

# Morgan Stanley Technology, Media & Telecom Conference

## Company Participants

- Andy Kearns, Analyst
- Keith Weiss, Analyst
- Qi Lu, EVP Applications, Services

## Other Participants

- Unidentified Participant, Analyst, Unknown

## Presentation

### Andy Kearns {BIO 19350899 <GO>}

Good morning, everybody. Welcome to the biggest technology media and telecoms conference in the industry. We are very excited to be getting going this morning. My name is Andy Kearns. I help run the global tech banking group here at Morgan Stanley.

Just some quick stats on the conference itself. We are up 25% year over year to an all-time high number of 1,300 investors who have registered and will be attending this event from all over the world. More than 250 companies will be presenting. And we've got very high representation at the CEO and CFO level with over 120 CEOs, 140 CFOs.

So kicking things off here, we've got a very strong market backdrop coming off of, I'd say, a very positive for the most part -- positive earnings season. The NASDAQ hit 5,000 this morning, as I understand it. So we are back to where we were last -- in March of 2000. In a much better place, by the way.

Morgan Stanley announced a couple of acquisitions this morning. We advise three scale on a \$16.7 billion sale to NXP Semiconductor. And we advise Mavenir on a \$557 million sale to Mitel Networks. So lots of kind of good, positive dynamics in place here.

So I'm going to kick things off with -- we've got Keith Weiss, who runs Americas research for us in the software area. And he's here with Qi Launch from Microsoft. Over to you, Keith.

### Keith Weiss {BIO 6993337 <GO>}

Excellent. Thank you, Andy. So we are very pleased to have with us this morning kicking off the conference, Dr. Qi Lu, who is the Executive Vice President of Microsoft Applications and Services Group. Before we get going, we have to read some safe harbors. Please note that all important disclosures including personal holdings, disclosures. And Morgan Stanley disclosures appear on the Morgan Stanley public website at [www.MorganStanley.com/researchdisclosures](http://www.MorganStanley.com/researchdisclosures) or at the registrations desk and (inaudible).

Before we begin, Qi may make some forward-looking statements during this presentation. And you should refer to Microsoft's SEC filings for the risk factors related to their business and whether you are here in person or listening on the Web.

All right. So with that out of the way, thank you very much for joining us again. You were nice enough to join us last year and came this year as well. There have definitely been a lot of changes at Microsoft over the past year or so. There's been leadership changes and new strategic vision, restructuring that was put into place. Can you, from your perspective -- from a leadership perspective -- can you describe what has changed for you? What is it like working at the new Microsoft now?

**Qi Lu** {BIO 21085704 <GO>}

First of all, thanks very much, Keith, for having me. And it's always great to have the opportunity to speak at this conference.

Just to elaborate my thinking on this, to come to the Silicon Valley Bay Area is pretty awesome -- almost every other week. A lot of my friends are telling me, hey, what's going on with the Renaissance Center [ph] with Microsoft? I think that's perhaps the way to think about it. There is a new beginning, truly a sense of this is a new era. Obviously, we have a new leadership team, we have a new CEO. But more importantly, let me share with you how I think about what's new and why it is driving so much energy and the positive progress at Microsoft.

First is clarity on positions and strategy. The new leaders, new leadership team, makes it very, very clear: let's go back to our Company's roots. Let's double down; let's focus. Our core D&A is productivity. So we made it very, very clear Microsoft is a productivity Company. And we are going to do so by doing also platforms. So it's a productivity Company and a platform Company. One of these being productivity for this new cloud first [ph] mobile portfolio -- that's very, very important.

The second piece of your question is from a leadership standpoint, what we've been focusing on across the Company is these three things in combination. One is driving clarity. Clarity on position on strategy is (inaudible) because with clarity you bring a lot more energy. Group clarity is number one. Number two is alignment. We need to align all our different business lines towards new positions, new strategies for our Company. And thirdly is intensity. The pace of all the programs is super-duper important. So that's number two.

Number three is focusing on delivering performance. Particularly from a business standpoint, there's a few things that we share with the larger investment community at what cost. One is our commercial cloud business is going through a very, very rapid pace of growth. Growing for six consecutive quarters, growing at the triple digits. And this is kind of continuing. And on pace to exceed our cloud commercial business for \$5.5 billion in annualized revenues. That's very, very important. The second -- while even for office consumer businesses, office, home. And the personal subscriptions is reaching 9.2 million subscribers. And we are growing quarter over quarter sequentially at the 30% pace. And the pace is accelerating. That's very, very exciting to see. And our annuity business is very strong; that's an indication of our customers have strong confidence in our future innovation agenda because that's why they buy annuities.

And another one to call out is our search business is going through also very, very healthy growth. We are growing year over year at the 23%. As we stated earlier from our CFO, we are going to reach profitability in the next fiscal year. In fact, we -- internally, we have been seeing the strong, positive trends. And the recent profitability is due to energizing events for the Bing team. The team is executing very, very strongly internally (inaudible). When we celebrate profitability, we are going to have a party, it's going to be a potluck party. We are going to maintain the strong discipline on controlled cost and while growing revenues.

To add those up, these are strong performance. But the last thing I want to call out is building future (inaudible). Our mental model is it's about delivering economic performance using today's earning engine. At the same time, we have to recharge battery to the earning engine. The earning engine is like a battery: if you drive a lot of performance, you have to recharge them. And at the same time, building new earnings engines; that's super, super important.

And as for focus on user and the usages. Because in cloud-based businesses, the consumption -- it's per user, per subscription. So how do we build a new muscle from R&D, from go-to-market, from sales in our field in many ways -- they used to sell licenses -- now selling cloud. But how do we drive usage, adoption, consumption? That's about building future (inaudible). So the combination of these four, I will repeat -- the new positioning of the Company focusing on productivity, platforms. The second is across Company driving clarity, alignments. And the intensity and delivery of performance and building future strength on driving use and usage. As the combination of these four, that's why you see the positive buzz as people at the Company, outside the Company -- that's a genuine very positive trend for the Company.

## **Keith Weiss** {BIO 6993337 <GO>}

Maybe to dig into the cloud services or the productivity side versus the platform side, when I talk to investors about the devices and services strategy, I think investors have a very positive view on cloud services. And we use an abundance (inaudible) cloud services, although perhaps a more pessimistic view of the prospects on the devices side, particularly in mobile. Why is it so critical that Microsoft has a play in mobile, that they have a mobile operating system themselves versus leveraging

some of the other platforms that are already existing out there with your cloud services?

**Qi Lu** {BIO 21085704 <GO>}

Keith, this is very good question. I believe actually we speak about this particular topic even last year. So there are a couple of dimensions I will share our thoughts. One is, our belief is our industry is in a phase -- at the phase whereby vertical integrations -- meaning that innovation across the boundary of hardware, software, operating systems, application of services can unlock a lot of end-user value and economic value. And there's many, many examples where this (inaudible) Microsoft can also point to by -- companies by driving integration across these boundaries. We see opportunities for Microsoft to be the main principle in Windows operating systems, in our first-party devices and driving end-point innovation using our services.

I'll give you one example. I see some people using Surface Pro 3. And that's one example of if you want to have the best inking experiences (inaudible) -- if you want to ink, to annotate, to capture, Surface Pro 3 across the board is by far the best experience. And that's just one of the many, many examples we are thinking driving innovations. And that's why we remain strong in principle using -- building our mobile devices, building our mobile businesses.

At the same time, it's also important for me to point out this -- we are also making our services available on other mobile platforms. Particularly for my group, we have been investing substantial engineering resources, product energy. So that we can deliver leading productivity experiences on our OS and on Android. For example, on our OS devices, our mobile downloads already exceeds 80 million user downloads and the numbers keep growing. And we recently announced that we have our Office for Android tablets available, I believe, in January. Internally, we have quite a bit of investing R&D resources so that we can keep the pace of innovation but deliver our leading productivity services across all different mobile platforms, at the same time inside of Microsoft driving end-to-end innovation so that we can have the best, most complete experiences on Microsoft's own operating system in the Microsoft first-party devices.

**Keith Weiss** {BIO 6993337 <GO>}

Got it. Maybe shifting gears a little bit, to drill down on Office 365, can you talk to us about how Office 365 has been tracking relative to you guys' internal expectations on both the enterprise side and the consumer side of the equation? Then I want to drill down a little bit on Enterprise.

**Qi Lu** {BIO 21085704 <GO>}

So in terms of driving Office 365 growth relative to our own expectations, we see very, very positive trends. On the commercial side, our focus, Keith, is driving adoption and the consumption. Because the game in cloud is different. It's less about selling licenses; it's about getting customers to migrate quickly and drive

usages and the consumption. And the specific focus is in the product and R&D side is making adoption a permanent part of the overall experience.

In the past, when we sold products, we used to have end-user experiences and IT experiences. We think in the future these barriers should not exist. There should just be one holistic experience; when end user adopts Office 365, the consumption adoption experience is all built in. So a lot of focus on driving usage and adoption.

And on the consumer side, we also need to do the same thing. But at the same time driving mobile end-point experiences so that product innovations can drive more usage adoption. Some of the product innovation was cutting us both across commercial side and the consumer side. One is Sway [ph]. Sway is a new operating product -- operating services -- essentially new (inaudible). You don't have file formats per se. It lives in the cloud. But it's a fantastic experiences. We have a mobile app. And we also have the Web experience as well. It enables you to author a document using very simple capability -- you can use camera, you can use ink, you can use voice, you can use all sorts of media. But the beauty is once you author it, it renders appropriate whether it's on a phone or a tablet or a large screen. The layout engine will automatically figure out what's the best way to showcase the document. That's one of the key innovations we tried to do.

Another innovation we should mentioned last year, Keith, I believe we talked about here is that the new product called Adell [ph]. And it's built on a new infrastructure called an Office Graph. If you think about; Office Graph is the first version of (inaudible). In a working environment whereby you can have a graph that has representation of people, documents, messages, work activities, events -- all those things are connected. And Adell is a product for the first time -- the document and the people -- the usages gets connected. And you can discover all the documents different people are using it. For example, (inaudible) a lot of people browse my clusters. Essentially, the document I am reviewing -- the trending documents people are sending to me with confidentiality, all these things being taking care of, people will see what kind of documents I am looking at. In (inaudible) that's huge because in the past you don't know what's going on -- what's trending -- what's important. Different teams -- that's the type of innovation that's really driving more adoption inside of commercial products and also across consumer products as well.

### **Keith Weiss** {BIO 6993337 <GO>}

With the consumer Office 365, the pricing of Office 365 pretty evident how Microsoft garners more value over the lifetime value of the product. The \$100 per year versus the average person buying \$250 once every five years. It's a little less clear on the enterprise. So while we see really good adoption in terms of CIOs looking to adopt Office 365, our most recent CIO survey showed 26% of CIOs using Office 365 today. Another 26% expecting to use it over the next two years. So great adoption trend. Can you talk just a little bit on how Microsoft plans to increase the lifetime value of those customers in terms of as an Office 365 subscriber versus having a licensed tied up in your enterprise agreement?

---

**Qi Lu** {BIO 21085704 <GO>}

Yes. This is, Keith, one of the key questions, both from product innovations and certainly from long-term value creation standpoint. There's a couple of things to emphasize here. One is the same service -- moving from on-premise service to the cloud would increase lifetime value by severalfold for fundamental reasons. One is, once it's (inaudible) services we immediately see the customer interactions. So the pace of innovation will be very different. In the past, when we deploy a new version of our software, adoption is always a long tail. Typically, any new version, only about 25% of individuals adopt the new version. So a lot of customers stay on older versions. So you don't get the benefit of the new features. So in cloud services, immediately you get the benefit of new features. The value is increasing -- end-user value is increasing; that's number one.

Number two, interactivity enables us to build digital models, as I mentioned earlier. Using digital representation of people, documents, messages, events, work activities, you can build those graphs. Those graphs give us intelligence which services or which features generate would more productivity for our users. So that further drives the pace of innovation to deliver more value to our customers.

We can think about the fundamental -- one of the fundamental trends of delivering value is by driving more fast-paced innovation for end users. So their productivity gets lifted; that's number one. Number two is adjacent areas. Our mental model is -- the past three decades [ph], today's productivity by and large using PC as endpoints as a device, using file folder documents as the main form of delivering productivity. When moving to cloud, the end point -- the computing edge moving to mobile devices and delivery can cover all different people.

So therefore the envelope of productivity will expand. Today, for our productivity services, we have 1.1 billion users. And we believe we can reach about 2 billion professionals in about three years because a new generation of productivity experience will be available on mobile devices. And we can reach a larger customer base. So enable us to expand; that's another area for value growth.

And a further area for value growth is the natural adjacencies. Of course, a couple of things. One is we've been focusing on adding more and more services for compliance for security. So when things move into the cloud, there's lots and lots of value. But protecting those data, that is critical for enterprise is very important, particularly in the (inaudible) NSA areas. There's lots of concerns about moving data in the cloud or moving services to the cloud. How do you protect those? So by beefing up more and more product offerings on those enables us, again, to add -- create more values in our growth initiatives.

As I said, inside of Microsoft there is also cross-sell (inaudible) opportunities. For example, last quarter we reached (inaudible) about mobile -- enterprise mobility services, EMS product. That's one of the many examples we can use Office 365 to integrate other Microsoft services to create more value. So a combination with all those -- (inaudible) how we think about driving more value productivity for end users

-- look at the natural adjacency, look at the boundary synergy opportunities inside of Microsoft, overall collectively grow our enterprise values by focusing innovation to using Office 365.

**Keith Weiss** {BIO 6993337 <GO>}

Got it. Maybe stepping off of one of those adjacencies, the newly renamed Cipher [ph] businesses. That's been one of your -- the fastest areas -- fast product-growing areas for you guys. Can you talk to us about what's resonating with customers within that Cipher business offering? How are they using it today? How does that expand over the next couple of years? And how does Cipher consumer play into that?

**Qi Lu** {BIO 21085704 <GO>}

That's a great question. The way I think -- we think about it is Cipher business represents a huge growth opportunity. As of today, Keith, it is already a multi-billion-dollar business. But the leading scenarios for enterprise customers, we see tons and tons of opportunity to remove pressure and create more value. By and large, today's meeting expenses are full of friction, based on our surveys. But on average, a meeting takes about 14 minutes to get started because there's all sorts of issues -- people calling in, the connection wasn't good. Sometimes people forgot to mute and keep talking. And then you have to remind them to please unmute. In all those, it turns out there's a lot of opportunities to really use technology innovation to remove friction. So that's one aspect.

The second aspect is we are building a tiered technological foundation -- a shared infrastructure that over time all the future communications, particularly audio-video conference communications, all become smart in the sense that today, let's say you and I have a phone call or a video call. We talk about planning a trip to Las Vegas. The software doesn't know you are going to Las Vegas; it can give you recommendation orders. In the future, you can envision all the future communication all become smart because we are building a full stack. So all communication going through -- we understood what's being talked about. And providing additional services -- additional tools made the conversations a lot more intelligent and easier to use. So we see fantastic opportunity to lift the quality of the experiences in full productivity for meeting scenarios.

Further, is affinity between Skype for Business and Skype. We are building a unified stack. So the future, Skype and Skype for Business has become a uniform, essentially coherent set of experiences both for consumers and enterprise customers. Today, we are already supporting interop. If you are a Skype user and if you are a Skype for Business user, you can interop. In the future, the experience will be the same. Because this is very important. We see the future trends -- each individual, they are not going to separate things -- this is the thing that I use for work, this is the thing I use for life. You are going to use the service that really works for you. So it's an opportunity for us to use -- to leverage the Skype brand.

The global user base -- Skype has huge global user base. And they also have very, very large mobile presence. In all of the Skype products is called GroupMe; that's

one of the most popular products in the United States for college students. So by merging these two with uniform product offering and single technology stacks consistently experience, we believe there's fantastic new opportunities to drive a lot more growth in the case of platform businesses.

**Keith Weiss** {BIO 6993337 <GO>}

So if we take those two answers together, in terms of getting higher lifetime value from the customers without moving to these adjacencies, it sounds like we are going to be bundling larger deals for customers and bundling more services into what you are trying to sell customers from a productivity application standpoint. At the same time, more and more of those bundles are going toward subscription days offerings. Is it wrong to think that over time your whole group is going to become 100% subscription revenues in terms of what you are offering to your customers?

**Qi Lu** {BIO 21085704 <GO>}

This is a great question. So economically, model-wise, Keith, our thinking is our baseline economics is going to be per-user subscription. The transformation will take time. Exactly how many years, we have to let things play out. But we see this business model is very compelling for a variety of different reasons. One is it frees up our innovation opportunity. Because in the future, we can innovate also the client experience; it doesn't matter which client wants to use it. And as long as you are connecting to the Microsoft cloud services, connecting to our computing intelligence, we get the economics because fundamentally it's a per-user subscription. So the migration path will be lots more. But we can envision a team of innovation. For certain people, if you want to you can stay on Win 32 -- all local apps are using the traditional experiences. For younger generation, you are going to move to fantastic new experiences. But everybody will be able to collaborate seamlessly because the economic model enables us to do that. Because in the past, if we are charging for clients, they really have to migrate to the cloud. The per-user subscription enables a very, very smooth transition for our customers to migrate to the cloud -- that's very, very appealing.

At the same time, we also think there's opportunity for us to add more value by driving different category innovations. For example, in the case of Microsoft productivity cloud, one of the things which is interesting -- most people didn't think search is fundamental to productivity tools. It would be very hard for me personally to imagine we can be productive as a professional without having access to certain services. But today, it's kind of bifurcated. You go to Google or Bing for consumer search experiences, then you go to your enterprise search to look for your internal Internet information or external information.

Why do you have to do that? Because we think there's fantastic opportunity for us to build a future generation of search experiences. If you are a professional, if you are a marketing person working for a pharmaceutical company, you just go to (inaudible) Bing -- whatever you type in, all the information is right there. Then search economics is part of that. Even though it's not necessary per user subscription, it's monetizing based on your intent. As we all know, the search economics, it's a very,



very potent value extraction engine. So we believe there's fantastic opportunities to focus our baseline, which is per-user subscription. We can add more and more value propositions to make that (inaudible) strong. And all the rich clients that move to the cloud move to the mobile (inaudible). At the same time, there's opportunity for us to augment that model so that collectively we can capture the most amount of economics by doing this.

**Keith Weiss** {BIO 6993337 <GO>}

Got it. And this is a good segue into the search business. I want to make sure we get to that side of your focus. How should we be thinking about ongoing investments in the online business on a going-forward business? Like you were talking about, Satya has talked about a path for profitability -- promising profitability from being in FY16. How are you weighing sort of need for that promise of profitability with the opportunity that you see out there to kind of extend what Bing is doing today and what search is doing today?

**Qi Lu** {BIO 21085704 <GO>}

This is a great question. Our thinking is the following. So while we believe -- the way we model everything and do everything is we build work/life experiences. Essentially every experience is always about work and life experience. Our fundamental thesis assumption, we believe in the future the friction is so low, people are going to pick the services that work for them across work and life. You are not going to choose, for work I'm going to do this, for life I'm going to do this. So therefore, every product group are all work/life products.

Mail -- we used to have separate mail stacks Hotmail.com and exchange Outlook; now it's a single stack. It's Outlook.com, Exchange on the cloud and Outlook client. It's one stack. OneDrive -- used to have OneDrive consumer, OneDrive for Business SharePoint; now it's one stack. Skype -- you used to have Skype for Business, it's all single stack. Bing -- Bing the future, Bing for Business, it's all single stack. Essentially, our consumer (inaudible) doesn't have to think about it's just a natural extension of the same workload, the same experience, the same stack technology. These are work/life experiences. That's number one.

Number two, our fundamental focus, our priority, is focus on work because that's -- we believe the Microsoft brand, our market footprint gives us the permission -- and it gives us the ability to differentiate and increase separation because we have more user data, more usages. More innovation opportunity to create group separation between Microsoft's offerings and our competitors. So we are going to win on work scenarios first. And our belief is once we are winning work scenarios for all professional, for all students, our future is going to be very bright because they will use -- these same users will use our services in their life occasions as well. So that's how we think about reasoning everything, how we invest. So it's work/life -- each workload is always going to be about work/life experiences, our priorities on work scenarios. And our belief is over time, these users will use more and more of our services for their work -- for their life scenarios.

---

**Keith Weiss** {BIO 6993337 <GO>}

Got it. In terms of the necessity and seeing success in mobile, can you talk about the synergies between the search business and having a presence in mobile? And how important is Windows 10 adoption going to be in kind of taking that online business into the mobile environment?

**Qi Lu** {BIO 21085704 <GO>}

This is very, very important, at least to what I mentioned earlier. Our industry, particularly for mobile, is really you can see it's a phase whereby vertical integration across device -- operating system services can drive a lot of innovation. And Cortana is one such example. Cortana is -- in many ways, you can think about it's an extension of Bing. It's built on the Bing engine, all the natural interactions. But we deeply integrate it into Windows Phone so that you can do commanding, you can do discovery, you can get recommendations. There's a lot of opportunity. By the way, Bing also supports Siri. So Apple Siri, Apple (inaudible) life -- the back end, the back (inaudible) supported by Bing as well.

So that's just one of the important examples of driving the end-to-end innovations. Using the search technology -- search services go much, much deeper. Because on a phone, experience is still at the early stage. So there's a lot of opportunity to build the next-generation experiences and capture economics. That's number one.

Number two, Keith, your question about Windows 10 options, that's very, very important. Because Windows 10, you can think about, is really a gigantic milestone to revitalize our Windows franchise, particularly for modern devices, for mobile phone (inaudible) in particular. So our internal alignment is super, super strong across different divisions.

And we -- based on all the early evidence we are seeing, we are going to drive a lot of what we call the smart search -- the next-generation Bing search, as part of -- integrates very, very seamlessly with Windows 10 devices, particularly for mobile phone (inaudible), whether it's tablets or phones. There's a lot of opportunity for us to drive adoption usage and certain economic growth for Microsoft.

**Keith Weiss** {BIO 6993337 <GO>}

Got it. I wanted to touch on the Yahoo relationship as well. In the press, we are perhaps seeing Mercer Meyer [ph] expressing some frustration about the search partnership in the past, the progress of shared gain versus Google. Do you believe the Yahoo partnership is going to remain durable to you guys over the next several years? What challenges remain in making sure that Yahoo relationship is beneficial for both sides of the equation? That everyone is a sort of happy participant in the partnership going forward?

**Qi Lu** {BIO 21085704 <GO>}

The original got new deal -- the basic premise is strong alignment on win-win scenarios between the two companies, particularly product innovation synergies and those economic synergies. We've been very committed to doing but we can on the Microsoft side to work with the Yahoo team to drive more overall growth and better innovation across the two endpoints -- the same platforms -- the same Bing platforms. You can think about the Bing.com for instance and Yahoo.com search, for instance.

There's all sorts of (inaudible) going off. And this is closer to the five-year anniversary. And there is opportunity to take another look to see what will look like next phase. I remain positive there's plenty other opportunity for the two companies. So we look at what fundamentally is important for us and find ways to continue the collaboration for the two companies.

**Keith Weiss** {BIO 6993337 <GO>}

Got it. So I want to take an opportunity here to open it up for questions from the floor if anyone in the audience has any questions for Qi. Up in the front here. (inaudible) see if I can all repeat it.

## Questions And Answers

### Q - Unidentified Participant

(inaudible - audience question)

**A - Keith Weiss** {BIO 6993337 <GO>}

So we'll break that up into two questions. So the first part of the question is the coopetition and the degree to which Microsoft is working more closely with partners in, say, like the file share. One drive is competitive with Dropbox. And you guys signed partnership agreements with. How do you guys think about the pluses and minuses, perhaps potential revenue loss because you are better enabling partners like a Box or a Dropbox versus the opportunities of working with these guys? Then we'll go into the second part of the question.

**A - Qi Lu** {BIO 21085704 <GO>}

Yes. So this is a great question. Thank you for that question. So here is how we think about this. We are the largest providers-players in the productivity space. And we are migrating to the cloud by going to mobile world. And along that journey, there will be coopetition instances all over the place. And we work each case by case. You mentioned Dropbox. Certainly we have been working with the Dropbox team. And we really love the partnership; we are going to continue with the partnership.

But as I meet with Drew and his team, we have been super clear. We are going to collaborate on here, collaborate on the experience whereby makes our combined customers better. Meaning that for those users who choose Dropbox over OneDrive and also use Microsoft Office productivity software, for those customers, they will

have better experiences. But we will also be clear, we are going to compete. We are going to compete -- on OneDrive, we are going to offer as compelling services as we can to drive more adoption and more customers. So we will be super clear on these.

The principle for me and my team is, are we getting more users and more usage? That's number one. Number two, overall, our combined customers -- are they getting a better experience or not? And if these are the two, then we will look at the trade-off. Sometimes the trade-off is complete positive when we do it. Sometimes the trade-off is more nuanced -- we have to negotiate (inaudible) it. But coopetition deals case by case. The principle is we are going to do a lot of those with many, many players; that's the simple reality. But if the net is, allow Microsoft Office to grow its user base, grow usages, ultimately over time will be a net win for our core businesses. That's what how we think about it.

**A - Keith Weiss {BIO 6993337 <GO>}**

And the second part of the question was on acquisition strategy. Is that over the past few years we've seen a couple of small acquisitions like Revolution Analytic, or Tom mentioned Sunrise, which I think is a calendaring app. How is Microsoft thinking about the buy versus build decision today? Is it more likely that you are going to be buying more functionality? And what's the potential for a larger acquisition out there with your functionality maybe heading into some of those adjacencies?

**A - Qi Lu {BIO 21085704 <GO>}**

So the common principle we use is always first declare what we want. Once we declare what we want then you always analyze the three options -- buy versus build versus (inaudible) each case is going through it like this -- the case of some examples I mentioned -- these acquisitions -- what we want is great products, that's number one.

Number two, great talent. Talent in many ways also weighs quite heavily because as we transform Microsoft one of the key things we drive is internally driving cultural change, driving a different product (inaudible) focusing on user/usage. Focused on customer orientation, focusing on designing mobile point screen experiences. Sometimes those transformations can be accelerated by bringing talent outside of Microsoft into Microsoft. So it's a combination of building -- acquiring great product, great talent. And in the case of a company with really -- excited about the opportunity because everything I can see -- I come to Silicon Valley, as I said, almost every other week. Clearly, it's the best mobile mail client that is out there. Once we rebrand as Outlook brand, the momentum is unbelievable. It's the opposite (inaudible) teams, every 10,000 downloads, you ring the bell and the bell just keeps ringing. There's opportunity truly for us to do software acquisitions to accelerate our growth for our core businesses.

**A - Keith Weiss {BIO 6993337 <GO>}**

Any additional questions from the audience?

## **Q - Unidentified Participant**

Thank you for the presentation. At the time when Microsoft bought Nokia's mobile business -- mobile (inaudible) business, they weren't going to talk about Microsoft being interested in the mapping asset of Nokia. Can I just ask given what you are saying regarding platforms and the rest of it, what would be the industrial logic of Microsoft owning a mapping asset in house, please?

## **A - Qi Lu {BIO 21085704 <GO>}**

This is a great question. So here is how we think about it. Mapping assets as a product is quite strategic for us. So we think about this as it's not just a navigation service to guide you from A to B. It's really the geospatial namespace to enable many, many other product innovations and the business synergies in that space. That's the most.

Number two, if you look at it historically the economics that's needed to support the mapping assets, there are several possibilities. One is the search economics. For Google, it's somewhat of a no-brainer. About 20% to 25% (inaudible) have local intent. As part of searches, we show a map screen because in such case it just adds fixed cost. For Google in particular, it kind of even makes more sense because if you are leading in business whereby fixed cost is a higher margin, the cost is low, it just adds more fixed cost to it.

So for Microsoft, it's a little bit of a challenge because Bing volume isn't nearly as big as Google's search volume. So founding the map assets is economically a little bit more challenging from a pure search perspective for Microsoft.

The other is you can find it by mobile devices. It turns out mapping becomes a must-have service for your phone. But the way the Apple economics works is they will pay \$1.50 -- whatever the (inaudible) material. If you have enough phone volume, you can fund that as well. So Microsoft, we have a combination of search volume and phone volume to fund it. So on an ongoing basis the key is to drive more innovation particularly for us to focus more on using geospatial namespace is for productivity. You can easily imagine all sorts of interesting possibilities. If you are a professional you are going to speak with particular important customers. Either you get to the place -- you do not know the campus map, you may not get to the right building in a quickly way. So in really all those future scenarios, Microsoft will have the best experiences for professional for enterprise applications. We see there's lots of opportunity for us to drive more value, drive more innovation.

## **A - Keith Weiss {BIO 6993337 <GO>}**

And we will take one last one up here.

## **Q - Unidentified Participant**

Can you comment on Azure and Office 365 prospects in China?

**A - Qi Lu** {BIO 21085704 <GO>}

Very, very good question. China is very special, very different because of the special rules the Chinese government established for multi-national companies to play in the cloud. So Microsoft is actually the first multi-national company in China to have a public cloud offering, which is what we call (inaudible). Essentially we worked with a partner (inaudible) -- essentially in China, we cannot be the direct operator; you have to be operated by a Chinese company. And we build technology -- we train our partners to operate the cloud. In Office, it applies the same. This is huge, huge growth opportunity for Microsoft because we see tremendous early adoption in the growth patterns for Chinese customers. And when I was visiting China I talked to our Chinese customers all the time. There's a lot of early adopters using Office 365, using Azure to build their new -- their future-generation product services. Particularly China also has a growing class of China-based multi-national companies. They are China based. But their Company is in the United States. Microsoft in particular provides a very, very strong value proposition in the services for these customers. This is one of the few areas we feel very good that we made early investments and we kind of bit the bullet. It's very complicated. You have to do so many one-off engineering work just to get that going. But once it's set up, the opportunity is generally there.

**A - Keith Weiss** {BIO 6993337 <GO>}

Just one last follow-up on that, China has been an area that you've had issues with suppliers to before and actually being able to monetize the use of your product. Do you think this push towards the cloud is going to help you guys combat some of that piracy and in general monetize the usage of Microsoft in China?

**A - Qi Lu** {BIO 21085704 <GO>}

Absolutely. Because in service, we have the provision of services. It's very hard for you to apply the normal piracy gains. Obviously there is always some potential possibility there (inaudible) cases. By and large, we feel very good about our ability to monetize once we move to the cloud services.

**A - Keith Weiss** {BIO 6993337 <GO>}

Excellent. Unfortunately, that takes us to the end of our allotted time frame. But thank you very much for joining us today. You've been great.

**A - Qi Lu** {BIO 21085704 <GO>}

Thanks for having me. Thank you.

*This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses,*

*or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2024, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.*