. And any forward-looking statements. At the same time, we will publish the new KPIs, starting with the Q1 results. And as we've previously said, we will still provide a supplemental table of the Q1 results in the old segments to ease the transition and help bridge back to any forward-looking statements we made last quarter. So with that, Frank and I will take some questions. Again, please limit your questions to items covered only in today's call. Operator, please go ahead and repeat your instructions.

Questions And Answers

Operator

(Operator Instructions)

Brent Thill, UBS.

Q - Brent Thill {BIO 1556691 <GO>}

As it relates to your guidance and how you expect to get back, going forward, you historically have given some metrics around each of the divisions. Is that -- in the new reporting segment, is that the way that you anticipate helping the street understand your forward look, as well, going forward?

A - Chris Suh {BIO 17955231 <GO>}

Yes. When we publish our results in Q1, we will -- any forward-looking statements that we make with the Q1 earnings will be discussed within the construct of the new reporting segments. And so very similar to the old segments. But updated for the new taxonomy.

Operator

Walter Pritchard, Citigroup.

Q - Walter Pritchard {BIO 4672133 <GO>}

I'm wondering, Frank, if you could talk about the other allocation you had before, how large you expect the other allocation to be here on expenses going forward? And any changes you have made in terms of that bucket, given all the new segmentation?

A - Frank Brod {BIO 3446588 <GO>}

When you talk about the other allocation, are you talking about the other segment?

Q - Walter Pritchard {BIO 4672133 <GO>}

Yes. The other -- more the corporate overhead. Should we expect to see a similar amount of expenses attributed to corporate overhead? Or have you more granularly allocated some of the previous corporate overhead that you had in the past?

A - Frank Brod {BIO 3446588 <GO>}

You will see two separate allocations of other. One being at the gross margin level, which will be more of the adjustments for large GAAP deferrals, like revenue adjustments and all. On the operating expense side, I think you will continue to see the same sorts of expenses in there that we had before. That represents our corporate IT function. And finance. And G&A, finance and HR and things. So we really don't have any meaningful change in that -- in the way we're doing that. Corporate R&D had been in there, our basic -- the futuristic R&D had been there. Now that, because of the way our R&D is being managed across the entire platform, that is now being allocated.

Q - Walter Pritchard {BIO 4672133 <GO>}

Got it. Then just on Xbox, it looks like the game royalties in Xbox LIVE revenue is going into hardware, which is a little strange, given that those are royalty licensing type or subscription type revenue streams. That plus -- it doesn't look like you're going to be breaking out the Xbox LIVE base anymore in terms of the numbers. I'm -- it feels like we are taking the spotlight off of the Xbox LIVE. And -- which has been a nice growing revenue stream. I'm just curious, the rationale behind that.

A - Frank Brod {BIO 3446588 <GO>}

Our Xbox platform is monetized in several different ways. We sell the consoles. We sell accessories with that. We have a royalty model on second and third party games, which are sold utilizing our technology. And we have Xbox LIVE, which is primarily a subscription service. We look at those as being completely linked together. They don't function without each other. Xbox LIVE is a key component. It allows for multi-gaming for players. It provides downloadable game content through the store there. It also has the ability to bring in TV services as well.

But when you look at that together, that is all very much connected into our Xbox strategy. And it's the way that our management team looks at the business. It looks at it together. As -- what I will point out is, as the business evolves over time, the drivers of the changes in revenue and profitability will always be brought out. So you -- it's not like you won't hear about Xbox LIVE anymore. But you will hear about the Xbox platform in its total, especially as we launch Xbox One later this year.

A - Chris Suh {BIO 17955231 <GO>}

And -- this is Chris. I will just add to that, as I said my comments, we will continue to discuss and talk about the membership numbers and other momentum as part of our earnings materials, especially as we hit milestones. So okay. Thanks, Walter. We will move to the next question, please, operator.

Operator

Keith Weiss, Morgan Stanley.

Q - Keith Weiss {BIO 6993337 <GO>}

Thanks for doing this presentation. And giving us all this new information. Sounds like we're going to get a lot more visibility into the business. First, a high level question for Chris. As you were putting together this new reporting structure and the new segment structure, any high level trends that you guys were trying to highlight? Or do you think it better exposed to this reporting structure that you would like to make us aware of?

A - Chris Suh {BIO 17955231 <GO>}

Yes. Thanks, Keith that's a good question. I think probably the most important nail[ph] that I will call out is the change to gross margin as part of each reporting segment. Gross margin really is the primary financial measure by which we are tracking the health and the performance of each of these businesses. And as you can see, the way that we've structured these segments, you can see actually fairly different gross margin profiles in each of the segments. And I think that is a good and clear metric for you to be able to watch over time, to see our improvement in gross margin, both from a percentage and a dollar perspective. So I think gross margin is really the thing that I would highlight as the incremental improvement in transparency and accountability in the new segments.

Q - Keith Weiss {BIO 6993337 <GO>}

Got it. And is there any chance that we will see any -- for the new KPIs that your guys going to be giving out on a go forward basis, any chance we are going to see any historical data sets on where those KPIs had been over the past year or so?

A - Chris Suh {BIO 17955231 <GO>}

Yes, I think where it makes sense, we will do so. Some things just -- looking back at historical growth rates don't make sense, like I'll take Office 365 Home Premium. Given that it's only really several months old now, we don't -- the growth rate going back eight quarters will either be nonexistent or not meaningful. So to the extent that it's an appropriate and meaningful metric, we will definitely give historical context on it.

Q - Keith Weiss {BIO 6993337 <GO>}

Got it. And then maybe if I could sneak one last one in. When you guys closed at a Nokia devices and services transaction, am I thinking about this right? That you're going to have a big chunk of revenue that is currently in devices and the devices licensing that's going to move into the hardware bucket? And once comes on board? If you just give us an idea of how that would slot into the new reporting structure?

A - Chris Suh {BIO 17955231 <GO>}

When you talk about movement, are you saying any current revenue that we generate as a royalty from Nokia?

Q - Keith Weiss {BIO 6993337 <GO>}

Yes, I'm thinking that Windows phone licensing moves from one bucket into the -- from the licensing bucket into -- that would then be a hardware bucket? If you're selling -- because then you would be selling the whole device.

A - Chris Suh {BIO 17955231 <GO>}

The hardware, no -- I think -- the first point is, I think it's probably too early to say definitively. But I don't -- I think the best way is to, once we close the transaction, we will definitely update it. I think it is not unreasonable to think the hardware will land with hardware. But I don't have any definitive statement on the royalty piece of it that we currently get, that we'll have to sort that out once the transaction closes.

Q - Keith Weiss {BIO 6993337 <GO>}

Just conceptually, wouldn't that be similar to a Surface device? Let me try to understand. When you sell a Surface device, does the operating system on top of the Surface device, that all goes into DNC hardware?

A - Chris Suh {BIO 17955231 <GO>}

That is true.

A - Frank Brod {BIO 3446588 <GO>}

(multiple speakers) We have -- yes, let -- Chris, maybe I can help you with that. Today, we do move product from one segment to another. So a Windows license would go in -- so what we do is value that license at a cost basis, moving from one segment to the others. So there is a small amount of inter-segment revenue today. We will have to look to see, now that that becomes more expensive after the Nokia acquisition, whether we look at that policy. And look at what the most appropriate inter-segment pricing would be. But the -- I would suspect it would impact both the -- where the phone revenue is recorded as well as the hardware revenue.

Q - Keith Weiss {BIO 6993337 <GO>}

Okay.

A - Frank Brod {BIO 3446588 <GO>}

But we will let you know after the acquisition is concluded.

Q - Keith Weiss {BIO 6993337 <GO>}

Yes. Okay. So just so I'm clear on it. So when you sell a Surface device, there is some portion that is going to D&C licensing?

A - Frank Brod {BIO 3446588 <GO>}

There is, yes, a small portion.

Q - Keith Weiss {BIO 6993337 <GO>}

Okay, even though it's -- you're not OEM-ing. It's yours.

A - Frank Brod {BIO 3446588 <GO>}

That's correct.

Q - Keith Weiss {BIO 6993337 <GO>}

Okay.

A - Chris Suh {BIO 17955231 <GO>}

Jessie, can you move to the next question, please?

Operator

Mark Moerdler, Sanford C. Bernstein & Company.

Q - Mark Moerdler {BIO 16855032 <GO>}

A couple quick questions. On the commercial side revenue growth, is that going to be a dollar amount or a percentage growth? And which products are included in that?

A - Chris Suh {BIO 17955231 <GO>}

It is a percentage growth. And it is comprised of all of the commercial cloud offerings that are reported in the commercial other segment. So that primarily includes Office 365, Azure. But also Intune, CRM Online. It is the aggregation of that. We -- it is a good measure of the performance of Microsoft's commercial cloud business, if you think about us as a leading cloud vendor for business customers around the world.

Q - Mark Moerdler {BIO 16855032 <GO>}

Okay. So that will be year over year growth and similar to that?

A - Chris Suh {BIO 17955231 <GO>}

Yes.

Q - Mark Moerdler {BIO 16855032 <GO>}

Okay. And on the MDD ones, on the Office, both of those are seats and a percentage growth, correct? Rather than a dollar amount?

A - Chris Suh {BIO 17955231 <GO>}

Yes. Those are seat growth totals, not revenue. And the seat growth -- for the Home Premium, we did talk about hitting the 2 million mark very recently. And so that's a good starting point, there.

Q - Mark Moerdler {BIO 16855032 <GO>}

Okay. And on the commercial seats that, if I have one product or I -- that -- the cloud -- the Office 365, or I exchange online, for example, where I have the desktop subscription, that counts as a seat. And if I have both, it -- that counts as one seat, right?

A - Chris Suh {BIO 17955231 <GO>}

Yes.

Q - Mark Moerdler {BIO 16855032 <GO>}

(multiple speakers) The cloud products or the SaaS? Yes.

A - Chris Suh {BIO 17955231 <GO>}

Yes. A seat is a seat, if you -- whatever form of Office 365 that you happen to subscribe to, a paid seat is a paid seat.

Q - Mark Moerdler {BIO 16855032 <GO>}

And whether it's cloud or whether it's subscription?

A - Chris Suh {BIO 17955231 <GO>}

Yes. If it's in within the Office 365 family, we would count it.

Q - Mark Moerdler {BIO 16855032 <GO>}

Okay. I did have one last question -- okay, thank you.

A - Chris Suh {BIO 17955231 <GO>}

No, go ahead -- you got half the question.

Q - Mark Moerdler {BIO 16855032 <GO>}

I'm just going to ask, (inaudible) get seats, whether you're going to (inaudible) re-use your normal (inaudible). For next quarter, which of these you're going to get some historical comparisons to?

A - Chris Suh {BIO 17955231 <GO>}

Yes, I think that will become clear. As I said a little bit ago, to the extent that it makes sense, if there is a good historical track record that fairly reflects the performance of the business. Like I said, some of these new business, having a growth number that is eight digits because it compares against, literally, an nonexistent number doesn't make sense. And it probably does is not helpful. So we would show it. But to the extent that there's an actual number that make sense, we will definitely show it.

Q - Mark Moerdler {BIO 16855032 <GO>}

Okay.

Operator

Kash Rangan, BofA Merrill Lynch.

Q - Kash Rangan {BIO 22095432 <GO>}

Hope you get some time off after investing the time to do this wonderful presentation. My question is on the gross margin variability. Looks like, on the gross margin side, you've got the devices and consumer hardware. You've got Azure and you've got online. To what extent are you guys going to be able to provide us some directional gross margin, considering there's a fair amount of volatility, variability in this particular aspect of the P&L? And also, just wanted to clarify with respect to your guidance. I think Brent asked this question. I just wanted to revisit that. Are you guys going to be framing your guidance based on server units, PC units, as you have done so the past? Or are we going to be constructing guidance in a different way?

A - Chris Suh {BIO 17955231 <GO>}

Okay. So I will start with the latter, which was the guidance question. We will be sharing the framework -- the business driver framework at our Q1 earnings. We will try to provide as much color as we can across the different things that drive the performance of the business. But I don't have the specific metrics and measures to share with you today on that one, Kash.

On the first question about -- I think your question was, are we going to provide some sort of a road map on gross margin? And I will say that I think the new addition of gross margin into the P&L's does help you see the performance of these different buckets of categories, if you will, of products. So hardware different from traditional licensing and different from services. And I think, over time, you'll be able to see if we are making progress from a gross margin percentage and a gross margin dollar perspective. I don't anticipate at this time that we will provide a specific number as a road map. But we will continue to evolve our thinking on that over time, I'm sure.

Q - Kash Rangan {BIO 22095432 <GO>}

Got it. Just if I could follow up very briefly. I know that -- I respect the fact that you may not be able to provide a gross margin guidance. But are you able to qualitatively talk about the trade-offs that you're willing to make? Are you going for share on the Nokia side or share on the Surface side, at the expense of some short-term hit to gross margins? I'm just wondering if there are ways to think about how the margin outlook for the Company progresses?

A - Chris Suh {BIO 17955231 <GO>}

Yes, I think it is a good framework. I think it is good for us to talk about the things in each of these categories that drive our margin performance over time. Amy talked about it at the analyst meeting, which we talked about specific to Azure and the capital expenditures. And how we are investing in some sense ahead of the curve. And that does result in some near-term margin pressure. But over time, as that business gets to scale, that we anticipate the margins improving. So that is the type of rationale and logic I think that we can apply to help you all -- share with you the way that we think about things. And obviously, as we get more -- as we all, you with us, get more and more accustomed to talking in the new framework, the new reporting segments will continue to evolve and improve, hopefully, over time as well. Next question, please.

Operator

Gregg Moskowitz, Cowen and Company.

Q - Gregg Moskowitz {BIO 5721834 <GO>}

First question is the expected revenue recognition of unearned by quarter that you will be providing. Will that be over the next 12 months, the remainder the current fiscal year, or some other period of time?

A - Chris Suh {BIO 17955231 <GO>}

That is a four-quarter, forward-looking recognition schedule.

Q - Gregg Moskowitz {BIO 5721834 <GO>}

Okay, perfect. Then going back to cloud, we all know that revenue is a lagging indicator for any subscription business. You mentioned that you will be providing commercial cloud revenue growth. But why not report commercial cloud bookings growth as well?

A - Chris Suh {BIO 17955231 <GO>}

It's part of the total bookings growth. But it is good feedback. We will take it under -- we will go back and take it under advisement. And take a look and see if there is a meaningful breakout of the bookings that may make sense and be helpful. And we can talk about it, maybe, on some of the earnings calls. But it is good, Gregg, I will make a note of that.

Q - Gregg Moskowitz {BIO 5721834 <GO>}

Okay. Great.

A - Chris Suh {BIO 17955231 <GO>}

Operator, I think we have time for one more question, please.

Operator

Rick Sherlund, Nomura Asset Management.

Q - Rick Sherlund {BIO 1504922 <GO>}

This is one of interpretation. I'm looking at slide 21. It shows hardware gross margin going down from 2012 to 2013 quite a bit. So maybe if we can drill into that number and understand that a little better. I think you probably have the charge, $900 million on Q4 charge. And that, I presume, for Surface. Xbox units were down. So there is less of a hardware gross margin -- gross profit contribution. Xbox LIVE would have grown. The second party titles -- software titles were down year over year. So that might have contributed to it as well. I'm just curious what that number is telling us? I think if I -- as I analyze it, it looks like there are parts of that business that have lower gross profit contributions. But first, I guess, is the charge in there? And is there anything more you can comment on in terms of the hardware piece itself. And what this might be telling us about the margins on the hardware side?

A - Chris Suh {BIO 17955231 <GO>}

Yes. The first off, yes, the charge is charges included in there. And so that is one of the drivers of the margin -- year over year margins that you are seeing there. So the $900 million charge that we took a couple quarters back is reflected there. Then I think you are actually hitting on the right things. What is going on with Xbox, as we get closer to end of a cycle on the current console, as well as the implications -- or the impact of Surface. Those are the two things that I would point you to. I think you are spot on.

Okay. Thank you. Thank you, all. So that wraps up the Q&A portion of today's conference call. Thanks, everyone, for joining us today. And thanks for your participation. If you have any follow-up questions, as I suspect you will come as you are updating your models, please do reach out to the IR team. And we will be happy to help where we can. Okay. Thanks again, everyone. And we will talk to you soon.

Operator

Thank you. Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time. And thank you for your participation.