Inside Microsoft: Last Quarter's Progress

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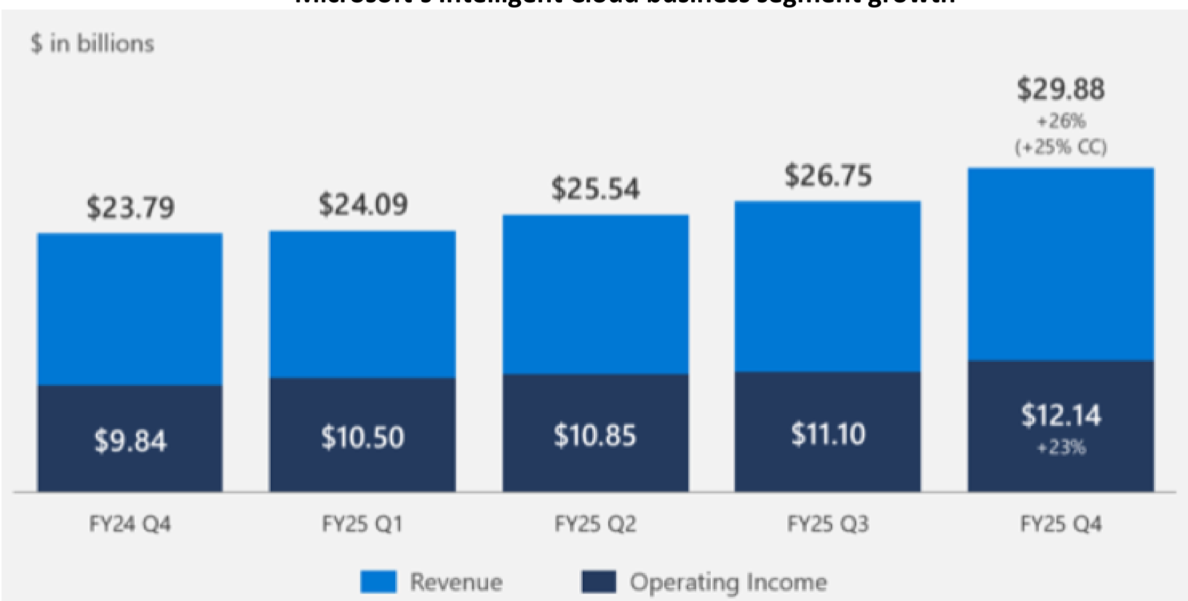
Microsoft seems to be defying gravity lately, posting quarter after quarter of strong revenue growth, on top of an already strong prior year result. This quarter was no exception. Its revenue grew 18%, the highest growth in over three years, driven by the usual cloud and AI demand. In the past three quarters, cloud revenue was $40 billion, $42 billion, and nearly $47 billion, all 20% or higher growth rates. For Microsoft's fiscal year, cloud revenue surpassed 168 billion in revenue, up 23%. AI is involved in nearly all of Microsoft's products now, including its cloud services. CEO Nadella says about AI, "the rate of innovation and the speed of diffusion is unlike anything we have seen".

Microsoft's Intelligent Cloud business segment growth



Microsoft's plan to build the most comprehensive suite of AI products across all tech applications has been very successful so far, as it has taken share for AI infrastructure every quarter of its fiscal year. It has over 400 data centers in 70 regions around the world and opened new data centers in 6 continents this year. Still, demand outpaced supply. Management thought in January this year that the supply/demand balance would be more normalized by June, and now that it's June, they are hoping it will be better by December. Microsoft is not slowing down on infrastructure spending, either. Even going at as fast a rate as possible, demand for more data centers improves.

Despite heavy spending on AI infrastructure, Microsoft has been able to keep profitability high. Overall company gross margin, a measure of profits, came in at 69% of revenue, only 1 point lower than a year ago. Spending more money on getting data centers built dragged the number down, but the impact was lessened by efficiency gains elsewhere. Free cash flow has grown for the last 2 quarters, and the company returned more to shareholders this past quarter (8% higher share buybacks and a 10% higher dividend). We are glad to be holding on to a company this financially strong and successful.