

Inside Microsoft: Last Quarter's Progress

Feb. 7, 2023

For the second quarter in a row Microsoft had weaker than usual revenue growth. All business segments still grew except for Personal Computing, affected by the downcycle in PC purchasing post pandemic-related boom. Growth was tempered by customers' reluctance to spend given widespread worry over economic conditions these days. So far, Microsoft's commercial business has remained stronger than its consumer business, but even that is now expected to decelerate over the next 6 months. This weaker business environment led to Microsoft's recent announcement of 10,000 layoffs to cut costs. It believes this and other cost cutting moves can almost completely cancel out the effect of lower sales on profitability for the year.

CEO Satya Nadella really emphasized the prediction that artificial intelligence will be the next big wave of computing. "The AI age is upon us and Microsoft is powering it". In recent months, improvement in AI capability has risen exponentially, and tech companies are trying to be the first to truly capitalize on the technology. Microsoft has been all over the news lately for its investment in OpenAI, the company behind the ChatGPT and DALL-E bots that have been so successful over the last couple of months. Chat GPT is a language model "bot" that gives surprisingly humanlike answers to questions, and DALL-E turns descriptive words into an image. Since OpenAI made ChatGPT available to the public, it gained over 1 million users in the first 5 days.

Sample ChatGPT Conversation from OpenAI's Website

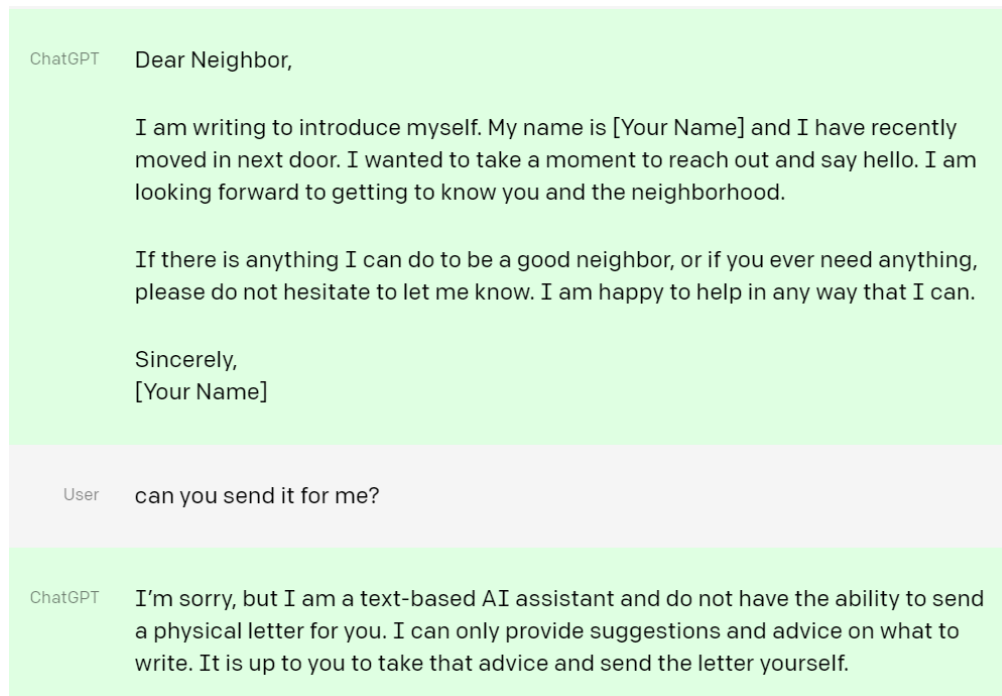
User help me write a short note to introduce myself to my neighbor

ChatGPT Hi there,

My name is [Your Name] and I just moved in next door. I wanted to reach out and introduce myself. I'm looking forward to getting to know you and the neighborhood. If you ever need anything or just want to chat, please don't hesitate to stop by or give me a call.

Best,
[Your Name]

User can you make it more formal?



Microsoft recently expanded its investment in OpenAI into a multibillion-dollar, multiyear deal where Azure will be the cloud provider for all OpenAI's platforms and Microsoft can incorporate OpenAI's tools into its own products, like its Bing search engine. Nadella believes eventually AI will be incorporated into every new app or platform.

This quarter's earnings call definitely marked a shift in tone towards investing in AI capabilities. Microsoft has enough of a strong and profitable core business that it can succeed in this strategy. Right now, that core business is in an "optimization" phase of tech spend. That's Mr. Nadella's fancy word for "Our customers bought like crazy for 2 years, now they're slamming the spending brakes and trying to make sure they're actually using what they bought." Mr. Nadella thinks this will go on all year, then tech spending will pick up again.

Of all the "Celebrity Tech" companies, we think Microsoft has the best long-term game plan and the best set of products and services to back up its plan. We don't think a year's spending pause will hurt us at all in the long run.