Greater Speed, Efficiency

Company Participants

- Amy Hood, CFO
- Frank Shaw, Head of Corporate Communications
- Julie Larson-Green, EVP Devices and Studios
- Kevin Turner, COO
- Lisa Brummel, EVP Human Resources
- Qi Lu, EVP Applications and Services
- Satya Nadella, EVP Cloud and Enterprise
- Steve Ballmer, CEO
- Tami Reller, EVP, Marketing
- Terry Myerson, EVP Operating Systems
- Tony Bates, EVP Business Development and Evangelism

Other Participants

- Adrianne Jeffries, Media, The Verge
- Brent Thill, Analyst, UBS
- Dina Bass, Media, Bloomberg News
- Edwin Chan, Analyst, Reuters
- Heather Bellini, Analyst, Goldman Sachs
- Janet Tu, Media, Seattle Times
- Juan Perez, Media, International Data Group
- Richard Waters, Analyst, Financial Times
- Walter Pritchard, Analyst, Citi Research

Presentation

Operator

Good afternoon. Welcome to the Microsoft conference call. This call is being recorded. At this time, all lines have been placed on listen-only mode. Following the Company's remarks, there will be a few minutes for questions. Speakers will only address questions that are specific to today's news. Please avoid long or multi-part questions.

(Operator Instructions)

At this time, I will turn the call over to Frank Shaw, Head of Corporate Communications. Sir, you may begin.

Frank Shaw {BIO 19408024 <GO>}

Thank you, operator. And thank you, everyone, for joining us this afternoon. With me today are Steve Ballmer, Chief Executive Officer. And the Microsoft senior leadership team. We are glad that we have this time to share a little bit more of the thinking behind the changes we are announcing. And what they mean for our future. And with that, I'd like to turn it over to Steve who will make a few prepared remarks. After that we will open it up for questions.

Steve?

Steve Ballmer {BIO 1390481 <GO>}

Hi, thanks, everybody, for joining us today. And it is great to have a chance to chat with you, along with our leadership team. This is certainly a big day for all of us. During today's call, we thought it would be valuable to share with you some additional context on the announcement. And then have a chance to take questions.

Over a year ago, we started a shift in our Business to a devices and services company. Software development as a core asset, delivered through devices of our own and our partners, as well as services. Since then, we've shipped a lot of great products. We launched Windows 8, Surface, Windows Phone 8, Office 365. And we very significantly advanced Windows Azure. We brought a consistent user interface to PCs, tablets, phones and the Xbox. And connected all of the content customers care about in the cloud via SkyDrive, all while moving to continuous product cycles.

However, we are excited to deliver more. And to do it with even greater speed, efficiency and capability. To do this, we really wanted to refine both our mission and the strategy that we've laid out. And then put in place the right structure to execute against that mission. As we thought about our mission, we went back to what has been our core mantra for the last 10-plus years -- to help people and businesses throughout the world realize their full potential. That mission still drives us today. And it is core to who all of us are.

So going forward, our strategy as a company will focus on creating a family of devices and services, for individuals and for businesses, that empower people around the globe at home, at work and on the go, for the activities they value most. And I would underscore that -- activities people really value. That is at the heart and soul of what it takes to help people realize their full potential. We are a company who helps people get stuff done, when it comes time to lean in. Even if it is for serious fun, like Xbox, we are the company that delivers great high-value experiences for work and for play. We are going to do this by leveraging our strengths.

We've actually been in the business of thinking about devices for many, many, many years. Really, in a sense, Windows is the definition of a device called the PC. And we have had the great honor to be part of shepherding that forward for many years. Xbox -- a product we've had in market for over 10 years. We've certainly focused in on high-value experience through products like Office. And Skype, a more recent acquisition, which focuses in on the moments in life that are most important and most valuable. And we've certainly focused in on business and enterprise customers as well, through products like Windows Server and Exchange.

The form of delivery of our value will shift to really thinking about devices and services versus packaged software. But the focus in on the high-value activities in people's lives will not change. The frontier of high-value scenarios that we enable will continue to march outward. And we have strengths in proven capabilities on which we will draw to define new experiences in expression, meeting, research, tasks, the way corporate information gets managed and held securely. And much, much more.

All of this means that we need to move forward as one Microsoft with one strategy and one set of goals. We will have one approach to the marketplace, whether it is business partners, innovation partners, developers, IT people, or consumers. We will have one technology base to enable us in core areas, as opposed to two or more. We are one Microsoft.

The next thing we will do is ensure that every discipline -- legal, finance, marketing, business development, et cetera -- at Microsoft becomes stronger. And the best way to get strength in each discipline is to pull them together. In the engineering area specifically, the best way to get to one technical base, or one technology base, is to make sure that we are pulling together things. And having people collaborate where they need to, not duplicating efforts. And of course, investing in very strong engineering systems and tools. So we will pull together into fewer core engineering groups. And we will pull together all of the other functions, all of the other disciplines, under leaders who work for me directly.

In order to execute, then, on this One Microsoft strategy, we are organizing by discipline and by engineering area. Of course, at the end of the day, we have to deliver great products, a great family of devices and services. And experiences that help people realize high-value activities. So we will have teams that function across the Company and across engineering areas to deliver on a high-value experience or device type, like Windows, which literally has engineering content already today from our entire Company. And involvement from a variety of innovation partners. So we have the notion today that teams work across the Company; that is fundamental. But we will formalize, we will organize by discipline. And we will have product champions who bring together our cross-company teams to deliver our core products and high-value (scenarios).

Certainly the new organization structure introduces changes to many of our employees. However, perhaps the larger change to each employee's experience over time will be new ways of working. We have the most talented people in the

industry. Their ideas, passion, focus and energy are paramount to us delivering delightful new high-value experiences to the billion-plus people around the world who are customers today. And the billions more we aspire to serve. To harness all of that, we are moving forward and working in new ways.

With our employees today, we shared five characteristics that we want to embody in each and every one of us. The first is being nimble. In a world of continuous services, the timeframe for product releases, customer interaction and competitive response are dramatically shorter than ever before. And we need to make the right decisions. And make them more quickly, balancing all the customer and business imperatives.

The next is communicative. In the new rapid-turn world, we need to communicate in ways that don't just exchange information. But drive agility, action, ownership and accountability.

The third is collaboration. That means the ability to coordinate effectively with and amongst our teams and disciplines to get results, build better products faster. And drive customer and shareholder value.

The fourth is decisive. We have a clear strategic direction. We've laid it out -- One Microsoft, focused in on a set of high-value experiences, delivered through devices and services for businesses and consumers. But we need to now empower the employees who are closest to the customers to make decisions in service of that larger mission.

The last is motivation. Our employees are incredibly motivated by the real opportunity we have to impact positively the lives of our customers -- when they are doing the things that are most important. In our industry, every day brings more opportunities than the day before. But we do have such an amazing opportunity to make a difference in the lives of billions of people around the world. And that motivates us in a significant way. I'm thrilled when talented new hires tell me they joined Microsoft to change the world. That is what we do today. And that's what we are motivated to do tomorrow.

I hope this gives you a little greater perspective on where we are headed. And how we will get there. As I said earlier, it's a big day for me. And the women and men around the table who form the Microsoft leadership team. And we appreciate your taking time from us. We are ready to take Microsoft in bold new directions. And really delight both our consumer and business customers.

Thanks for your time. And we look forward to your questions.

Frank Shaw {BIO 19408024 <GO>}

Thanks, Steve. We want to get as many questions as we can. So please stick to just one question. And avoid long or multi-part questions. Operator, go ahead and repeat your instructions.

Questions And Answers

Operator

(Operator Instructions)

Brent Thill, UBS.

Q - Brent Thill {BIO 1556691 <GO>}

Thanks. Steve, if you could just discuss the impact to revenue and operating expenses. I certainly understand in the near time it won't have a dramatic impact. But how you think about this long term if your game plan plays out relative to the revenue and operating expenses.

A - Steve Ballmer {BIO 1390481 <GO>}

The key goal, of course, is to extend the impact we can have. And the efficacy, the innovation. And the breadth of footprint of innovation. Which is a real focus in on innovation and the revenue and profitability that goes with it. I will let Amy Hood, our CFO, fill in additionally.

A - Amy Hood {BIO 18040963 <GO>}

I think that is right. As we've said, this is really about setting us up for long-term profit growth. And I look forward and believe that this best sets us up to do that.

Operator

Dina Bass, Bloomberg News.

Q - Dina Bass {BIO 2507423 <GO>}

Steve, do you anticipate any job cuts as a result of this? For example, in the marketing area, you used to have a central marketing group and then marketing in the individual product units. Those are now being consolidated into one unit. Do you expect that will result in redundancies?

A - Steve Ballmer {BIO 1390481 <GO>}

We have no plans for layoffs. We certainly want to extend what we're doing. And we will -- obviously, part of a reorganization is mapping people to new and expanded needs. And we anticipate lots of opportunities to do that.

Q - Dina Bass {BIO 2507423 <GO>}

Thanks.

Operator

Janet Tu, Seattle Times.

Q - Janet Tu {BIO 19143062 <GO>}

Hi. I'm wondering how this reorg will be reflected in the financial reporting. And what will be the divisions in the earnings report when that's reported?

A - Amy Hood {BIO 18040963 <GO>}

Hi, it's Amy again. Obviously, we have an earnings announcement next week. We will be reporting using our current operating sections, as planned. Obviously, the requirement over a period of time is to report your business in a way that the CEO manages it. So as we go through this reorg and do the realignment, we will obviously investigate any needed changes over time.

Operator

Heather Bellini, Goldman Sachs.

Q - Heather Bellini {BIO 2268229 <GO>}

Hi, great, thank you. And congratulations on the announcement. Steve, I was wondering if you could share with us a little bit on how this realignment might enable you to change your go-to-market strategy on the device side of the business. In particular, things like Surface. And your ability to maybe embrace the partner channel a little bit more as a result. And maybe get involved in some bundled selling with some of your existing offerings like Office.

A - Steve Ballmer {BIO 1390481 <GO>}

Perhaps I'll let Tami Reller lead off. And then Kevin Turner also give some comment.

A - Tami Reller {BIO 1978866 <GO>}

Thanks, Heather. This is Tami. I think that definitely behind this One marketing strategy and organization that we have, we fundamentally believe we are just going to be able to go to market much more effectively in an integrated way. And I think that is something that our partners, whether it is retail partners or the OEM partners that we work so closely with, have been asking us to consider. It will help them be more efficient. And I think it will make us more effective in the field. And we think that is something that will help our sellers, whether they are Microsoft employees or our partners.

A - Kevin Turner {BIO 5265779 <GO>}

Yes. This is Kevin. On the first-party hardware side, as well as the third-party hardware side that we have, we are driving both changes in our go-to-market approach. We've retransitioned some people, repurposed some people around device selling. And we are also driving device quotas in addition to that -- something we haven't done in the past. You are also seeing us do some strategic partnerships with the likes of Best Buy and others, as well as our own stores, to be able to light up the scenarios and the experience and really get the learnings first-hand. So yes, we are really tuning the

go-to-markets. And radically changing them in some capacity to really ramp up the devices and services go-to-market.

A - Steve Ballmer {BIO 1390481 <GO>}

Maybe just one other thing I will add. On the OEM front work, our work with HP, Dell, Lenovo, I would say we have always had a very engaged relationship. But the level of engagement continues to dial up. The level of innovation in their devices keeps dialing up. Kevin and I were both just at our worldwide partner conference. Actually, many of us were. We had a device bar, we call it, at the conference that had, I think, 105 different devices from probably 15 different manufacturers. And I think we are starting to really see that shift from our partner base to a modern-looking device. It's almost hard to call the new Windows devices PCs in all cases. They look so different that, quote, traditional PCs. But it is good to see Windows and our OEM partnerships and devices with Intel processors changing so much. And adapting to the needs and changes in the world.

Operator

Walter Pritchard, Citi Research.

Q - Walter Pritchard {BIO 4672133 <GO>}

Thanks. My question is actually a follow-up to what was just asked on devices. Steve, you, even from your shareholder letter a year ago, talked about devices. And you now have a whole group focused on it with a competent leader. And it just seems, though, the footprint out in the market today is relatively minimal, especially versus where it was five years ago. It hasn't changed a lot. And I'm wondering, as we think forward to the next -- I think at (Lafayette) you've added Windows abstractly as part of the device portfolio you have. As you look forward over the next three to five years, can you talk about how we should expect to see that device portfolio expand? I understand you're not going to pre-announce products. But just in an abstract sense how we should think about areas of the business where the delivery may include devices where it does not today. Thank you.

A - Steve Ballmer {BIO 1390481 <GO>}

I think what we highlight in our communication with our folks is, whether it is the very smallest or the very largest device, we need to ensure that we see innovation in our operating system, in our partners' hardware. And in our own hardware to meet the opportunities that we see in the market for quite a broad range of device types. And with Xbox One coming to market here over the holiday season, with some of the work we've done with Surface, with some of the work our partners Nokia has done with the incredible line of Lumia phones, we certainly see an expanding breadth of Windows devices quite dramatically. And I would say, expect to see it. I can tell you one thing. If you want to have a knock down, gorgeous experience with an enterprise customer, you show them our 82-inch Windows 8 tablet, sometimes known as the PPI board. I don't fail to get every CEO who sees one to say -- get me one in my office. And oh, by the way, we better get the devices, the phones, the tablets, the PCs that work well with that. So you'll see us invest across a wide range of device types, both first party and third party.

Operator

Adrianne Jeffries, The Verge.

Q - Adrianne Jeffries

Hello, thanks so much. My question is, Steve, with Julie and Terry leading separate hardware and software teams, how do you feel you can bring devices to the market in a way that Apple and other competitors do? Will they work closely enough. And collaboratively enough, to compete with Apple?

A - Steve Ballmer {BIO 1390481 <GO>}

Yes, Julie and Terry will answer that.

A - Julie Larson-Green {BIO 17409552 <GO>}

I think it is a perfect way for us to approach it. Terry and I have worked together for a long time. We both have worked on the operating side, systems side. I've worked on the hardware side. And it is a good blending of our skills and our teams to deliver things together. So the structure that we are putting in place for the whole Company is about working across the different disciplines and having product champions. So Terry and I will working to lead delivery to market of our first-party and third-party devices.

A - Steve Ballmer {BIO 1390481 <GO>}

Yes. And maybe just also have Tony Bates add a little bit. Tony is going to have a critical role running business development and evangelism from a role with our hardware innovation partners, our OEMs. Tony?

A - Tony Bates {BIO 2499557 <GO>}

I would just add to that, as Julie alluded to this first party but there's also third party. And I think having a single, one, both interface to our key innovation partners. But, two, bringing together the way we think about offers without partners, is going to be absolutely critical. So when we think about how we work together, I think it is going back to one strategy, one team. So we are all going to be part of that and it is going to be critical that we have that interface going forward.

Q - Adrianne Jeffries

And is Terry there?

A - Terry Myerson {BIO 17496274 <GO>}

Yes. There is innovative ideas coming from our OEM partners. And Julie's team has some very innovative ideas. The platform needs to span from the PPI white board that Tony talked about, to Xbox, to our phones. And beyond. And so it's exciting to have all these hardware partners in the Windows ecosystem, or in the Microsoft ecosystem. And all the innovative ideas. And to bring it to market together.

Operator

Juan Perez, International Data Group.

Q - Juan Perez {BIO 1514756 <GO>}

Hello, thanks for taking my call. I assume that under the applications and services group, you have under that division consumer online services like Bing. And also the Office stack, including Word, Excel, as well as the server-side of products like SharePoint and Exchange. If you guys could comment on what the goal is there and what you hope to accomplish with that particular product realignment.

A - Steve Ballmer {BIO 1390481 <GO>}

Qi Lu will handle that one.

A - Qi Lu {BIO 21085704 <GO>}

Yes. Thanks for the question. If you look at our strategy, the key focus is for Microsoft to deliver scenarios to enable our users to pursue activities they value the most. The new groups, the application services groups for Bing, as you mentioned, our mission is always to help people not just find information but complete tasks. Because when people search, they always are doing research in a context of accomplishing a task. They look at the Office. Its strong set of assets enable people to get more done. Skyping, our new division, is a key asset to Lync, to connect all the people because you do all these things always in context of collaborating, sharing with somebody else. So from that perspective, the application services group's fundamental focus is to use all those assets to truly deliver high-value scenarios, enable our users to accomplish their goals doing things they value the most.

A - Steve Ballmer {BIO 1390481 <GO>}

One other thing I would add is, one of the technologies we believe in very much is machine learning. And we need to both develop more capabilities and serve our users through our applications, as well as make machine learning basically a strong service to support other developers. And maybe Satya can talk a little bit about where we are going with the cloud and some of the things we are trying to do as we learn from our own first-party applications.

A - Satya Nadella {BIO 3224315 <GO>}

Yes. Our strategy, as far as the cloud goes, it all stems for this One strategy and mission that the Company has. So if you look at our cloud footprint, in fact, it starts with all of the first-party applications, from Xbox Live to Bing to Office 365. So we build the cloud infrastructure and our data center footprint in support of our first-party application. That not only battle tests our infrastructure, which then we provide to our third parties, both as a public cloud service in Windows Azure, as well as our server products. And our server products are increasingly getting better because of that reinforcing cycle we have with our first party. And machine learning is one set of technologies that we learned in Bing. Now we are productizing as a set of services

inside of Windows Azure. And the data services that we have. And that is something that you will see in many other instances, as well.

Operator

Edwin Chan, Reuters.

Q - Edwin Chan {BIO 15265279 <GO>}

Hello, thanks for take my question. There is a sense out there that this being a growing level of, how do you say it, unproductive proliferation of red tape. And even a little infighting of past years that might have stifled time-to-market for product. To what extent was that a part of your thinking and planning this reorganization? And a follow-up question to that, does this effectively hand or direct control over the process to Steve?

A - Steve Ballmer {BIO 1390481 <GO>}

Let me maybe make a comment or two and then pass it to Lisa. We've spent, as a leadership team, literally hundreds of hours over the last six months further developing this notion of devices and services. What capabilities does the Company need to really execute well? What capabilities do we need in engineering, operations, sales? What is it in our business development function in order to reach out more effectively? How do we add depth to it? And we've really fleshed out what we are thinking about high-value activities, how do we really execute on it. Qi Lu likes to say we have to be more like a football team -- that is, we all play a specific position and we run every play together -- than we do like a baseball team where athletes are oftentimes more individual in their orientation, if you will. From strategy to execution, we have been driven on this thing. And I think that's quite important.

The truth of the matter is, a company this size doesn't run in any one person's brain. And in a way, it's a much better way to run the Company because now every day we have a whole group that is involved in the Company strategy, as opposed to just a handful of people who are involved in the whole Company strategy. And I think it let's us go stronger and deeper as a leadership team, frankly, than, let me say, our old approach. I don't know if Lisa Brummel maybe wants to make a comment or two.

A - Lisa Brummel {BIO 5121094 <GO>}

Yes, I will just add that I think bureaucracy stems from people trying to translate how they should work together. And when you have singular units, you have to put in a lot of translation layer. As we go to one strategy and one team, there's a lot less translation that needs to happen. And I think that's what you're going to see going forward.

Operator

Richard Waters, the Financial Times.

Q - Richard Waters {BIO 19196837 <GO>}

Thank you, hello. Does this mean that senior managers won't have direct profit and loss account responsibility that they might've had before? And if so, how are you going to hold people accountable? What kind of measures are you going to use? What kind of incentives and measures are actually going to make this new senior management team work?

A - Steve Ballmer {BIO 1390481 <GO>}

Suffice it to say, the level of accountability we all feel for the success of the Company rises when we all have to look at the Company's integrated profitability. I will let Amy talk a little bit about the concepts. I won't go into specifics. But the concepts in terms of how we are thinking. And there are pieces, obviously, that will have to have attention. When it comes time to how we're doing with our consulting business, which is a multi-billion dollar business that doesn't get discussed much, I think we're all pretty clear. Kevin's on point, he thinks about it, he lives it, he eats it, he breathes it, he sleeps it every day. And I sleep well knowing that. There will be pieces.

But I think the problem we've had, in a sense -- not the problem but the opportunity we have is, if you subdivide the thing into too fine a set of parts, you don't think about your R&D investments as a general corporate resource that should be repurposed and used very broadly. It is my resources, my business. And so this notion, even from a P&L and resourcing perspective, of getting to a more One Microsoft strategy, is very important. And yet we need to have strong financial accountability. Maybe Amy can talk about that.

A - Amy Hood {BIO 18040963 <GO>}

Yes. I would not say that, I wouldn't necessarily associate this new org chart to any reduction in accountability from a financial perspective. I think we have always thought about personal accountability around this table to product success. And I think that will not change in the new organizational structure. Steve's used words like that already. I think whether we call it accountability or a P&L or financial accountability, it will still remain just as it has in the past.

A - Steve Ballmer {BIO 1390481 <GO>}

In fact, I believe we have, because of the focus on increasing discipline expertise, particularly in the devices and services world, we have a basis to improve our financial accountability. Particularly in these new delivery formats, where, frankly, it is different to deliver something that has production cost, if you will, than it is software which basically has no production cost. And we are going to get excellent at that. And part of accountability and excellence is what drives us in this transformation.

A - Frank Shaw {BIO 19408024 <GO>}

Thank you very much. That wraps up our Q&A. We appreciate you taking the time today and the opportunity for us to talk a little bit more about what we announced today. And that concludes our event. Thank you.

Operator

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