

Inside Microsoft: Last Quarter's Progress.

Nov. 3, 2020

This last quarter was typical of Microsoft over the last few years: 12% revenue growth created 32% earnings growth. The strongest business areas were cloud (growth highlighted in the slide below) and personal computing (PCs, gaming, personal software, etc), backed by the 2020 era of “digitize everything” and “work, play, learn from home”. In addition to strong bottom line growth, Microsoft returned over \$9 billion to shareholders through dividends and repurchases, up 21% from last year.

Quarterly Commercial Highlights

Investor Metrics	FY20 Q1	FY20 Q2	FY20 Q3	FY20 Q4	FY21 Q1
Commercial bookings growth (y/y)	30% / 35%	31% / 30%	7% / 12%	12%	23% / 18%
Commercial remaining performance obligation (in billions)	\$86	\$90	\$89	\$107	\$107
Commercial revenue annuity mix	91%	89%	92%	94%	93%
Commercial cloud revenue (in billions)	\$11.6	\$12.5	\$13.3	\$14.3	\$15.2
Commercial cloud gross margin percentage	66%	67%	67%	66%	71%

Growth rates include non-GAAP CC growth (GAAP % / CC%).

Commercial business

- Commercial bookings growth of 23% year-over-year (up 18% CC) driven by consistent execution across our core annuity sales motions and an increase in the number of larger, long-term Azure contracts
- Commercial remaining performance obligation \$107 billion, up 24% year-over-year (up 23% CC)
- Commercial revenue annuity mix of 93%, up 2 points year-over-year with continued shift to cloud

Commercial cloud

- Commercial cloud revenue \$15.2 billion, up 31% year-over-year
- Commercial cloud gross margin percentage of 71%, up 5 points year-over-year primarily due to the change in accounting estimate for the useful life of server and network equipment. Excluding this impact, improvement in Azure gross margin was mostly offset by sales mix shift to Azure.

Commercial cloud includes Office 365 Commercial, Azure, the commercial portion of LinkedIn, Dynamics 365, and other cloud properties. Includes non-GAAP constant currency ("CC") growth. See Appendix for reconciliation of GAAP and non-GAAP measures. Growth rates in GAAP and CC are equivalent unless otherwise noted.

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(First, a reminder that “cloud” just means that data and programs are stored somewhere off-site (rather than on a user’s PC, tablet or cell phone) and accessed over the internet. “Public cloud” means they’re stored on computers owned by firms like Amazon and Microsoft. “Private cloud” means they’re stored on computers owned by (for example) a non-tech company—but still not on the employees’ workstations. “Hybrid cloud,” of course, means a mix of the two.)

Azure, Microsoft’s cloud platform, hit the milestone of surpassing Windows business revenue for the first time. Azure brought in 17% of revenues this past quarter, up from just 4% 3 years ago. Revenues have grown at or above 50% each quarter for the last 2-3 years. With growth this explosive, the natural questions are “how long can it last?” and “what is the future of Azure?” CEO Nadella believes that the future of Azure lies in the distributed cloud infrastructure, which includes both a centralized cloud and “point of presences” at the edge of the cloud. A point of presence can be something as small as a single server in someone’s cabinet, but using distributed cloud infrastructure, Microsoft can “distribute” its cloud services out to that point. This helps that point of presence compute, store, and analyze data much faster than it normally would. It also helps companies comply with ever increasing regulations on location of data storage. Nadella believes that this distributed cloud infrastructure has only reached about 20% of

its potential, and that the next decade brings many opportunities for companies like Microsoft to take advantage of this trend.

One of the biggest reasons for Azure's initial growth was Microsoft's expertise as a hybrid cloud provider, that is, allowing its users to migrate between public and private cloud usage. It has taken that concept even further recently with Arc, which allows customers to manage cloud resources through Azure and other clouds (even competitors Amazon Web Services, Google Cloud) through one location. This means a company still running a decade old version of a certain application can join the hybrid cloud club without revamping its entire IT department. The broad scope of Microsoft and its "all are welcome" attitude should continue to drive strong growth in sales and earnings over the next few years.