Bank of America Merrill Lynch Global Technology Conference

Company Participants

- Bob Kelly, VP Server and Tools Business Development and Strategy Team

Other Participants

- Kash Rangan, Analyst, BofA Merrill Lynch
- Unidentified Participant, Analyst, Unknown

Presentation

Kash Rangan {BIO 22095432 <GO>}

Thank you. So much for coming out to our conference in muggy San Francisco. Delighted to be able to introduce our next Company. Bob Kelly, Corporate Vice President at Microsoft in the Server and Tools Business and (inaudible) in the IR Department. Bob's going to be talking about his business for about 15-20 minutes and then we'll open up for questions and answers. With that, Bob, take the stage.

Bob Kelly {BIO 16032998 <GO>}

Thank you, Kash, appreciate that. It's good to see everybody here. As Kash mentioned, my name is Bob Kelly. I've been at Microsoft for almost 17 years. I have done everything you can possibly imagine in the Server and Tools business. And it's a pretty wild time in our segment right now. And what I wanted to do is just set some framing essentially for you for how to think about the Server and Tools business. It's one of those, I'm expecting that since you're here you know it's not a little secret. But it's a little secret to the rest of the world about this business that we have that's almost $19 billion large. So let's tell you a little bit about what we see going on in the ecosystem.

But before I do of course, this presentation does in fact contain forward-looking statements. And so take them as they are.

There are a few things to remember about the Server and Tools business. The first is it's really a big business. It's a $19 billion business for Microsoft with a five-year CAGR of 11%. That's pretty stunning and if you look at underneath that, the hardware market this year, the server hardware market, is going to decline. So growing 11 points in a market that's actually declining is really pretty shocking. Very, very strong business for the Company.

Our contribution margin continues to grow year-over-year at nearly 50%. This is a very, very healthy business and getting healthier every year. There are six separate $1 billion businesses within the Server and Tools business. That is a remarkable statement. Having started on Server and Tools when Windows Server was shipping 3,000 units a month to a business that's now got six separate $1 billion businesses across the management, the database, the OS category and more, is a phenomenal achievement.

And yet we're also continuing to grow our share position. We have grown 4 points over the last year in Hyper-V market share. That's versus VMware and the market itself. SQL Server Premium, our high-end SKUs are growing greater than 20% over the last five quarters. And Windows Azure, if you will, the new addition to our portfolio has added over 50 services just over the last year. Remarkable, remarkable success story and actually one that we think is really just set for its next phase of growth.

There are some things I want you to understand though as we see them. Because I think for you to understand how we see them will help you frame up how you want to look at our success or our failures.

There are really four fundamental transformational trends that are occurring in the ecosystem. And these trends are all built off of sort of the underpinning, if you will, of the virtualization of compute, storage and network. The computer, storage and network virtualization.

These four trends you see outside the ring, they're very important because it's actually these trends that are forming the strategic direction that we're taking for the Server and Tools Business.

The first is these new social and app patterns. You see Facebook and Twitter and Pinterest and LinkedIn. Massive scale. But these new social and application patterns are really driven off of a whole new set of verbs like share. They have intelligence built into them. They auto-fill search. These are really intelligent applications that have a very new paradigm for how applications are being built. And it's not just consumer applications, these new kinds of apps are now finding their way into the commercial sector as well.

The data explosion. This is a staggering statistic. 90% of the world's data was created in the last two years. IEC is predicting 44X growth of data over the next five years. Now this could either be the most daunting thing that hits customers or a tremendous opportunity to drive new applications and new scenarios around insight. And that's how we're viewing it. We think there's actually this really unique opportunity where data becomes the new platform and the tools around data, the Office 365 and the BI category, really become very, very powerful for where the customers actually derive new value and new scenarios for their own businesses.

The consumerization of IT. How many of you are carrying a smart phone or an iPad? Or maybe even a Surface, dear God. Consumerization of IT is a reality. This is something that is so true -- every one of us is bringing these devices into the business and expect our applications to be there. This is a huge burden on IT. They have to build new systems to secure, to manage and stay compliant with corporate policy on devices they do not control. By 2015 it's forecasted that there will be more than 2X the number of smart devices than there are people on the planet. This is the new reality and business has to deal with that new reality.

And finally, cloud computing is just exploding like crazy, whether that's Windows Azure or AWS or Google's cloud platform or Salesforce or Rackspace, just tremendous capacity being built. When you have that much capacity with these other trends, you have a really unique opportunity to create new value and to go drive transformational change, both within the industry and within the customer.

Now, we are responding to this aggressively. And we call this cloud OS the modern platform for the world's apps. Fundamentally what's happening to this new world is going to require a new way of managing systems. A new way of deploying services. A new way of what today we think of as resource management that an operating system does, now at global scale. Now a system that's distributed across millions of servers in order to deliver against the needs of those transformational trends.

So this modern platform for the world's apps fundamentally transforms the data center. And I need you to think of the data center not just as the four walls that some customer owns. But instead the walls are now logical and they're now wherever their applications are. And so this new cloud OS has to take into account that the data center's being redefined.

It enables and empowers people centric IT. It turns out actually it's not just the devices that are important, it's actually the user experience. The user has now become the center of IT, not the other way around. For so long it's been that central IT made the decisions about what users did. In this new world, the users are making the decisions and IT has to deal with it. IT has to manage, secure and comply.

This new platform will unlock insights on any data, small, big, whatever kind of data you want to have. The key is insights. It's not about the data per se, it's really about what can we derive from the new patterns that are emerging and a new ability to actually see into shocking amounts of data that otherwise three years ago we would all thrown away and discarded. Now you can actually keep that data and actually do really interesting things to find out more about your users, about your business and therefore take better action.

And finally, this modern platform also enables a whole new class of business applications. This cloud OS is really a whole new construct. It's no longer thinking about things as a singular machine, it's now this vast distributed fabric that enables a whole new class of applications, a whole new case of user scenarios and in fact a new way of thinking about IT.

So what makes the cloud OS unique? Microsoft's approach to this, with this cloud OS, is to have one consistent platform that spans the customer's data center, our own data center and third party service providers. One consistent platform that allows the customer to deploy applications or solutions or infrastructure where they want to. But expect a certain level of consistency. This cloud OS enables flexible development.

What that really means is we will support not just dot net in a world-class way, we'll support running Linux on our fabric, we'll support PHP and Java. In fact, we do today at scale. Flexible development means also that the developer, the customer can build an application and decide where to deploy it later. That's the way the customer wants to build applications. They want to build them and deploy them wherever they see fit based on what their business needs are.

But this cloud OS also needs to have a unified management approach. Our unified management approach means a single pane of glass through which the Company can look at all of their assets, no matter where they're deployed, on their premises, on our premises or in third party. That is a really important part, because at the end of the day what today they think of as their data center, tomorrow is now just a logical boundary and they need to be able to manage all those assets through that one single pane of glass.

As part of that, they need a common identity fabric, meaning you need to be able to log into a set of assets that are deployed anywhere on the planet and be able to federate across multiple platforms. You need integrated virtualization across this platform, one that has the common layer for virtualizing any part of the stack on my premises, your premises or third party service providers and finding this complete data platform. So this cloud OS absolutely is unique because it actually enables this set of capabilities against the premises where customers want to deploy their applications and their solutions.

Now it's not just us talking about this, we have tremendous momentum. Tremendous momentum. What you're going to see on this slide is a lot of ampersands. What that really means is our approach is fundamentally an and approach, not an or approach. It's not the private cloud or the public cloud. It's not Microsoft or the service providers. We have fundamentally an and approach.

93% of the Fortune 1000 use Active Directory as a primary log in and our Windows Azure active directory has 265 billion authentications against it. It is the same software, with 3 million entities, corporations, businesses using Azure Active Directory.

46% of the databases deployed in the world are using SQL Server. And 300,000 SQL Azure databases in Windows Azure. Similarly on the 76% of enterprise apps are using Windows Server and we have over 100,000 websites hosted in Windows Azure. All of these are in. Our core strategy is to deliver a fabric that's cloud OS that allows the customer to deploy their solution where they see fit. And that's really

critical because the customers tell us every single day that IT cannot get in the way of them running their business. They must be able to actually do what they see fit, based on whatever rules or regulations they have in play.

We've had a tremendous year of product momentum, tremendous. Whether it was Windows Server 2012 or System Center 2012 where we neutralized the playing ground vis-a-vis VMware and have now a competitive offering to go take a bunch of share. Or SQL Server 2012, where we really upped the game and show significant revenue growth and share adoption in our database category. Or Windows Intune, our management server. A SASS offering for managing the PC environment. These are all tremendously successful products for us and are accelerating our growth in each of these categories.

And of course over the next 12 months we have significant products coming as well. In addition to those, as I said, 50 new services that we've delivered on Windows Azure this year, we just yesterday announced a whole new set of updates to Windows Azure as well at our Tech Ed event down in New Orleans. Windows Server and System Center Blue, which you've heard on the Windows client side of Windows Blue, Windows 8.1, there's also a server release coming at that timeframe where we will bring a bunch of the innovation that we have around Windows Azure into the server release itself. So that customers can take the advantages that we have of Windows Azure and deploy it on their premises.

SQL Server 14 has a feature called Always on Backup, meaning that it actually literally is doing a continuous backup into Windows Azure and the customer therefore has a disaster recovery solution built in the box. Cloud BI, visual studio, Windows Intune, all of these are key products that we will innovate on and reiterate on over the course of the next 12 months.

With that, that is a quick view of how to frame the Server and Tools Business through the lens of this cloud OS. There are lots of different categories we play in. The database category, the OS category, the management category. And we're incredibly successful. But as the world moves to these new demands it's imperative -- our customers tell us it's imperative that we have a fabric that enables them to deploy solutions anywhere they see fit.

So with that, I'm going to pause and we'll sit down and take some Q&A. Thank you.

Questions And Answers

Q - Kash Rangan {BIO 22095432 <GO>}

Thanks so much, Bob. So I'll ask a couple of questions and feel free to jump in with your questions as well.

We've heard a lot about as the work that Azure -- or you guys have been doing with Azure and Amazon Web Services has been talking about their infrastructure

(inaudible) strategy as well. How do you see Azure playing alongside AWS? Is it going to be a head-on conversation or are you guys in different segments of the market? How do you see your unique strengths and points of differentiation versus Amazon Web Services?

A - Bob Kelly {BIO 16032998 <GO>}

I see a couple of different things. One is the first and foremost there are lots of buzzwords around cloud. Infrastructure as a service, platform as a service, software as a service. They're all different ways of thinking about the core capabilities, if you will, of the platform.

In real terms, infrastructure as a service is just sort of the current application model but delivered as a rented VM from the cloud. Platform as a service is a set of managed APIs. What Windows Azure does is it delivers both. We have a full set of platform as a service capabilities and a full set of infrastructure as a service capability, meaning that customers can actually deploy both the existing application model and the new application model into Windows Azure. So that's what it is.

We feel very good about what we've built. But the reason why we think we're actually going to be successful versus Amazon is really because at the end of the day we think we're targeting the enterprise customer first and Amazon is targeting the startup first. Those are two different starting points. I'm not trying to denigrate their business at all, they've done a successful job of really capturing momentum around the startup ecosystem. But the presence we have in the enterprise space, if Amazon owns the consumer credit card, Microsoft owns the enterprise credit card. And if we can establish this beach hold where customers can actually extend their data center into Windows Azure using IAS or pads, we think we have a really, really strong position and differentiated offer versus AWS.

Q - Kash Rangan {BIO 22095432 <GO>}

Got it. We hear a lot of private clouds, public clouds. You guys have a public clouds offering. You also have a product load offering which you enable product data centers to. Where do you see your customers spending most amount of investment dollars? Are they going towards public clouds or private clouds or what's interestingly called hybrid clouds? Which (inaudible) there?

A - Bob Kelly {BIO 16032998 <GO>}

Well obviously based on our strategy we think that the end state is some notion of hybrid, between our cloud, their cloud and a third party cloud. And given where we are in the life cycle, if you will, or the adoption of public cloud technologies, which is relatively early in its life cycle, the vast majority at least of the spend against Server and Tools, of the $19 billion, is on software that customers are deploying on their own premises. But we have very, very, very early signs of very strong momentum.

Last year I stood up here, I told you that we had 100,000 customers on Windows Azure. Today we have 200,000. We're adding 1,000 customers a day. We have 30,000 customers who have adopted our infrastructure as a service offering that

went live in April. We really just have seen tremendous momentum. We have 50% of the Fortune 500 who have at least one application on Windows Azure.

So we have very strong momentum. Additionally, if you look at all the software that we sell as cloud software for Server and Tools Business, either delivered through Azure or delivered through the service provider, that's over $1 billion in the trailing 12 months.

So we've seen really solid momentum. We have tremendous capability in private cloud and huge revenue and we're starting to see the early signs of software delivered through Windows Azure and through service providers getting to scale. So a long way to go. But really good start.

Q - Kash Rangan {BIO 22095432 <GO>}

As you look at the business model and (inaudible) when (inaudible) if you like, is (inaudible) a business model of Azure, the public (inaudible) offering versus the private is more ratable (inaudible) acquisition versus the license. I know that in your core Server and Tools Business the majority of the business is structured as a programming contract that's ratably recognized. But when you look a the incremental value of an Azure deal versus a regular Server and Tools deal, are you breakeven from a revenue dollar perspective, margin dollar perspective? What is it that you've gained? What is it that you give up? The puts and takes of that?

A - Bob Kelly {BIO 16032998 <GO>}

This is one of those questions where you know I'm not rally going to answer it.

Q - Kash Rangan {BIO 22095432 <GO>}

Yes.

A - Bob Kelly {BIO 16032998 <GO>}

I'm going to answer a different question. Put it in context. Today the Server and Tools Business, which is $20 billion revenue, is in a category of enterprise software of about $100 billion. That $100 billion participates in a total $2 trillion IT business. We think what's happening here is actually the entire $2 trillion is being dusted up. Entire $2 trillion is up for grabs. And there are going to be major winners and major losers in this transition. Okay? So we actually don't look at it as a cannibalistic or a substitution risk. We look at it as really significant potential for revenue and margin dollar growth.

Second thing to remember, every analyst I've ever looked at says about 70% of every enterprise IT dollar is going to maintaining existing systems and only 30% to new capabilities. So if you could unlock the ability to deliver the backlog of apps, there's huge opportunity there as well. That's what we're seeing. We actually see that this cloud thing is additive to our business, not subtractive. And because we have such a strong position on premises, with multi-year contracts, we're able to monetize that transition to the hybrid world very efficiently and very effectively.

So with the macro we're playing in a way bigger pool and we believe fundamentally that it's additive to what we're getting today. And we can transition at the rate the customer wants to. So for us it feels a win-win.

Q - Kash Rangan {BIO 22095432 <GO>}

And if you look at the large enterprise, we've got 7,000 of those using Azure. What are some of the applications and workloads they're running on Azure?

A - Bob Kelly {BIO 16032998 <GO>}

We're seeing everything, right? Obviously you see everything from Cheeseburger or (Zingali) consumer facing applications. Then you go into the core enterprise and you see applications like a company called EasyJet. EasyJet is a company in Europe that does basically seasonal flights. That's kind of the core business model. The way they used to have to do it before was in spring they'd ship a bunch of servers and people to a site in an airport, stand up systems, collect the fees, collect the tickets and then collapse it all and go.

Well now what they do is they actually have a handheld, a scanner. They use Windows Azure as a giant service bus in the cloud that's integrated with their mainframe. And so now they have this cloud fabric that allows them to completely transform their business using existing assets.

Or you've got companies like Milliman, who are doing Monte Carlo simulation where they actually need tremendous compute capacity. But only on demand. So they can stand up thousands of compute nodes, run a simulation, pass off the answer and deflate all those. Very, very different application patterns. But both very real.

We also see Boeing has built a consumer facing experience for immersive -- they wanted to show off the Dreamliner. So they wanted a consumer facing experience for how to sort of see what the thing it like. And they built this really rich client fed application. So everything and all the above. And we'll see more and more and more of the core, if you will, transaction capabilities of applications on prem moving to the cloud as well.

Q - Kash Rangan {BIO 22095432 <GO>}

Got it. The (inaudible) talk about and the industry itself has been talking about the management of an automation officer on top of the virtual machine installed. How big is your VM install base and how do you view the management opportunity? How is Microsoft going to monetize that?

A - Bob Kelly {BIO 16032998 <GO>}

If you look at IDC's data, IDC has Hyper-V share just north of 30% and VMware share just about 55%, if my number's correct. We. And as I said, we've grown a point a quarter over the course of the last four quarters. Aggressive growth and we will get to a point where in essence in the enterprise space it'll be two platforms. Customers will have a Hyper-V based world and an ESX based world.

The money is not in the hyper visor. The money is in the automation and in the management. Our systems and our portfolio, one of our $1 billion categories, is a very important piece of the way that we monetize. But more importantly it's also a very important piece of the strategy for this cloud OS.

The cloud OS, again has this construct of deploy the application wherever you see fit, whatever suits your need best. System Center is the single pane of glass that allows you to manage, monitor, provision, update all of those applications wherever they sit. So our strategy is really fundamentally about unlocking the power of that cloud OS.

A final thing I'll say is for those customers who do want to migrate off of a competing stack, System Center can manage ESX and can manage and provision that infrastructure as a customer decides to move over.

Q - Kash Rangan {BIO 22095432 <GO>}

Are you seeing customers do that?

A - Bob Kelly {BIO 16032998 <GO>}

We've seen a tremendous interest, let me say it that way because there's still -- we released 2012 last October-November. Tremendous interest from customers of moving off of or deploying next to ESX over the course of the next 12 to 18 months.

Q - Kash Rangan {BIO 22095432 <GO>}

Are you more bullish on the database industry or your vertical gain share in the database industry?

A - Bob Kelly {BIO 16032998 <GO>}

Absolutely the latter. The thing that's happening across the ecosystem is -- or I should have said both as an option. Well both is an option. But I think you have to say more. I think our -- look, if we -- our revenue is growing 20X %. If you look at the industry for the database category, it's growing 6%, 7%, 8%, somewhere in that range. So we're growing anywhere from 2 to 3X in that market. That's a good start, okay?

The competitors have a stronger position than we do in that category from a revenue standpoint. And so we have worked -- but very, very strong product, very strong momentum.

Additionally, as you look into the public cloud space, this is unlimited opportunity for us. And as applications kind of migrate to that new world of delivering databases of service, the whole notion of tier 1 apps gets disrupted. And the iceberg that Oracle holds in the enterprise will start to melt. And it will melt because the market's moving to the public cloud as a way to consume and deliver that service, not because we were chipping away at it.

Q - Kash Rangan {BIO 22095432 <GO>}

Before I turn it over to the audience, what are your thoughts on the open source initiatives, open stack, closed stack? What do you feel from your customers as to whether they want Microsoft participating?

A - Bob Kelly {BIO 16032998 <GO>}

I'd say it's a complicated answer. The first is honestly I don't think open stack has a chance of having any success in the public cloud. And the reason I say that is the economics of the public cloud are such that you have to be at extraordinary scale in order to derive and deliver those economics. It's just flat out true. And the only players that are going to be doing that at scale are the Microsofts, the Amazons, the Googles, maybe the Salesforces. But they're very, very few and far between. Because it's such a huge capital outlay. It is such a huge commitment.

So for someone to take -- for OpenStack to be successful in the public cloud, one of the bigs would have to take OpenStack and completely weld that thing to their offer. That's the only way it will ever get to scale and real usage in the public cloud.

Now if you look at the private cloud, I think actually OpenStack does have a likely shot at gaining some traction. And for somewhat good reasons. I mean the ecosystem historically has never wanted a one-horse raced. It prefers a two-horse race and if you could have a three-horse race, that'd be great. So I think that there will be enough momentum around an OpenStack like (Plaeda) from HP or from others for private cloud.

So very different dynamics. I like our chances in both worlds. But I firmly believe that the public cloud space is one that just won't have any momentum.

Q - Kash Rangan {BIO 22095432 <GO>}

And (inaudible) to the private cloud, are customers pausing because they're evaluating OpenStack? Would their assessment of the maturity of OpenStack, vis-a-vis your guys' product (inaudible)?

A - Bob Kelly {BIO 16032998 <GO>}

If someone could find me a customer who's deployed OpenStack at scale, I'd like to talk with them.

Q - Kash Rangan {BIO 22095432 <GO>}

Apparently eBay has been using (inaudible).

A - Bob Kelly {BIO 16032998 <GO>}

Who's that, eBay?

Q - Kash Rangan {BIO 22095432 <GO>}

Yes.

A - Bob Kelly {BIO 16032998 <GO>}

Yes, I know there are some. I know there are. I have not had the chance to talk to them because they're just hard to find. There's an awful lot of interest in OpenStack. There's not an awful lot of deployment. That's the big difference. And quite frankly, as it moves forward if it needs to have Hyper-V or System Center integration. And customers demand it, we'll do it. We're not afraid of that by any stretch of the imagination. I just don't see enough momentum behind it yet, I see a lot of noise.

Q - Kash Rangan {BIO 22095432 <GO>}

Got it, okay. At this point, are there any questions from the audience?

Q - Unidentified Participant

You're first to China with the Azure platform versus AWF. Can you talk a little bit about the partner that you chose and your expected uptake?

A - Bob Kelly {BIO 16032998 <GO>}

One of my core responsibilities is actually China and specifically for delivering a Windows Azure offering into China. The company that we've chosen to work with over there is 21Vianet. Essentially there are really four players you could work with over there. The telcos and 21V. And so in real terms, it was imperative that we work with a local company that's part and parcel of what it will take to actually operate in China to comply with local regulations, et cetera. And it was also imperative for us that we do so in a way that is actually beneficial to the ecosystem at large. And 21V is the number one non-telco hoster at data center operator in China. So we chose them for very specific reasons.

There is just unending upside for us in China. Unending upside. As all of you know, we have a massive piracy challenge across Microsoft software, particularly in China. Steve has said in times past that it cost the Company billions of dollars a year. That's a lot of profit. That could be utilized in lots of good ways. So it's much harder to steal a service than it is to steal packaged software.

So services are going to be absolutely key to our success in China. We're very, very excited about the early momentum. We have Coca-Cola, (inaudible), Redbox, a whole bunch of really great customers who have adopted us in China and hopefully later this year we'll be in general availability there.

Q - Unidentified Participant

Talk about the growth that you're seeing in Azure an the revenue growing and the opportunity for Microsoft. But when I think about it from a customer perspective, what is the ROI that customers are getting from going over to Azure and how does it compare to other platforms out there?

Q - Kash Rangan {BIO 22095432 <GO>}

ROI's a funny because at the end of the day they have to have something to compare it against. And really that's not how customers tell us that they're looking at Azure. What they're looking at Azure for is actually agility, not cost reduction. And actually it's because fundamentally they can't deliver what they need to deliver in the current construct. Even with server virtualization, it still takes too long to provision the environment, to provision the application architecture, et cetera.

If you had an instant on capability, then you can get to the application much faster. But that's actually the first thing we're seeing is actually agility, not like TCR or ROI. So very few of the customer (inaudible) look like that. Whereas all the on premise world looks like that. Tell me about the ROI, et cetera. So public cloud, at least from our experience, doesn't look like that just yet.

Q - Unidentified Participant

Given your relations -- I mean given your install base at how important you are on premise today, isn't that a little bit of a conflict of interest if you're, I guess, trying to free-up maintenance dollars? Essentially those maintenance dollars could have paid the guys that were -- buy your products or have them buying the products for decades. Isn't it a little bit of conflict of interest that you might have to manage or may not be best positioned to manage when you're trying to grow this essentially disruptive or really disruptive technology?

A - Bob Kelly {BIO 16032998 <GO>}

Again, it's not the kind of conversation we typically have with the customer. It really does turn out, everyone here is familiar with what Andreessen said, right? Software is going to eat the world. If you look at the $2 trillion of IT spend, the vast majority of it is in non-hardware or software things. It's in maintenance, it's in people costs. And all these things are actually -- software can automate. That's really the play. So it's not so much that we have a conflict of interest, it's really much more about the fact that where you talked about software automation, sometimes you do get people saying what does it mean for my job? Right? Do I have that problem?

But every time that this has occurred, more jobs have been created, not fewer. And what happens is you shift where people do their work. Why should people be doing the sort of plugging together of things if you could automate that? That's always been the sort of value of software in an IT.

So most of our conversations are more about what scenario can I unlock? Not if I use public cloud, do I have to lay off my IT staff? We rarely hear anything like that.

Q - Kash Rangan {BIO 22095432 <GO>}

I had a question on your growth rate in the business is far and above the server unit growth rate. Can you just help us break the gap between that growth rate and the server unit growth rate? What is that?

A - Bob Kelly {BIO 16032998 <GO>}

So there are a few things. I'm glad you asked this question because it's another important way to think about what's going on with Microsoft and how we're thinking about our play. Over the course of the last 18 months, we have fundamentally changed the way that we license our database and our OS/management products. The database was always licensed by the per PC or per box. We flip it to per core. On the OS, we went from per box to per CPU. Why?

With virtualization and core density, there was just so much more power out of each of these boxes. And so customers weren't having to buy as many boxes and therefore we weren't monetizing it efficiently. So by flipping the core and CPU, we actually are able to more efficiently monetize fewer boxes and we now have a common unit of monetization across the private cloud and the public cloud. Those are two very important parts of how we're going to market and how we actually drive more value. So even in a shrinking hardware market, we're monetizing more efficiently.

The second big thing that we've done is --

Q - Kash Rangan {BIO 22095432 <GO>}

More for the timing when you made the transition?

A - Bob Kelly {BIO 16032998 <GO>}

Well over the 12 and -- 18 months. Depends on which release we're talking about. SQL's about 18 months, (inaudible) Windows is about 10 months ago, okay?

The second big thing that is happening is we're seeing a tremendous shift to our premium SKUs. Through a combination of the density and the desire for customers to soak their boxes longer. And our licensing packaging around our premium SKUs is shifting our dollar per unit dramatically up.

Q - Kash Rangan {BIO 22095432 <GO>}

I'm assuming the rough map, you had about 200,000 customers for Azure, about $1 billion run rate. It's not a big amount of money per customer works at about 5,000 boxes. So I'm sure there's a pretty big distribution of customers that spend a lot more money, a lot less money. Where are we in the adoption cycle relative to a customer's IT budget and where is Azure slotted in? And how would a customer think about spending more money there for new projects?

A - Bob Kelly {BIO 16032998 <GO>}

I'll answer the second question first. It's absolutely for new projects. That's absolutely where we see the dollar slowing. Everyone's carrying these devices around, every app has to get mobilized, if you will. There's a whole new set of scenarios that are coming because of these apps. There's data and BI and just huge scenarios that are being unlocked. And customers are saying new apps. That's the first thing.

The second thing is, look, we are early, early, early in the cycle of a transition of $2 trillion. Even if you take AWS at $2 billion and you take us at whatever number you want to take us at, there's still a rounding error on overall category. So we are very early in this cycle, it'll play out over a long period of time. It's material but not material. It's going to take time for us to see this burn itself out.

Q - Kash Rangan {BIO 22095432 <GO>}

I'm surprised nobody asked about Rackspace. This is another infrastructure of the service company. What do you, (inaudible) is the lead analyst on this stock. Do you ever see Rackspace as a contender in the enterprise?

A - Bob Kelly {BIO 16032998 <GO>}

Well first of all, I love Rackspace. I mean they're a great company. I really do. And the reason I think they're a great company is because they have a very unique value prop, which is maniacal support. And there are lots of customers who will pay for maniacal support full stop. They don't have the technical capability, if you will, of a software driven company like us. But that's not the point. They have a very loyal customer base. Will they have penetration in the enterprise? Of course they will. Will they have the app scale advantages we have? No. They don't have the cost structure to do it, nor quite frankly do I think they have the appetite to do it.

So I think they're a real player, I like them. At the end of the day, I wouldn't trade my position for theirs.

Q - Kash Rangan {BIO 22095432 <GO>}

Got it. With that, that was very insightful. Thank you very much. Good to see the product of Azure and thank you as a customer coming out (multiple speakers).

A - Bob Kelly {BIO 16032998 <GO>}

Thanks, everybody. Appreciate it.

Q - Kash Rangan {BIO 22095432 <GO>}

Thank you for your time and presence as well. Have a great day.

A - Bob Kelly {BIO 16032998 <GO>}

Thank you.