

Inside Microsoft: Last Quarter's Progress

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Microsoft reported a very strong last quarter, with revenue up over 13% and profitability up 17%. Its cloud business, which passed \$40 billion in revenue for the first time 3 months ago, passed \$42 billion in revenue this past quarter. It opened new data centers in ten countries. AI model capabilities are doubling in performance every six months thanks to scaling laws. Cloud migrations are accelerating in every industry, and Microsoft has more regional availability than any other large cloud provider. Data and analytics usage keeps increasing, with Fabric, Microsoft's data workload service, seeing an 80% increase in paid customers. An AI token is the smallest unit of data that AI language models use to generate text, and can be thought of as the building blocks of AI. Microsoft's Foundry is the agent of its AI app factory, used by over 70,000 companies. Foundry processed over 100 trillion tokens during the last quarter, with 50 trillion tokens used in the last month alone.

The growth in all of these parts of Microsoft's business highlights the continued strength of its cloud and AI businesses. CEO Nadella put it this way: "Our biggest business by far, now and in the future, is simply "infrastructure." (Meaning Microsoft is where much of the world's business sector goes to for its most crucial information technology needs.)

There has been a lot of talk in the news lately about major companies like Microsoft, Meta, and Google slowing down in their data center leases. As we already talked about, Microsoft brought 10 new data centers online last quarter alone, which sure doesn't suggest hitting the brakes on data center expansion. Management also explained that opening a data center is a 5-7 year process. It is constantly making decisions about the timing of various stages of construction. CEO Nadella said, "the reality is that we have always made adjustments to the pace we build over that last 15 years, it's just that Wall Street pays a lot more attention to our quarterly fluctuations now".

Map of Microsoft's 276 Data Centers



One of the highlights of the quarter was Microsoft's acceleration in Azure growth at 33%. Azure, its cloud platform, now contains both AI revenue and non-AI revenue. While AI revenue has been growing for a number of quarters, non-AI revenue also grew this past quarter. This growth is driven by three aspects: migrations to the cloud (moving new workloads to the cloud), increased data and analytics usage, and increased cloud native usage (applications specifically designed to be used in the cloud). All three of these are related to each other, so when one grows, the possibility of the other two growing increases. The beauty of Microsoft's AI business is that the addition of AI as a revenue source doesn't need a complete rebuild of infrastructure, like the original cloud business did. Microsoft is simply adding AI to nearly every single service it already provides through Azure. Therefore, although Microsoft has spent a lot recently on data center buildout, which has lowered its new profit margin slightly, those investments should lead to revenue gains that are easily scalable for years in the future. We have begun to see that in the past quarter and expect it to only accelerate in following quarters.