UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended December 31, 2024

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition Period From to

Commission File Number 001-37845

MICROSOFT CORPORATION

WASHINGTON	**91-1144442**
(STATE OF INCORPORATION)	**(I.R.S. ID)**

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(425) 882-8080
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Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of exchange on which registered
Common stock, $0.00000625 par value per share	**MSFT**	**NASDAQ**
3.125% Notes due 2028	**MSFT**	**NASDAQ**
2.625% Notes due 2033	**MSFT**	**NASDAQ**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ☒	Accelerated Filer ☐
Non-accelerated Filer ☐	Smaller Reporting Company ☐
	Emerging Growth Company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

Class	**Outstanding as of January 23, 2025**
Common Stock, $0.00000625 par value per share	7,433,982,235 shares

MICROSOFT CORPORATION
FORM 10-Q
For the Quarter Ended December 31, 2024
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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INCOME STATEMENTS

(In millions, except per share amounts) (Unaudited)	Three Months Ended December 31,		Six Months Ended December 31,	
	2024	**2023**	**2024**	**2023**
Revenue:				
Product	**$ 16,219**	$ 18,941	**$ 31,491**	$ 34,476
Service and other	**53,413**	43,079	**103,726**	84,061
Total revenue	**69,632**	62,020	**135,217**	118,537
Cost of revenue:				
Product	**3,856**	5,964	**7,150**	9,495
Service and other	**17,943**	13,659	**34,748**	26,430
Total cost of revenue	**21,799**	19,623	**41,898**	35,925
Gross margin	**47,833**	42,397	**93,319**	82,612
Research and development	**7,917**	7,142	**15,461**	13,801
Sales and marketing	**6,440**	6,246	**12,157**	11,433
General and administrative	**1,823**	1,977	**3,496**	3,451
Operating income	**31,653**	27,032	**62,205**	53,927
Other expense, net	**(2,288)**	(506)	**(2,571)**	(117)
Income before income taxes	**29,365**	26,526	**59,634**	53,810
Provision for income taxes	**5,257**	4,656	**10,859**	9,649
Net income	**$ 24,108**	$ 21,870	**$ 48,775**	$ 44,161
Earnings per share:				
Basic	**$ 3.24**	$ 2.94	**$ 6.56**	$ 5.94
Diluted	**$ 3.23**	$ 2.93	**$ 6.53**	$ 5.92
Weighted average shares outstanding:				
Basic	**7,435**	7,432	**7,434**	7,431
Diluted	**7,468**	7,468	**7,469**	7,465

Refer to accompanying notes.

PART I
Item 1

COMPREHENSIVE INCOME STATEMENTS

(In millions) (Unaudited)	Three Months Ended December 31,		Six Months Ended December 31,	
	2024	**2023**	**2024**	**2023**
Net income	**$ 24,108**	$ 21,870	**$ 48,775**	$ 44,161
Other comprehensive income (loss), net of tax:				
Net change related to derivatives	**34**	(3)	**24**	18
Net change related to investments	**(434)**	1,331	**680**	1,071
Translation adjustments and other	**(1,034)**	660	**(730)**	305
Other comprehensive income (loss)	**(1,434)**	1,988	**(26)**	1,394
Comprehensive income	**$ 22,674**	$ 23,858	**$ 48,749**	$ 45,555

Refer to accompanying notes.

PART I
Item 1

BALANCE SHEETS

(In millions) (Unaudited)

	December 31, 2024	June 30, 2024
Assets		
Current assets:		
Cash and cash equivalents	**$ 17,482**	$ 18,315
Short-term investments	**54,073**	57,228
Total cash, cash equivalents, and short-term investments	**71,555**	75,543
Accounts receivable, net of allowance for doubtful accounts of **$662** and $830	**48,188**	56,924
Inventories	**909**	1,246
Other current assets	**26,428**	26,021
Total current assets	**147,080**	159,734
Property and equipment, net of accumulated depreciation of **$82,820** and $76,421	**166,902**	135,591
Operating lease right-of-use assets	**22,816**	18,961
Equity and other investments	**15,581**	14,600
Goodwill	**119,191**	119,220
Intangible assets, net	**25,385**	27,597
Other long-term assets	**36,943**	36,460
Total assets	**$ 533,898**	$ 512,163
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	**$ 22,608**	$ 21,996
Short-term debt	**0**	6,693
Current portion of long-term debt	**5,248**	2,249
Accrued compensation	**9,176**	12,564
Short-term income taxes	**6,056**	5,017
Short-term unearned revenue	**45,508**	57,582
Other current liabilities	**20,286**	19,185
Total current liabilities	**108,882**	125,286
Long-term debt	**39,722**	42,688
Long-term income taxes	**24,389**	27,931
Long-term unearned revenue	**2,537**	2,602
Deferred income taxes	**2,513**	2,618
Operating lease liabilities	**17,254**	15,497
Other long-term liabilities	**35,906**	27,064
Total liabilities	**231,203**	243,686
Commitments and contingencies		
Stockholders' equity:		
Common stock and paid-in capital – shares authorized 24,000; outstanding **7,435** and 7,434	**104,829**	100,923
Retained earnings	**203,482**	173,144
Accumulated other comprehensive loss	**(5,616)**	(5,590)
Total stockholders' equity	**302,695**	268,477
Total liabilities and stockholders' equity	**$ 533,898**	$ 512,163

Refer to accompanying notes.

PART I
Item 1

CASH FLOWS STATEMENTS

(In millions) (Unaudited)	Three Months Ended December 31, 2024	Three Months Ended December 31, 2023	Six Months Ended December 31, 2024	Six Months Ended December 31, 2023
Operations				
Net income	**$ 24,108**	$ 21,870	**$ 48,775**	$ 44,161
Adjustments to reconcile net income to net cash from operations:				
Depreciation, amortization, and other	**6,827**	5,959	**14,210**	9,880
Stock-based compensation expense	**3,089**	2,828	**5,921**	5,335
Net recognized losses on investments and derivatives	**976**	198	**851**	212
Deferred income taxes	**(1,158)**	(1,702)	**(2,591)**	(2,270)
Changes in operating assets and liabilities:				
Accounts receivable	**(5,978)**	(2,951)	**8,059**	8,083
Inventories	**711**	1,474	**338**	969
Other current assets	**(353)**	725	**(435)**	(71)
Other long-term assets	**(1,089)**	(1,427)	**(2,850)**	(3,440)
Accounts payable	**958**	(2,521)	**42**	(1,307)
Unearned revenue	**(6,338)**	(5,538)	**(11,891)**	(9,664)
Income taxes	**(3,395)**	(1,554)	**(2,379)**	(129)
Other current liabilities	**3,217**	1,518	**(2,262)**	(2,588)
Other long-term liabilities	**716**	(26)	**683**	265
Net cash from operations	**22,291**	18,853	**56,471**	49,436
Financing				
Proceeds from issuance (repayments) of debt, maturities of 90 days or less, net	**0**	(8,490)	**(5,746)**	10,202
Proceeds from issuance of debt	**0**	10,773	**0**	17,846
Repayments of debt	**0**	(2,916)	**(966)**	(4,416)
Common stock issued	**256**	261	**962**	946
Common stock repurchased	**(4,986)**	(4,000)	**(9,093)**	(8,831)
Common stock cash dividends paid	**(6,170)**	(5,574)	**(11,744)**	(10,625)
Other, net	**(343)**	(201)	**(1,232)**	(508)
Net cash from (used in) financing	**(11,243)**	(10,147)	**(27,819)**	4,614
Investing				
Additions to property and equipment	**(15,804)**	(9,735)	**(30,727)**	(19,652)
Acquisition of companies, net of cash acquired, and purchases of intangible and other assets	**(1,405)**	(65,029)	**(3,254)**	(66,215)
Purchases of investments	**(2,050)**	(4,258)	**(3,670)**	(12,718)
Maturities of investments	**2,604**	4,150	**4,740**	19,868
Sales of investments	**2,559**	1,600	**4,527**	6,930
Other, net	**(16)**	1,347	**(929)**	365
Net cash used in investing	**(14,112)**	(71,925)	**(29,313)**	(71,422)
Effect of foreign exchange rates on cash and cash equivalents	**(294)**	72	**(172)**	(27)
Net change in cash and cash equivalents	**(3,358)**	(63,147)	**(833)**	(17,399)
Cash and cash equivalents, beginning of period	**20,840**	80,452	**18,315**	34,704
Cash and cash equivalents, end of period	**$ 17,482**	$ 17,305	**$ 17,482**	$ 17,305

Refer to accompanying notes.

STOCKHOLDERS' EQUITY STATEMENTS

(In millions, except per share amounts) (Unaudited)	Three Months Ended December 31,		Six Months Ended December 31,	
	2024	**2023**	**2024**	**2023**
Common stock and paid-in capital				
Balance, beginning of period	**$ 102,976**	$ 95,508	**$ 100,923**	$ 93,718
Common stock issued	**256**	261	**962**	946
Common stock repurchased	**(1,491)**	(1,300)	**(2,976)**	(2,701)
Stock-based compensation expense	**3,089**	2,828	**5,921**	5,335
Other, net	**(1)**	183	**(1)**	182
Balance, end of period	**104,829**	97,480	**104,829**	97,480
Retained earnings				
Balance, beginning of period	**188,929**	132,143	**173,144**	118,848
Net income	**24,108**	21,870	**48,775**	44,161
Common stock cash dividends	**(6,169)**	(5,574)	**(12,340)**	(11,145)
Common stock repurchased	**(3,386)**	(2,702)	**(6,097)**	(6,127)
Balance, end of period	**203,482**	145,737	**203,482**	145,737
Accumulated other comprehensive loss				
Balance, beginning of period	**(4,182)**	(6,937)	**(5,590)**	(6,343)
Other comprehensive income (loss)	**(1,434)**	1,988	**(26)**	1,394
Balance, end of period	**(5,616)**	(4,949)	**(5,616)**	(4,949)
Total stockholders' equity	**$ 302,695**	$ 238,268	**$ 302,695**	$ 238,268
Cash dividends declared per common share	**$ 0.83**	$ 0.75	**$ 1.66**	$ 1.50

Refer to accompanying notes.

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 — ACCOUNTING POLICIES

Accounting Principles

Our unaudited interim consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). In the opinion of management, the unaudited interim consolidated financial statements reflect all adjustments of a normal recurring nature that are necessary for a fair presentation of the results for the interim periods presented. Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with information included in the Microsoft Corporation fiscal year 2024 Form 10-K and Form 8-K filed with the U.S. Securities and Exchange Commission on July 30, 2024 and December 3, 2024, respectively.

Principles of Consolidation

The consolidated financial statements include the accounts of Microsoft Corporation and its subsidiaries. Intercompany transactions and balances have been eliminated.

Recast of Certain Prior Period Information

In August 2024, we announced changes to the composition of our segments. These changes align our segments with how we currently manage our business, most notably bringing the commercial components of Microsoft 365 together in the Productivity and Business Processes segment. Beginning in fiscal year 2025, the information that our chief operating decision maker is regularly provided and reviews for purposes of allocating resources and assessing performance reflects these segment changes. Prior period segment information has been recast to conform to the way we internally manage and monitor our business during fiscal year 2025. These changes impacted Note 8 – Goodwill, Note 12 – Unearned Revenue, and Note 17 – Segment Information and Geographic Data.

The recast of prior period information had no impact on our consolidated balance sheets, consolidated income statements, or consolidated cash flows statements.

Estimates and Assumptions

Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples of estimates and assumptions include: for revenue recognition, determining the nature and timing of satisfaction of performance obligations, and determining the standalone selling price of performance obligations, variable consideration, and other obligations such as product returns and refunds; loss contingencies; product warranties; the fair value of and/or potential impairment of goodwill and intangible assets for our reporting units; product life cycles; useful lives of our tangible and intangible assets; allowances for doubtful accounts; the market value of, and demand for, our inventory; stock-based compensation forfeiture rates; when technological feasibility is achieved for our products; the potential outcome of uncertain tax positions that have been recognized in our consolidated financial statements or tax returns; and determining the timing and amount of impairments for investments. Actual results and outcomes may differ from management's estimates and assumptions due to risks and uncertainties.

Financial Instruments

Investments

We consider all highly liquid interest-earning investments with a maturity of three months or less at the date of purchase to be cash equivalents. The fair values of these investments approximate their carrying values. In general, investments with original maturities of greater than three months and remaining maturities of less than one year are classified as short-term investments. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations.

Debt investments are classified as available-for-sale and realized gains and losses are recorded using the specific identification method. Changes in fair value, excluding credit losses and impairments, are recorded in other comprehensive income. Fair value is calculated based on publicly available market information or other estimates determined by management. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, credit quality of debt instrument issuers, and the extent to which the fair value is less than cost. To determine credit losses, we employ a systematic methodology that considers available quantitative and qualitative evidence. In addition, we consider specific adverse conditions related to the financial health of, and business outlook for, the investee. If we have plans to sell the security or it is more likely than not that we will be required to sell the security before recovery, then a decline in fair value below cost is recorded as an impairment charge in other income (expense), net and a new cost basis in the investment is established. If market, industry, and/or investee conditions deteriorate, we may incur future impairments.

Equity investments with readily determinable fair values are measured at fair value. Equity investments without readily determinable fair values are measured using the equity method or measured at cost with adjustments for observable changes in price or impairments (referred to as the measurement alternative). We perform a qualitative assessment on a periodic basis and recognize an impairment if there are sufficient indicators that the fair value of the investment is less than carrying value. Changes in value are recorded in other income (expense), net.

Investments that are considered variable interest entities (“VIEs”) are evaluated to determine whether we are the primary beneficiary of the VIE, in which case we would be required to consolidate the entity. We evaluate whether we have (1) the power to direct the activities that most significantly impact the VIE’s economic performance, and (2) the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE. We have determined we are not the primary beneficiary of any of our VIE investments. Therefore, our VIE investments are not consolidated and the majority are accounted for under the equity method of accounting. We have an investment in OpenAI Global, LLC (“OpenAI”) and have made total funding commitments of $13 billion. The investment is accounted for under the equity method of accounting.

Derivatives

Derivative instruments are recognized as either assets or liabilities and measured at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

For derivative instruments designated as fair value hedges, gains and losses are recognized in other income (expense), net with offsetting gains and losses on the hedged items. Gains and losses representing hedge components excluded from the assessment of effectiveness are recognized in other income (expense), net.

For derivative instruments designated as cash flow hedges, gains and losses are initially reported as a component of other comprehensive income and subsequently recognized in other income (expense), net with the corresponding hedged item. Gains and losses representing hedge components excluded from the assessment of effectiveness are recognized in other income (expense), net.

For derivative instruments that are not designated as hedges, gains and losses from changes in fair values are primarily recognized in other income (expense), net.

Fair Value Measurements

We account for certain assets and liabilities at fair value. The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. We categorize each of our fair value measurements in one of these three levels based on the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

- *Level 1* – inputs are based upon unadjusted quoted prices for identical instruments in active markets. Our Level 1 investments include U.S. government securities, common and preferred stock, and mutual funds. Our Level 1 derivative assets and liabilities include those actively traded on exchanges.

- *Level 2* – inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques (e.g. the Black-Scholes model) for which all significant inputs are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, credit spreads, foreign exchange rates, and forward and spot prices for currencies. Our Level 2 investments include commercial paper, certificates of deposit, U.S. agency securities, foreign government bonds, mortgage- and asset-backed securities, corporate notes and bonds, and municipal securities. Our Level 2 derivative assets and liabilities include certain cleared swap contracts and over-the-counter forward, option, and swap contracts.
- *Level 3* – inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques, including option pricing models and discounted cash flow models. Our Level 3 assets and liabilities include investments in corporate notes and bonds, municipal securities, and goodwill and intangible assets, when they are recorded at fair value due to an impairment charge. Unobservable inputs used in the models are significant to the fair values of the assets and liabilities.

We measure equity investments without readily determinable fair values on a nonrecurring basis. The fair values of these investments are determined based on valuation techniques using the best information available, and may include quoted market prices, market comparables, and discounted cash flow projections.

Our other current financial assets and current financial liabilities have fair values that approximate their carrying values.

Contract Balances and Other Receivables

As of both December 31, 2024 and June 30, 2024, long-term accounts receivable, net of allowance for doubtful accounts, was $4.9 billion and is included in other long-term assets in our consolidated balance sheets.

As of December 31, 2024 and June 30, 2024, other receivables related to activities to facilitate the purchase of server components were $11.4 billion and $10.5 billion, respectively, and are included in other current assets in our consolidated balance sheets.

We record financing receivables when we offer certain customers the option to acquire our software products and services offerings through a financing program in a limited number of countries. As of December 31, 2024 and June 30, 2024, our financing receivables, net were $3.1 billion and $4.5 billion, respectively, for short-term and long-term financing receivables, which are included in other current assets and other long-term assets in our consolidated balance sheets. We record an allowance to cover expected losses based on troubled accounts, historical experience, and other currently available evidence.

Related Party Transactions

In March 2024, we entered into an agreement with Inflection AI, Inc. ("Inflection"), pursuant to which we obtained a non-exclusive license to Inflection's intellectual property. Reid Hoffman, a member of our Board of Directors, is a co-founder of and serves on the board of directors of Inflection. As of the date of the agreement with Inflection, Reprogrammed Interchange LLC ("Reprogrammed") and entities affiliated with Greylock Ventures ("Greylock") each held less than a 10% equity interest in Inflection. Mr. Hoffman may be deemed to beneficially own the shares held by Reprogrammed and Greylock by virtue of his relationship with such entities. Mr. Hoffman did not participate in any portions of the meetings of our Board of Directors or any committee thereof to review and approve the transaction with Inflection.

Recent Accounting Guidance

Segment Reporting – Improvements to Reportable Segment Disclosures

In November 2023, the Financial Accounting Standards Board ("FASB") issued a new standard to improve reportable segment disclosures. The guidance expands the disclosures required for reportable segments in our annual and interim consolidated financial statements, primarily through enhanced disclosures about significant segment expenses. The standard will be effective for us beginning with our annual reporting for fiscal year 2025 and interim periods thereafter, with early adoption permitted. We are currently evaluating the impact of this standard on our segment disclosures.

Income Taxes – Improvements to Income Tax Disclosures

In December 2023, the FASB issued a new standard to improve income tax disclosures. The guidance requires disclosure of disaggregated income taxes paid, prescribes standardized categories for the components of the effective tax rate reconciliation, and modifies other income tax-related disclosures. The standard will be effective for us beginning with our annual reporting for fiscal year 2026, with early adoption permitted. We are currently evaluating the impact of this standard on our income tax disclosures.

Income Statement – Disaggregation of Income Statement Expenses

In November 2024, the FASB issued a new standard to expand disclosures about income statement expenses. The guidance requires disaggregation of certain costs and expenses included in each relevant expense caption on our consolidated income statements in a separate note to the financial statements at each interim and annual reporting period, including amounts of purchases of inventory, employee compensation, depreciation, and intangible asset amortization. The standard will be effective for us beginning with our annual reporting for fiscal year 2028 and interim periods thereafter, with early adoption permitted. We are currently evaluating the impact of this standard on our disclosures.

NOTE 2 — EARNINGS PER SHARE

Basic earnings per share ("EPS") is computed based on the weighted average number of shares of common stock outstanding during the period. Diluted EPS is computed based on the weighted average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include outstanding stock options and stock awards.

The components of basic and diluted EPS were as follows:

(In millions, except per share amounts)	Three Months Ended December 31,		Six Months Ended December 31,	
	2024	**2023**	**2024**	**2023**
Net income available for common shareholders (A)	**$ 24,108**	$ 21,870	**$ 48,775**	$ 44,161
Weighted average outstanding shares of common stock (B)	**7,435**	7,432	**7,434**	7,431
Dilutive effect of stock-based awards	**33**	36	**35**	34
Common stock and common stock equivalents (C)	**7,468**	7,468	**7,469**	7,465
Earnings Per Share				
Basic (A/B)	**$ 3.24**	$ 2.94	**$ 6.56**	$ 5.94
Diluted (A/C)	**$ 3.23**	$ 2.93	**$ 6.53**	$ 5.92

Anti-dilutive stock-based awards excluded from the calculations of diluted EPS were immaterial during the periods presented.

NOTE 3 — OTHER INCOME (EXPENSE), NET

The components of other income (expense), net were as follows:

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2024	2023	**2024**	2023
Interest and dividends income	**$ 600**	$ 734	**$ 1,281**	$ 1,900
Interest expense	**(594)**	(909)	**(1,176)**	(1,434)
Net recognized gains (losses) on investments	**(860)**	69	**(397)**	(38)
Net losses on derivatives	**(116)**	(267)	**(454)**	(174)
Net gains (losses) on foreign currency remeasurements	**(153)**	36	**23**	(65)
Other, net	**(1,165)**	(169)	**(1,848)**	(306)
Total	**$ (2,288)**	$ (506)	**$ (2,571)**	$ (117)

Other, net primarily reflects net recognized losses on equity method investments, including OpenAI.

Net Recognized Gains (Losses) on Investments

Net recognized gains (losses) on debt investments were as follows:

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2024	2023	**2024**	2023
Realized gains from sales of available-for-sale securities	**$ 9**	$ 4	**$ 17**	$ 6
Realized losses from sales of available-for-sale securities	**(19)**	(29)	**(34)**	(54)
Impairments and allowance for credit losses	**(14)**	18	**(2)**	12
Total	**$ (24)**	$ (7)	**$ (19)**	$ (36)

Net recognized gains (losses) on equity investments were as follows:

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2024	2023	**2024**	2023
Net realized gains (losses) on investments sold	**$ (8)**	$ (31)	**$ 57**	$ 14
Net unrealized gains on investments still held	**25**	286	**437**	163
Impairments of investments	**(853)**	(179)	**(872)**	(179)
Total	**$ (836)**	$ 76	**$ (378)**	$ (2)

NOTE 4 — INVESTMENTS

Investment Components

The components of investments were as follows:

(In millions)	Fair Value Level	Adjusted Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity and Other Investments
December 31, 2024								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 3,515	$ 0	$ 0	$ 3,515	$ 3,515	$ 0	$ 0
Certificates of deposit	Level 2	3,349	0	0	3,349	3,302	47	0
U.S. government securities	Level 1	46,013	1	(2,233)	43,781	18	43,763	0
U.S. agency securities	Level 2	11	0	0	11	0	11	0
Foreign government bonds	Level 2	311	7	(17)	301	0	301	0
Mortgage- and asset-backed securities	Level 2	987	5	(33)	959	0	959	0
Corporate notes and bonds	Level 2	8,693	38	(198)	8,533	0	8,533	0
Corporate notes and bonds	Level 3	2,376	27	(3)	2,400	0	123	2,277
Municipal securities	Level 2	254	1	(11)	244	0	244	0
Municipal securities	Level 3	104	0	(16)	88	0	88	0
Total debt investments		$ 65,613	$ 79	$ (2,511)	$ 63,181	$ 6,835	$ 54,069	$ 2,277
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				$ 4,425	$ 1,000	$ 0	$ 3,425
Equity investments	Other				9,879	0	0	9,879
Total equity investments					$ 14,304	$ 1,000	$ 0	$ 13,304
Cash					$ 9,647	$ 9,647	$ 0	$ 0
Derivatives, net [(a)]					4	0	4	0
Total					$ 87,136	$ 17,482	$ 54,073	$ 15,581

(In millions)	Fair Value Level	Adjusted Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity and Other Investments
June 30, 2024								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 4,666	$ 0	$ 0	$ 4,666	$ 4,666	$ 0	$ 0
Certificates of deposit	Level 2	1,547	0	0	1,547	1,503	44	0
U.S. government securities	Level 1	49,603	4	(2,948)	46,659	14	46,645	0
U.S. agency securities	Level 2	17	0	0	17	0	17	0
Foreign government bonds	Level 2	319	3	(16)	306	0	306	0
Mortgage- and asset-backed securities	Level 2	944	3	(35)	912	0	912	0
Corporate notes and bonds	Level 2	9,106	28	(318)	8,816	0	8,816	0
Corporate notes and bonds	Level 3	1,641	0	(1)	1,640	0	140	1,500
Municipal securities	Level 2	262	0	(13)	249	0	249	0
Municipal securities	Level 3	104	0	(17)	87	0	87	0
Total debt investments		$ 68,209	$ 38	$ (3,348)	$ 64,899	$ 6,183	$ 57,216	$ 1,500
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				$ 3,547	$ 561	$ 0	$ 2,986
Equity investments	Other				10,114	0	0	10,114
Total equity investments					$ 13,661	$ 561	$ 0	$ 13,100
Cash					$ 11,571	$ 11,571	$ 0	$ 0
Derivatives, net [(a)]					12	0	12	0
Total					$ 90,143	$ 18,315	$ 57,228	$ 14,600

(a) *Refer to Note 5 – Derivatives for further information on the fair value of our derivative instruments.*

Equity investments presented as “Other” in the tables above include investments without readily determinable fair values measured at cost with adjustments for observable changes in price or impairments, measured using the equity method, or measured at fair value using net asset value as a practical expedient which are not categorized in the fair value hierarchy. As of December 31, 2024 and June 30, 2024, equity investments without readily determinable fair values measured at cost with adjustments for observable changes in price or impairments were $2.9 billion and $3.9 billion, respectively, and equity investments measured using the equity method were $6.8 billion and $6.0 billion, respectively.

Unrealized Losses on Debt Investments

Debt investments with continuous unrealized losses for less than 12 months and 12 months or greater and their related fair values were as follows:

(In millions)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses	Total Fair Value	Total Unrealized Losses
December 31, 2024						
U.S. government and agency securities	**$ 871**	**$ (61)**	**$ 42,775**	**$ (2,172)**	**$ 43,646**	**$ (2,233)**
Foreign government bonds	**99**	**(4)**	**127**	**(13)**	**226**	**(17)**
Mortgage- and asset-backed securities	**277**	**(6)**	**244**	**(27)**	**521**	**(33)**
Corporate notes and bonds	**1,781**	**(17)**	**4,339**	**(184)**	**6,120**	**(201)**
Municipal securities	**0**	**0**	**237**	**(27)**	**237**	**(27)**
Total	**$ 3,028**	**$ (88)**	**$ 47,722**	**$ (2,423)**	**$ 50,750**	**$ (2,511)**

(In millions)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses	Total Fair Value	Total Unrealized Losses
June 30, 2024						
U.S. government and agency securities	$ 529	$ (12)	$ 45,821	$ (2,936)	$ 46,350	$ (2,948)
Foreign government bonds	79	(2)	180	(14)	259	(16)
Mortgage- and asset-backed securities	201	(1)	409	(34)	610	(35)
Corporate notes and bonds	1,310	(9)	5,779	(310)	7,089	(319)
Municipal securities	38	(1)	243	(29)	281	(30)
Total	$ 2,157	$ (25)	$ 52,432	$ (3,323)	$ 54,589	$ (3,348)

Unrealized losses from fixed-income securities are primarily attributable to changes in interest rates. Management does not believe any remaining unrealized losses represent impairments based on our evaluation of available evidence.

Debt Investment Maturities

The following table outlines maturities of our debt investments as of December 31, 2024:

(In millions)	Adjusted Cost Basis	Estimated Fair Value
December 31, 2024		
Due in one year or less	**$ 22,927**	**$ 22,788**
Due after one year through five years	**33,344**	**31,774**
Due after five years through 10 years	**7,934**	**7,325**
Due after 10 years	**1,408**	**1,294**
Total	**$ 65,613**	**$ 63,181**

NOTE 5 — DERIVATIVES

We use derivative instruments to manage risks related to foreign currencies, interest rates, equity prices, and credit; to enhance investment returns; and to facilitate portfolio diversification. Our objectives for holding derivatives include reducing, eliminating, and efficiently managing the economic impact of these exposures as effectively as possible. Our derivative programs include strategies that both qualify and do not qualify for hedge accounting treatment.

Foreign Currencies

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily to maximize the economic effectiveness of our foreign currency hedge positions.

Foreign currency risks related to certain Euro-denominated debt are hedged using foreign exchange forward contracts that are designated as cash flow hedging instruments.

Certain options and forwards not designated as hedging instruments are also used to manage the variability in foreign exchange rates on certain balance sheet amounts and to manage other foreign currency exposures.

Interest Rate

Interest rate risks related to certain fixed-rate debt are hedged using interest rate swaps that are designated as fair value hedging instruments to effectively convert the fixed interest rates to floating interest rates.

Securities held in our fixed-income portfolio are subject to different interest rate risks based on their maturities. We manage the average maturity of our fixed-income portfolio to achieve economic returns that correlate to certain broad-based fixed-income indices using option, futures, and swap contracts. These contracts are not designated as hedging instruments and are included in “Other contracts” in the tables below.

Equity

Securities held in our equity investments portfolio are subject to market price risk. At times, we may hold options, futures, and swap contracts. These contracts are not designated as hedging instruments.

Credit

Our fixed-income portfolio is diversified and consists primarily of investment-grade securities. We use credit default swap contracts to manage credit exposures relative to broad-based indices and to facilitate portfolio diversification. These contracts are not designated as hedging instruments and are included in “Other contracts” in the tables below.

Credit-Risk-Related Contingent Features

Certain counterparty agreements for derivative instruments contain provisions that require our issued and outstanding long-term unsecured debt to maintain an investment grade credit rating and require us to maintain minimum liquidity of $1.0 billion. To the extent we fail to meet these requirements, we will be required to post collateral, similar to the standard convention related to over-the-counter derivatives. As of December 31, 2024, our long-term unsecured debt rating was AAA, and cash investments were in excess of $1.0 billion. As a result, no collateral was required to be posted.

The following table presents the notional amounts of our outstanding derivative instruments measured in U.S. dollar equivalents:

(In millions)	December 31, 2024	June 30, 2024
Designated as Hedging Instruments		
Foreign exchange contracts purchased	**$ 1,492**	$ 1,492
Interest rate contracts purchased	**1,126**	1,100
Not Designated as Hedging Instruments		
Foreign exchange contracts purchased	**7,791**	7,167
Foreign exchange contracts sold	**30,921**	31,793
Equity contracts purchased	**5,198**	4,016
Equity contracts sold	**2,170**	2,165
Other contracts purchased	**2,636**	2,113
Other contracts sold	**1,162**	811

Fair Values of Derivative Instruments

The following table presents our derivative instruments:

(In millions)	Derivative Assets	Derivative Liabilities	Derivative Assets	Derivative Liabilities
		December 31, 2024		June 30, 2024
Designated as Hedging Instruments				
Foreign exchange contracts	**$ 9**	**$ (88)**	$ 24	$ (76)
Interest rate contracts	**17**	**0**	19	0
Not Designated as Hedging Instruments				
Foreign exchange contracts	**835**	**(325)**	213	(230)
Equity contracts	**19**	**(1,018)**	63	(491)
Other contracts	**4**	**(21)**	12	(3)
Gross amounts of derivatives	**884**	**(1,452)**	331	(800)
Gross amounts of derivatives offset in the balance sheets	**(301)**	**303**	(151)	152
Cash collateral received	**0**	**(156)**	0	(104)
Net amounts of derivatives	**$ 583**	**$ (1,305)**	$ 180	$ (752)
Reported as				
Short-term investments	**$ 4**	**$ 0**	$ 12	$ 0
Other current assets	**561**	**0**	149	0
Other long-term assets	**18**	**0**	19	0
Other current liabilities	**0**	**(764)**	0	(401)
Other long-term liabilities	**0**	**(541)**	0	(351)
Total	**$ 583**	**$ (1,305)**	$ 180	$ (752)

Gross derivative assets and liabilities subject to legally enforceable master netting agreements for which we have elected to offset were $858 million and $1.4 billion, respectively, as of December 31, 2024, and $304 million and $800 million, respectively, as of June 30, 2024.

The following table presents the fair value of our derivatives instruments on a gross basis:

(In millions)	Level 1	Level 2	Level 3	Total
December 31, 2024				
Derivative assets	**$ 0**	**$ 878**	**$ 6**	**$ 884**
Derivative liabilities	**0**	**(1,427)**	**(25)**	**(1,452)**
June 30, 2024				
Derivative assets	0	327	4	331
Derivative liabilities	(1)	(799)	0	(800)

Gains (losses) on derivative instruments recognized in other income (expense), net were as follows:

(In millions)	Three Months Ended December 31, 2024	2023	Six Months Ended December 31, 2024	2023
Designated as Fair Value Hedging Instruments				
Interest rate contracts				
Derivatives	**$ (18)**	$ 22	**$ 2**	$ 6
Hedged items	**8**	(34)	**(24)**	(31)
Designated as Cash Flow Hedging Instruments				
Foreign exchange contracts				
Amount reclassified from accumulated other comprehensive loss	**(106)**	51	**(57)**	5
Not Designated as Hedging Instruments				
Foreign exchange contracts	**1,138**	(334)	**755**	(128)
Equity contracts	**(111)**	(287)	**(459)**	(174)
Other contracts	**(26)**	36	**(2)**	3

Gains (losses), net of tax, on derivative instruments recognized in our consolidated comprehensive income statements were as follows:

(In millions)	Three Months Ended December 31, 2024	2023	Six Months Ended December 31, 2024	2023
Designated as Cash Flow Hedging Instruments				
Foreign exchange contracts				
Included in effectiveness assessment	**$ (50)**	$ 37	**$ (21)**	$ 22

NOTE 6 — INVENTORIES

The components of inventories were as follows:

(In millions)	December 31, 2024	June 30, 2024
Raw materials	**$ 345**	$ 394
Work in process	**7**	7
Finished goods	**557**	845
Total	**$ 909**	$ 1,246

NOTE 7 — BUSINESS COMBINATIONS

Activision Blizzard, Inc.

On October 13, 2023, we completed our acquisition of Activision Blizzard, Inc. (“Activision Blizzard”) for a total purchase price of $75.4 billion, consisting primarily of cash. Activision Blizzard is a leader in game development and an interactive entertainment content publisher. The acquisition will accelerate the growth in our gaming business across mobile, PC, console, and cloud gaming. The financial results of Activision Blizzard have been included in our consolidated financial statements since the date of the acquisition. Activision Blizzard is reported as part of our More Personal Computing segment.

The allocation of the purchase price to the assets acquired and liabilities assumed was completed as of September 30, 2024. The major classes of assets and liabilities to which we have allocated the purchase price were as follows:

(In millions)	
Cash and cash equivalents	$ 12,976
Goodwill	51,001
Intangible assets	21,969
Other assets	2,503
Long-term debt	(2,799)
Long-term income taxes	(1,946)
Deferred income taxes	(4,676)
Other liabilities	(3,620)
Total purchase price	$ 75,408

Goodwill was assigned to our More Personal Computing segment. The goodwill was primarily attributed to increased synergies that are expected to be achieved from the integration of Activision Blizzard. Substantially all of the goodwill is expected to be non-deductible for income tax purposes.

Following are the details of the purchase price allocated to the intangible assets acquired:

(In millions, except average life)	Amount	Weighted Average Life
Marketing-related	$ 11,619	24 years
Technology-based	9,689	4 years
Customer-related	661	4 years
Fair value of intangible assets acquired	$ 21,969	15 years

Following are the supplemental consolidated financial results of Microsoft Corporation on an unaudited pro forma basis, as if the acquisition had been consummated on July 1, 2022:

(In millions, except per share amounts)	Three Months Ended December 31,	Six Months Ended December 31,
	2023	2023
Revenue	$ 62,297	$ 120,857
Net income	22,025	44,334
Diluted earnings per share	2.95	5.94

These pro forma results were based on estimates and assumptions, which we believe are reasonable. They are not the results that would have been realized had we been a combined company during the periods presented and are not necessarily indicative of our consolidated results of operations in future periods. The pro forma results include adjustments related to purchase accounting, primarily amortization of intangible assets. Acquisition costs and other nonrecurring charges were immaterial and are included in the earliest period presented.

NOTE 8 — GOODWILL

Changes in the carrying amount of goodwill were as follows:

(In millions)	June 30, 2024	Acquisitions	Other	December 31, 2024
Productivity and Business Processes	**$ 31,361**	**$ 0**	**$ (29)**	**$ 31,332**
Intelligent Cloud	**25,648**	**0**	**(1)**	**25,647**
More Personal Computing	**62,211**	**0**	**1**	**62,212**
Total	**$ 119,220**	**$ 0**	**$ (29)**	**$ 119,191**

We have recast certain prior period amounts to conform to the way we internally manage and monitor our business. Refer to Note 1 – Accounting Policies for further information.

The measurement periods for the valuation of assets acquired and liabilities assumed end as soon as information on the facts and circumstances that existed as of the acquisition dates becomes available, but do not exceed 12 months. Adjustments in purchase price allocations may require a change in the amounts allocated to goodwill during the periods in which the adjustments are determined.

Any change in the goodwill amounts resulting from foreign currency translations and purchase accounting adjustments are presented as “Other” in the table above. Also included in “Other” are business dispositions and transfers between segments due to reorganizations, as applicable.

As discussed in Note 1 – Accounting Policies, during the first quarter of fiscal year 2025 we made changes to our segments. These segment changes also resulted in changes to our reporting units. We reallocated goodwill across impacted reporting units using a relative fair value approach. In addition, we completed an assessment of any potential goodwill impairment for all reporting units immediately prior to the reallocation and determined that no impairment existed.

NOTE 9 — INTANGIBLE ASSETS

The components of intangible assets, all of which are finite-lived, were as follows:

(In millions)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
			December 31, 2024			June 30, 2024
Marketing-related	**$ 16,489**	**$ (3,499)**	**$ 12,990**	$ 16,500	$ (3,101)	$ 13,399
Technology-based	**22,481**	**(12,785)**	**9,696**	21,913	(10,741)	11,172
Customer-related	**6,030**	**(3,444)**	**2,586**	6,038	(3,051)	2,987
Contract-based	**135**	**(22)**	**113**	58	(19)	39
Total	**$ 45,135**	**$ (19,750)**	**$ 25,385**	$ 44,509	$ (16,912)	$ 27,597

Intangible assets amortization expense was $1.5 billion and $3.0 billion for the three and six months ended December 31, 2024, respectively, and $1.3 billion and $2.0 billion for the three and six months ended December 31, 2023, respectively.

The following table outlines the estimated future amortization expense related to intangible assets held as of December 31, 2024:

(In millions)	
Year Ending June 30,	
2025 (excluding the six months ended December 31, 2024)	**$ 3,075**
2026	**4,576**
2027	**2,850**
2028	**1,986**
2029	**1,804**
Thereafter	**11,094**
Total	**$ 25,385**

NOTE 10 — DEBT

Short-term Debt

As of December 31, 2024, we had no commercial paper issued or outstanding. As of June 30, 2024, we had $6.7 billion of commercial paper issued and outstanding, with a weighted average interest rate of 5.4% and maturities ranging from 28 days to 152 days. The estimated fair value of this commercial paper approximates its carrying value.

Long-term Debt

The components of long-term debt were as follows:

(In millions, issuance by calendar year)	Maturities (calendar year)	Stated Interest Rate	Effective Interest Rate	December 31, 2024	June 30, 2024
2009 issuance of $3.8 billion	**2039**	**5.20%**	**5.24%**	**$ 520**	$ 520
2010 issuance of $4.8 billion	**2040**	**4.50%**	**4.57%**	**486**	486
2011 issuance of $2.3 billion	**2041**	**5.30%**	**5.36%**	**718**	718
2012 issuance of $2.3 billion	**2042**	**3.50%**	**3.57%**	**454**	454
2013 issuance of $5.2 billion	**2043**	**3.75%–4.88%**	**3.83%–4.92%**	**314**	314
2013 issuance of €4.1 billion	**2028–2033**	**2.63%–3.13%**	**2.69%–3.22%**	**2,382**	2,465
2015 issuance of $23.8 billion	**2025–2055**	**2.70%–4.75%**	**2.77%–4.78%**	**9,805**	9,805
2016 issuance of $19.8 billion	**2026–2056**	**2.40%–3.95%**	**2.46%–4.03%**	**7,930**	7,930
2017 issuance of $17.1 billion	**2026–2057**	**3.30%–4.50%**	**3.38%–5.49%**	**6,833**	6,833
2020 issuance of $10.1 billion	**2030–2060**	**1.35%–2.68%**	**2.53%–5.43%**	**10,111**	10,111
2021 issuance of $8.2 billion	**2052–2062**	**2.92%–3.04%**	**2.92%–3.04%**	**8,185**	8,185
2023 issuance of $0.1 billion	**2026–2050**	**1.35%–4.50%**	**5.16%–5.49%**	**56**	56
2024 issuance of $3.3 billion	**2026–2050**	**1.35%–4.50%**	**5.16%–5.49%**	**3,344**	3,344
Total face value				**51,138**	51,221
Unamortized discount and issuance costs				**(1,191)**	(1,227)
Hedge fair value adjustments [(a)]				**(57)**	(81)
Premium on debt exchange				**(4,920)**	(4,976)
Total debt				**44,970**	44,937
Current portion of long-term debt				**(5,248)**	(2,249)
Long-term debt				**$ 39,722**	$ 42,688

(a) *Refer to Note 5 – Derivatives for further information on the interest rate swaps related to fixed-rate debt.*

As of December 31, 2024 and June 30, 2024, the estimated fair value of long-term debt, including the current portion, was $42.0 billion and $42.3 billion, respectively. The estimated fair values are based on Level 2 inputs.

Debt in the table above is comprised of senior unsecured obligations and ranks equally with our other outstanding obligations. Interest is paid semi-annually, except for the Euro-denominated debt, which is paid annually.

The following table outlines maturities of our long-term debt, including the current portion, as of December 31, 2024:

(In millions)	
Year Ending June 30,	
2025 (excluding the six months ended December 31, 2024)	**$ 2,250**
2026	**3,000**
2027	**9,250**
2028	**0**
2029	**1,812**
Thereafter	**34,826**
Total	**$ 51,138**

NOTE 11 — INCOME TAXES

Effective Tax Rate

Our effective tax rate was 18% for both the three months ended December 31, 2024 and 2023, and 18% for both the six months ended December 31, 2024 and 2023. Our effective tax rate for the three and six months ended December 31, 2024 was primarily impacted by tax benefits from tax law changes in the prior fiscal year, including the delay of the effective date of final foreign tax credit regulations, and changes in the mix of our earnings and tax expenses between the U.S. and foreign countries.

Our effective tax rate was lower than the U.S. federal statutory rate for the three and six months ended December 31, 2024, primarily due to earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations center in Ireland.

Uncertain Tax Positions

As of December 31, 2024 and June 30, 2024, unrecognized tax benefits and other income tax liabilities were $25.8 billion and $24.9 billion, respectively, and are included in long-term income taxes in our consolidated balance sheets.

We remain under audit by the IRS for tax years 2014 to 2017. With respect to the audit for tax years 2004 to 2013, on September 26, 2023, we received Notices of Proposed Adjustment (“NOPAs”) from the IRS. The primary issues in the NOPAs relate to intercompany transfer pricing. In the NOPAs, the IRS is seeking an additional tax payment of $28.9 billion plus penalties and interest. As of December 31, 2024, we believe our allowances for income tax contingencies are adequate. We disagree with the proposed adjustments and will vigorously contest the NOPAs through the IRS’s administrative appeals office and, if necessary, judicial proceedings. We do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our income tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2024, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NOTE 12 — UNEARNED REVENUE

Unearned revenue by segment was as follows:

(In millions)

	December 31, 2024	June 30, 2024
Productivity and Business Processes	**$ 33,582**	$ 43,599
Intelligent Cloud	**10,979**	13,683
More Personal Computing	**3,484**	2,902
Total	**$ 48,045**	$ 60,184

We have recast certain prior period amounts to conform to the way we internally manage and monitor our business. Refer to Note 1 – Accounting Policies for further information.

Changes in unearned revenue were as follows:

(In millions)

Six Months Ended December 31, 2024	
Balance, beginning of period	**$ 60,184**
Deferral of revenue	**74,211**
Recognition of unearned revenue	**(86,350)**
Balance, end of period	**$ 48,045**

Revenue allocated to remaining performance obligations, which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods, was $304 billion as of December 31, 2024, of which $298 billion is related to the commercial portion of revenue. We expect to recognize approximately 40% of our total company remaining performance obligation revenue over the next 12 months and the remainder thereafter.

NOTE 13 — LEASES

We have operating and finance leases for datacenters, corporate offices, research and development facilities, Microsoft Experience Centers, and certain equipment. Our leases have remaining lease terms of less than 1 year to 20 years, some of which include options to extend the leases for up to 5 years, and some of which include options to terminate the leases within 1 year.

The components of lease expense were as follows:

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2024	**2023**	**2024**	**2023**
Operating lease cost	**$ 1,293**	$ 817	**$ 2,453**	$ 1,591
Finance lease cost:				
Amortization of right-of-use assets	**$ 830**	$ 408	**$ 1,524**	$ 788
Interest on lease liabilities	**337**	168	**611**	317
Total finance lease cost	**$ 1,167**	$ 576	**$ 2,135**	$ 1,105

Supplemental cash flow information related to leases was as follows:

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2024	**2023**	**2024**	**2023**
Cash paid for amounts included in the measurement of lease liabilities:				
Operating cash flows from operating leases	**$ 962**	$ 803	**$ 2,169**	$ 1,597
Operating cash flows from finance leases	**319**	168	**594**	317
Financing cash flows from finance leases	**480**	288	**1,282**	573
Right-of-use assets obtained in exchange for lease obligations:				
Operating leases	**3,098**	847	**4,991**	2,651
Finance leases	**6,435**	1,796	**10,767**	3,500

Supplemental balance sheet information related to leases was as follows:

(In millions, except lease term and discount rate)	December 31, 2024	June 30, 2024
Operating Leases		
Operating lease right-of-use assets	**$ 22,816**	$ 18,961
Other current liabilities	**$ 4,608**	$ 3,580
Operating lease liabilities	**17,254**	15,497
Total operating lease liabilities	**$ 21,862**	$ 19,077
Finance Leases		
Property and equipment, at cost	**$ 42,539**	$ 32,248
Accumulated depreciation	**(7,650)**	(6,386)
Property and equipment, net	**$ 34,889**	$ 25,862
Other current liabilities	**$ 2,673**	$ 2,349
Other long-term liabilities	**33,404**	24,796
Total finance lease liabilities	**$ 36,077**	$ 27,145
Weighted Average Remaining Lease Term		
Operating leases	**7 years**	7 years
Finance leases	**12 years**	12 years
Weighted Average Discount Rate		
Operating leases	**3.4%**	3.3%
Finance leases	**4.0%**	3.9%

The following table outlines maturities of our lease liabilities as of December 31, 2024:

(In millions) Year Ending June 30,	Operating Leases	Finance Leases
2025 (excluding the six months ended December 31, 2024)	**$ 2,726**	**$ 1,979**
2026	**4,920**	**4,149**
2027	**4,063**	**4,180**
2028	**3,025**	**4,175**
2029	**2,203**	**3,528**
Thereafter	**7,433**	**28,350**
Total lease payments	**24,370**	**46,361**
Less imputed interest	**(2,508)**	**(10,284)**
Total	**$ 21,862**	**$ 36,077**

As of December 31, 2024, we had additional operating and finance leases, primarily for datacenters, that had not yet commenced of $6.0 billion and $99.4 billion, respectively. These operating and finance leases will commence between fiscal year 2025 and fiscal year 2030 with lease terms of 1 year to 25 years.

NOTE 14 — CONTINGENCIES

U.S. Cell Phone Litigation

Microsoft Mobile Oy, a subsidiary of Microsoft, along with other handset manufacturers and network operators, is a defendant in 45 lawsuits filed in the Superior Court for the District of Columbia by individual plaintiffs who allege that radio emissions from cellular handsets caused their brain tumors and other adverse health effects. We assumed responsibility for these claims in our agreement to acquire Nokia's Devices and Services business and have been substituted for the Nokia defendants. Twelve of these cases were consolidated for certain pre-trial proceedings; the remaining cases are stayed. In a separate 2009 decision, the Court of Appeals for the District of Columbia held that adverse health effect claims arising from the use of cellular handsets that operate within the U.S. Federal Communications Commission radio frequency emission guidelines ("FCC Guidelines") are pre-empted by federal law. The plaintiffs allege that their handsets either operated outside the FCC Guidelines or were manufactured before the FCC Guidelines went into effect. The lawsuits also allege an industry-wide conspiracy to manipulate the science and testing around emission guidelines.

In 2013, the defendants in the consolidated cases moved to exclude the plaintiffs' expert evidence of general causation on the basis of flawed scientific methodologies. In 2014, the trial court granted in part and denied in part the defendants' motion to exclude the plaintiffs' general causation experts. The defendants filed an interlocutory appeal to the District of Columbia Court of Appeals challenging the standard for evaluating expert scientific evidence. In October 2016, the Court of Appeals issued its decision adopting the standard advocated by the defendants and remanding the cases to the trial court for further proceedings under that standard. The plaintiffs have filed supplemental expert evidence, portions of which were stricken by the court. A hearing on general causation took place in September of 2022. In April of 2023, the court granted defendants' motion to strike the testimony of plaintiffs' experts that cell phones cause brain cancer and entered an order excluding all of plaintiffs' experts from testifying. The parties agreed to a stipulated dismissal of the consolidated cases to allow plaintiffs to appeal the expert testimony order. Plaintiffs appealed the court's order in August of 2023, and the appeal was argued in January of 2025. A hearing on the status of the stayed cases occurred in December of 2023. In July 2024, the court entered summary judgment in nine of the stayed cases on the grounds that plaintiffs had agreed to be bound by the general causation outcome in the consolidated cases.

Irish Data Protection Commission Matter

In 2018, the Irish Data Protection Commission ("IDPC") began investigating a complaint against LinkedIn as to whether LinkedIn's targeted advertising practices violated the recently implemented European Union General Data Protection Regulation ("GDPR"). Microsoft cooperated throughout the period of inquiry. In October 2024, the IDPC provided LinkedIn with a final decision alleging GDPR violations and assessing a fine. In November 2024, LinkedIn appealed the final decision to the Irish courts.

Other Contingencies

We also are subject to a variety of other claims and suits that arise from time to time in the ordinary course of our business. Although management currently believes that resolving claims against us, individually or in aggregate, will not have a material adverse impact in our consolidated financial statements, these matters are subject to inherent uncertainties and management's view of these matters may change in the future.

As of December 31, 2024, we accrued aggregate legal liabilities of $510 million. While we intend to defend these matters vigorously, adverse outcomes that we estimate could reach approximately $800 million in aggregate beyond recorded amounts are reasonably possible. Were unfavorable final outcomes to occur, there exists the possibility of a material adverse impact in our consolidated financial statements for the period in which the effects become reasonably estimable.

NOTE 15 — STOCKHOLDERS' EQUITY

Share Repurchases

On September 14, 2021, our Board of Directors approved a share repurchase program authorizing up to $60.0 billion in share repurchases. This share repurchase program commenced in November 2021, has no expiration date, and may be terminated at any time. As of December 31, 2024, $4.0 billion remained of this $60.0 billion share repurchase program.

On September 16, 2024, our Board of Directors approved a share repurchase program authorizing up to $60.0 billion in share repurchases. This share repurchase program will commence following completion of the program approved on September 14, 2021, has no expiration date, and may be terminated at any time.

We repurchased the following shares of common stock under the share repurchase program:

(In millions)	Shares	Amount	Shares	Amount
Fiscal Year		2025		2024
First Quarter	**7**	**$ 2,800**	11	$ 3,560
Second Quarter	**8**	**3,500**	7	2,800
Total	**15**	**$ 6,300**	18	$ 6,360

All repurchases were made using cash resources. All shares repurchased were under the share repurchase program approved on September 14, 2021. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards of $1.5 billion and $2.8 billion for the three and six months ended December 31, 2024, respectively, and $1.2 billion and $2.5 billion for the three and six months ended December 31, 2023, respectively.

Dividends

Our Board of Directors declared the following dividends:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
Fiscal Year 2025				(In millions)
September 16, 2024	**November 21, 2024**	**December 12, 2024**	**$ 0.83**	**$ 6,170**
December 3, 2024	**February 20, 2025**	**March 13, 2025**	**0.83**	**6,171**
Total			**$ 1.66**	**$ 12,341**
Fiscal Year 2024				
September 19, 2023	November 16, 2023	December 14, 2023	$ 0.75	$ 5,574
November 28, 2023	February 15, 2024	March 14, 2024	0.75	5,573
Total			$ 1.50	$ 11,147

The dividend declared on December 3, 2024 was included in other current liabilities as of December 31, 2024.

NOTE 16 — ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table summarizes the changes in accumulated other comprehensive income (loss) by component:

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2024	**2023**	**2024**	**2023**
Derivatives				
Balance, beginning of period	**$ (13)**	$ (6)	**$ (3)**	$ (27)
Unrealized gains (losses), net of tax of **$(13)**, $10, **$(6),** and $6	**(50)**	37	**(21)**	22
Reclassification adjustments for (gains) losses included in other income (expense), net	**106**	(51)	**57**	(5)
Tax expense (benefit) included in provision for income taxes	**(22)**	11	**(12)**	1
Amounts reclassified from accumulated other comprehensive loss	**84**	(40)	**45**	(4)
Net change related to derivatives, net of tax of **$9**, $(1), **$6**, and $5	**34**	(3)	**24**	18
Balance, end of period	**$ 21**	$ (9)	**$ 21**	$ (9)
Investments				
Balance, beginning of period	**$ (1,511)**	$ (3,842)	**$ (2,625)**	$ (3,582)
Unrealized gains (losses), net of tax of **$(121)**, $352, **$176**, and $277	**(453)**	1,325	**665**	1,042
Reclassification adjustments for losses included in other income (expense), net	**24**	7	**19**	36
Tax benefit included in provision for income taxes	**(5)**	(1)	**(4)**	(7)
Amounts reclassified from accumulated other comprehensive loss	**19**	6	**15**	29
Net change related to investments, net of tax of **$(116),** $353, **$180**, and $284	**(434)**	1,331	**680**	1,071
Balance, end of period	**$ (1,945)**	$ (2,511)	**$ (1,945)**	$ (2,511)
Translation Adjustments and Other				
Balance, beginning of period	**$ (2,658)**	$ (3,089)	**$ (2,962)**	$ (2,734)
Translation adjustments and other, net of tax of **$0**, $0, **$0**, and $0	**(1,034)**	660	**(730)**	305
Balance, end of period	**$ (3,692)**	$ (2,429)	**$ (3,692)**	$ (2,429)
Accumulated other comprehensive loss, end of period	**$ (5,616)**	$ (4,949)	**$ (5,616)**	$ (4,949)

NOTE 17 — SEGMENT INFORMATION AND GEOGRAPHIC DATA

In its operation of the business, management, including our chief operating decision maker, who is also our Chief Executive Officer, reviews certain financial information, including segmented internal profit and loss statements prepared on a basis not consistent with GAAP. During the periods presented, we reported our financial performance based on the following segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing.

We have recast certain prior period amounts to conform to the way we internally manage and monitor our business. Refer to Note 1 – Accounting Policies for further information.

Our reportable segments are described below.

Productivity and Business Processes

Our Productivity and Business Processes segment consists of products and services in our portfolio of productivity, communication, and information services, spanning a variety of devices and platforms. This segment primarily comprises:

- Microsoft 365 Commercial products and cloud services, including Microsoft 365 Commercial cloud, comprising Microsoft 365 Commercial, Enterprise Mobility + Security, the cloud portion of Windows Commercial, the per-user portion of Power BI, Exchange, SharePoint, Microsoft Teams, Microsoft 365 Security and Compliance, Microsoft Viva, and Microsoft 365 Copilot; and Microsoft 365 Commercial products, comprising Windows Commercial on-premises and Office licensed on-premises.
- Microsoft 365 Consumer products and cloud services, including Microsoft 365 Consumer subscriptions, Office licensed on-premises, and other consumer services.
- LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions.
- Dynamics products and cloud services, including Dynamics 365, comprising a set of intelligent, cloud-based applications across ERP, CRM, Power Apps, and Power Automate; and on-premises ERP and CRM applications.

Intelligent Cloud

Our Intelligent Cloud segment consists of our public, private, and hybrid server products and cloud services that can power modern business and developers. This segment primarily comprises:

- Server products and cloud services, including Azure and other cloud services, comprising cloud and AI consumption-based services, GitHub cloud services, Nuance Healthcare cloud services, virtual desktop offerings, and other cloud services; and Server products, comprising SQL Server, Windows Server, Visual Studio, System Center, related Client Access Licenses ("CALs"), and other on-premises offerings.
- Enterprise and partner services, including Enterprise Support Services, Industry Solutions, Nuance professional services, Microsoft Partner Network, and Learning Experience.

More Personal Computing

Our More Personal Computing segment consists of products and services that put customers at the center of the experience with our technology. This segment primarily comprises:

- Windows and Devices, including Windows, comprising Windows OEM licensing (Windows Pro and non-Pro licenses sold through the OEM channel), Windows Internet of Things, and patent licensing; and Devices, comprising Surface, HoloLens, and PC accessories.
- Gaming, including Xbox hardware and Xbox content and services, comprising first- and third-party content (including games and in-game content), Xbox Game Pass and other subscriptions, Xbox Cloud Gaming, advertising, third-party disc royalties, and other cloud services.
- Search and news advertising, comprising Bing (including Copilot), Microsoft News, Microsoft Edge, and third-party affiliates.

Revenue and costs are generally directly attributed to our segments. However, due to the integrated structure of our business, certain revenue recognized and costs incurred by one segment may benefit other segments. Revenue from certain contracts is allocated among the segments based on the relative value of the underlying products and services, which can include allocation based on actual prices charged, prices when sold separately, or estimated costs plus a profit margin. Cost of revenue is allocated in certain cases based on a relative revenue methodology. Operating expenses that are allocated primarily include those relating to marketing of products and services from which multiple segments benefit and are generally allocated based on relative gross margin.

In addition, certain costs are incurred at a corporate level and allocated to our segments. These allocated costs generally include legal, including settlements and fines, information technology, human resources, finance, excise taxes, field selling, shared facilities services, customer service and support, and severance incurred as part of a corporate program. Each allocation is measured differently based on the specific facts and circumstances of the costs being allocated and is generally based on relative gross margin or relative headcount.

Segment revenue and operating income were as follows during the periods presented:

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2024	2023	**2024**	2023
Revenue				
Productivity and Business Processes	**$ 29,437**	$ 25,854	**$ 57,754**	$ 51,080
Intelligent Cloud	**25,544**	21,525	**49,636**	41,538
More Personal Computing	**14,651**	14,641	**27,827**	25,919
Total	**$ 69,632**	$ 62,020	**$ 135,217**	$ 118,537
Operating Income				
Productivity and Business Processes	**$ 16,885**	$ 14,515	**$ 33,401**	$ 28,812
Intelligent Cloud	**10,851**	9,555	**21,354**	18,463
More Personal Computing	**3,917**	2,962	**7,450**	6,652
Total	**$ 31,653**	$ 27,032	**$ 62,205**	$ 53,927

No sales to an individual customer or country other than the United States accounted for more than 10% of revenue for the three or six months ended December 31, 2024 or 2023. Revenue, classified by the major geographic areas in which our customers were located, was as follows:

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2024	2023	**2024**	2023
United States [(a)]	**$ 35,537**	$ 32,295	**$ 69,450**	$ 61,107
Other countries	**34,095**	29,725	**65,767**	57,430
Total	**$ 69,632**	$ 62,020	**$ 135,217**	$ 118,537

(a) *Includes billings to OEMs and certain multinational organizations because of the nature of these businesses and the impracticability of determining the geographic source of the revenue.*

Revenue, classified by significant product and service offerings, was as follows:

(In millions)	Three Months Ended December 31, 2024	Three Months Ended December 31, 2023	Six Months Ended December 31, 2024	Six Months Ended December 31, 2023
Server products and cloud services	**$ 23,641**	$ 19,597	**$ 45,796**	$ 37,659
Microsoft 365 Commercial products and cloud services	**21,117**	18,321	**41,566**	36,365
Gaming	**6,581**	7,111	**12,202**	11,030
LinkedIn	**4,587**	4,195	**8,879**	8,108
Windows and Devices	**4,512**	4,363	**8,841**	8,703
Search and news advertising	**3,558**	3,168	**6,783**	6,186
Enterprise and partner services	**1,892**	1,917	**3,820**	3,861
Dynamics products and cloud services	**1,913**	1,659	**3,762**	3,285
Microsoft 365 Consumer products and cloud services	**1,821**	1,679	**3,548**	3,322
Other	**10**	10	**20**	18
Total	**$ 69,632**	$ 62,020	**$ 135,217**	$ 118,537

Our Microsoft Cloud revenue, which includes Microsoft 365 Commercial cloud, Azure and other cloud services, the commercial portion of LinkedIn, and Dynamics 365, was $40.9 billion and $79.8 billion for the three and six months ended December 31, 2024, respectively, and $33.7 billion and $65.6 billion for the three and six months ended December 31, 2023, respectively. These amounts are included in Microsoft 365 Commercial products and cloud services, Server products and cloud services, LinkedIn, and Dynamics products and cloud services in the table above.

Assets are not allocated to segments for internal reporting presentations. A portion of amortization and depreciation is included with various other costs in an overhead allocation to each segment. It is impracticable for us to separately identify the amount of amortization and depreciation by segment that is included in the measure of segment profit or loss.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Microsoft Corporation

Results of Review of Interim Financial Information

We have reviewed the accompanying consolidated balance sheet of Microsoft Corporation and subsidiaries (the "Company") as of December 31, 2024, the related consolidated statements of income, comprehensive income, cash flows, and stockholders' equity for the three-month and six-month periods ended December 31, 2024 and 2023, and the related notes (collectively referred to as the "interim financial information"). Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheet of the Company as of June 30, 2024, and the related consolidated statements of income, comprehensive income, cash flows, and stockholders' equity for the year then ended (not presented herein); and in our report dated July 30, 2024 (December 3, 2024 as to the effects of the retrospective adjustments in Notes 1, 8, 9, 13, and 19), we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of June 30, 2024, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Basis for Review Results

This interim financial information is the responsibility of the Company's management. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our reviews in accordance with standards of the PCAOB. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the PCAOB, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

/S/ DELOITTE & TOUCHE LLP

Seattle, Washington
January 29, 2025

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Note About Forward-Looking Statements

This report includes estimates, projections, statements relating to our business plans, objectives, and expected operating results that are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may appear throughout this report, including the following sections: "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors" (Part II, Item 1A of this Form 10-Q). These forward-looking statements generally are identified by the words "believe," "project," "expect," "anticipate," "estimate," "intend," "strategy," "future," "opportunity," "plan," "may," "should," "will," "would," "will be," "will continue," "will likely result," and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties that may cause actual results to differ materially. We describe risks and uncertainties that could cause actual results and events to differ materially in "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Quantitative and Qualitative Disclosures About Market Risk" (Part I, Item 3 of this Form 10-Q), and "Risk Factors". We undertake no obligation to update or revise publicly any forward-looking statements, whether because of new information, future events, or otherwise.

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to help the reader understand the results of operations and financial condition of Microsoft Corporation. MD&A is provided as a supplement to, and should be read in conjunction with, our Annual Report on Form 10-K for the year ended June 30, 2024, our Form 8-K filed on December 3, 2024, and our consolidated financial statements and the accompanying Notes to Financial Statements (Part I, Item 1 of this Form 10-Q).

OVERVIEW

Microsoft is a technology company committed to making digital technology and artificial intelligence ("AI") available broadly and doing so responsibly, with a mission to empower every person and every organization on the planet to achieve more. We create platforms and tools, powered by AI, that deliver innovative solutions that meet the evolving needs of our customers.

We generate revenue by offering a wide range of cloud-based solutions, content, and other services to people and businesses; licensing and supporting an array of software products; delivering relevant online advertising to a global audience; and designing and selling devices. Our most significant expenses are related to compensating employees; supporting and investing in our cloud-based services, including datacenter operations; designing, manufacturing, marketing, and selling our other products and services; and income taxes.

Highlights from the second quarter of fiscal year 2025 compared with the second quarter of fiscal year 2024 included:

- Microsoft Cloud revenue increased 21% to $40.9 billion.
- Microsoft 365 Commercial products and cloud services revenue increased 15% driven by Microsoft 365 Commercial cloud revenue growth of 16%.
- Microsoft 365 Consumer products and cloud services revenue increased 8% driven by Microsoft 365 Consumer cloud revenue growth of 8%.
- LinkedIn revenue increased 9%.
- Dynamics products and cloud services revenue increased 15% driven by Dynamics 365 revenue growth of 19%.
- Server products and cloud services revenue increased 21% driven by Azure and other cloud services revenue growth of 31%.
- Windows OEM and Devices revenue increased 4%.
- Xbox content and services revenue increased 2%.
- Search and news advertising revenue excluding traffic acquisition costs increased 21%.

Industry Trends

Our industry is dynamic and highly competitive, with frequent changes in both technologies and business models. Each industry shift is an opportunity to conceive new products, new technologies, or new ideas that can further transform the industry and our business. At Microsoft, we push the boundaries of what is possible through a broad range of research and development activities that seek to identify and address the changing demands of customers and users, industry trends, and competitive forces.

Economic Conditions, Challenges, and Risks

The markets for software, devices, and cloud-based services are dynamic and highly competitive. Our competitors are developing new software and devices, while also deploying competing cloud-based services for consumers and businesses. The devices and form factors customers prefer evolve rapidly, influencing how users access services in the cloud and, in some cases, the user's choice of which suite of cloud-based services to use. Aggregate demand for our software, services, and devices is also correlated to global macroeconomic and geopolitical factors, which remain dynamic. We must continue to evolve and adapt over an extended time in pace with this changing environment.

The investments we are making in cloud and AI infrastructure and devices will continue to increase our operating costs and may decrease our operating margins. We continue to identify and evaluate opportunities to expand our datacenter locations and increase our server capacity to meet the evolving needs of our customers, particularly given the growing demand for AI services. Our datacenters depend on the availability of permitted and buildable land, predictable energy, networking supplies, and servers, including graphics processing units ("GPUs") and other components. Our devices are primarily manufactured by third-party contract manufacturers. For the majority of our products, we have the ability to use other manufacturers if a current vendor becomes unavailable or unable to meet our requirements. However, some of our products contain certain components for which there are very few qualified suppliers. Extended disruptions at these suppliers could impact our ability to manufacture devices on time to meet consumer demand.

Our success is highly dependent on our ability to attract and retain qualified employees. We hire a mix of university and industry talent worldwide. We compete for talented individuals globally by offering an exceptional working environment, broad customer reach, scale in resources, the ability to grow one's career across many different products and businesses, and competitive compensation and benefits.

Our international operations provide a significant portion of our total revenue and expenses. Many of these revenue and expenses are denominated in currencies other than the U.S. dollar. As a result, changes in foreign exchange rates may significantly affect revenue and expenses. Fluctuations in the U.S. dollar relative to certain foreign currencies did not have a material impact on reported revenue and expenses from our international operations for the three and six months ended December 31, 2024.

Refer to Risk Factors (Part II, Item 1A of this Form 10-Q) for a discussion of these factors and other risks.

Seasonality

Our revenue fluctuates quarterly and is generally higher in the fourth quarter of our fiscal year. Fourth quarter revenue is driven by a higher volume of multi-year contracts executed during the period.

Reportable Segments

We report our financial performance based on the following segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing. The segment amounts included in MD&A are presented on a basis consistent with our internal management reporting.

In August 2024, we announced changes to the composition of our segments. These changes align our segments with how we currently manage our business, most notably bringing the commercial components of Microsoft 365 together in the Productivity and Business Processes segment. Beginning in fiscal year 2025, the information that our chief operating decision maker is regularly provided and reviews for purposes of allocating resources and assessing performance reflects these segment changes. Prior period segment information has been recast to conform to the way we internally manage and monitor our business during fiscal year 2025.

Additional information on our reportable segments is contained in Note 17 – Segment Information and Geographic Data of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q).

Metrics

We use metrics in assessing the performance of our business and to make informed decisions regarding the allocation of resources. We disclose metrics to enable investors to evaluate progress against our ambitions, provide transparency into performance trends, and reflect the continued evolution of our products and services. Our commercial and other business metrics are fundamentally connected based on how customers use our products and services. The metrics are disclosed in the MD&A or the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q). Financial metrics are calculated based on financial results prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"), and growth comparisons relate to the corresponding period of last fiscal year.

In the first quarter of fiscal year 2025, we made updates to our metrics in connection with the segment changes described above. These changes align our metrics with how we manage and monitor certain businesses. The key change was bringing the commercial components of Microsoft 365 together and creating a new Microsoft 365 Commercial cloud revenue growth metric. Other changes include combining Windows OEM and Devices into a single revenue growth metric that brings revenue from PC market-driven businesses together, as well as elevating our cloud revenue growth metrics to align to our strategic focus on cloud growth.

Commercial

Our commercial business primarily consists of Server products and cloud services, Microsoft 365 Commercial products and cloud services, the commercial portion of LinkedIn, Enterprise and partner services, and Dynamics products and cloud services. Our commercial metrics allow management and investors to assess the overall health of our commercial business and include leading indicators of future performance.

Commercial remaining performance obligation	Commercial portion of revenue allocated to remaining performance obligations, which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods
Microsoft Cloud revenue and revenue growth	Revenue from Microsoft 365 Commercial cloud, Azure and other cloud services, the commercial portion of LinkedIn, and Dynamics 365
Microsoft Cloud gross margin percentage	Gross margin percentage for our Microsoft Cloud business

Productivity and Business Processes and Intelligent Cloud

Metrics related to our Productivity and Business Processes and Intelligent Cloud segments assess the health of our core businesses within these segments. The metrics primarily reflect growth across our cloud services.

Microsoft 365 Commercial cloud revenue growth	Revenue from Microsoft 365 Commercial subscriptions, comprising Microsoft 365 Commercial, Enterprise Mobility + Security, the cloud portion of Windows Commercial, the per-user portion of Power BI, Exchange, SharePoint, Microsoft Teams, Microsoft 365 Security and Compliance, Microsoft Viva, and Microsoft 365 Copilot
Microsoft 365 Commercial seat growth	The number of Microsoft 365 Commercial seats at end of period where seats are paid users covered by a Microsoft 365 Commercial subscription
Microsoft 365 Consumer cloud revenue growth	Revenue from Microsoft 365 Consumer subscriptions and other consumer services
Microsoft 365 Consumer subscribers	The number of Microsoft 365 Consumer subscribers at end of period
LinkedIn revenue growth	Revenue from LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions
Dynamics 365 revenue growth	Revenue from Dynamics 365, including a set of intelligent, cloud-based applications across ERP, CRM, Power Apps, and Power Automate
Azure and other cloud services revenue growth	Revenue from Azure and other cloud services, including cloud and AI consumption-based services, GitHub cloud services, Nuance Healthcare cloud services, virtual desktop offerings, and other cloud services

More Personal Computing

Metrics related to our More Personal Computing segment assess the performance of our key consumer businesses.

Windows OEM and Devices revenue growth	Revenue from sales of Windows Pro and non-Pro licenses sold through the OEM channel and sales of first-party Devices, including Surface, HoloLens, and PC accessories
Xbox content and services revenue growth	Revenue from Xbox content and services, comprising first- and third-party content (including games and in-game content), Xbox Game Pass and other subscriptions, Xbox Cloud Gaming, advertising, third-party disc royalties, and other cloud services
Search and news advertising revenue (ex TAC) growth	Revenue from search and news advertising excluding traffic acquisition costs ("TAC") paid to Bing Ads network publishers and news partners

SUMMARY RESULTS OF OPERATIONS

(In millions, except percentages and per share amounts)	Three Months Ended December 31,		Percentage Change	Six Months Ended December 31,		Percentage Change
	2024	2023		**2024**	2023	
Revenue	**$ 69,632**	$ 62,020	12%	**$ 135,217**	$ 118,537	14%
Gross margin	**47,833**	42,397	13%	**93,319**	82,612	13%
Operating income	**31,653**	27,032	17%	**62,205**	53,927	15%
Net income	**24,108**	21,870	10%	**48,775**	44,161	10%
Diluted earnings per share	**3.23**	2.93	10%	**6.53**	5.92	10%

Three Months Ended December 31, 2024 Compared with Three Months Ended December 31, 2023

Revenue increased $7.6 billion or 12% driven by growth in Intelligent Cloud and Productivity and Business Processes. Intelligent Cloud revenue increased driven by Azure. Productivity and Business Processes revenue increased driven by Microsoft 365 Commercial cloud. More Personal Computing revenue was relatively unchanged.

Cost of revenue increased $2.2 billion or 11% driven by growth in Microsoft Cloud, offset in part by Gaming.

Gross margin increased $5.4 billion or 13% driven by growth across each of our segments.

- Gross margin percentage increased slightly driven by More Personal Computing and sales mix shift to higher margin businesses within More Personal Computing, offset in part by Intelligent Cloud.
- Microsoft Cloud gross margin percentage decreased to 70% driven by scaling our AI infrastructure.

Operating expenses increased $815 million or 5% driven by investments in cloud engineering.

Operating income increased $4.6 billion or 17% driven by growth across each of our segments.

Six Months Ended December 31, 2024 Compared with Six Months Ended December 31, 2023

Revenue increased $16.7 billion or 14% driven by growth across each of our segments. Intelligent Cloud revenue increased driven by Azure. Productivity and Business Processes revenue increased driven by Microsoft 365 Commercial cloud. More Personal Computing revenue increased driven by Gaming.

Cost of revenue increased $6.0 billion or 17% driven by growth in Microsoft Cloud.

Gross margin increased $10.7 billion or 13% driven by growth across each of our segments.

- Gross margin percentage decreased slightly driven by Intelligent Cloud, offset in part by More Personal Computing.
- Microsoft Cloud gross margin percentage decreased to 70% driven by scaling our AI infrastructure.

Operating expenses increased $2.4 billion or 8% driven by investments in cloud engineering and the impact of the Activision Blizzard acquisition.

Operating income increased $8.3 billion or 15% driven by growth across each of our segments.

SEGMENT RESULTS OF OPERATIONS

(In millions, except percentages)	Three Months Ended December 31, 2024	2023	Percentage Change	Six Months Ended December 31, 2024	2023	Percentage Change
Revenue						
Productivity and Business Processes	**$ 29,437**	$ 25,854	14%	**$ 57,754**	$ 51,080	13%
Intelligent Cloud	**25,544**	21,525	19%	**49,636**	41,538	19%
More Personal Computing	**14,651**	14,641	0%	**27,827**	25,919	7%
Total	**$ 69,632**	$ 62,020	12%	**$ 135,217**	$ 118,537	14%
Operating Income						
Productivity and Business Processes	**$ 16,885**	$ 14,515	16%	**$ 33,401**	$ 28,812	16%
Intelligent Cloud	**10,851**	9,555	14%	**21,354**	18,463	16%
More Personal Computing	**3,917**	2,962	32%	**7,450**	6,652	12%
Total	**$ 31,653**	$ 27,032	17%	**$ 62,205**	$ 53,927	15%

Reportable Segments

Three Months Ended December 31, 2024 Compared with Three Months Ended December 31, 2023

Productivity and Business Processes

Revenue increased $3.6 billion or 14%.

- Microsoft 365 Commercial products and cloud services revenue increased $2.8 billion or 15%. Microsoft 365 Commercial cloud revenue grew 16% with Microsoft 365 Commercial seat growth of 7% driven by small and medium business and frontline worker offerings, as well as growth in revenue per user. Microsoft 365 Commercial products revenue grew 13% driven by the Windows Commercial on-premises components of Microsoft 365 suite sales and an increase in transactional purchasing with the launch of Office 2024.
- Microsoft 365 Consumer products and cloud services revenue increased $142 million or 8%. Microsoft 365 Consumer cloud revenue grew 8% driven by Microsoft 365 Consumer subscriber growth of 10% to 86.3 million with mix shift to Microsoft 365 Basic.
- LinkedIn revenue increased $392 million or 9% driven by growth across all lines of business – Marketing Solutions, Talent Solutions, Premium Subscriptions, and Sales Solutions.
- Dynamics products and cloud services revenue increased $254 million or 15% driven by growth in Dynamics 365, offset in part by a decline in Dynamics on-premises products. Dynamics 365 revenue grew 19% driven by growth across all workloads.

Operating income increased $2.4 billion or 16%.

- Gross margin increased $2.8 billion or 13% driven by growth in Microsoft 365 Commercial cloud. Gross margin percentage decreased slightly driven by scaling our AI infrastructure.
- Operating expenses increased $390 million or 6% driven by investments in cloud engineering.

Intelligent Cloud

Revenue increased $4.0 billion or 19%.

- Server products and cloud services revenue increased $4.0 billion or 21% driven by Azure and other cloud services. Azure and other cloud services revenue grew 31% driven by demand for our portfolio of services, including 13 points from our AI services which grew 157%. Server products revenue decreased 3% driven by a decrease in transactional purchasing and a prior year comparable that benefited from purchasing ahead of Windows Server 2012 end of support.
- Enterprise and partner services revenue decreased $25 million or 1% driven by a decline in Industry Solutions, offset in part by growth in Enterprise Support Services.

Operating income increased $1.3 billion or 14%.

- Gross margin increased $1.8 billion or 12% driven by growth in Azure. Gross margin percentage decreased driven by scaling our AI infrastructure.
- Operating expenses increased $482 million or 10% driven by investments in cloud engineering.

More Personal Computing

Revenue was relatively unchanged.

- Windows and Devices revenue increased $149 million or 3%. Windows OEM and Devices revenue increased 4% as commercial inventory builds drove growth in Windows OEM, offset in part by a decline in Devices.
- Gaming revenue decreased $530 million or 7% driven by a decline in Xbox hardware, offset in part by growth in Xbox content and services. Xbox hardware revenue decreased 29% driven by lower volume of consoles sold. Xbox content and services revenue increased 2% driven by growth in Xbox Game Pass.
- Search and news advertising revenue increased $390 million or 12%. Search and news advertising revenue excluding traffic acquisition costs increased 21% driven by higher search volume and higher revenue per search.

Operating income increased $955 million or 32%, including a favorable foreign currency impact of 2%.

- Gross margin increased $898 million or 13% driven by growth in Gaming, Search and news advertising, and Windows and Devices. Gross margin percentage increased driven by sales mix shift to higher margin businesses and improvement in Gaming and Search and news advertising.
- Operating expenses decreased $57 million or 1% primarily driven by Gaming.

Six Months Ended December 31, 2024 Compared with Six Months Ended December 31, 2023

Productivity and Business Processes

Revenue increased $6.7 billion or 13%.

- Microsoft 365 Commercial products and cloud services revenue increased $5.2 billion or 14%. Microsoft 365 Commercial cloud revenue grew 15% driven by seat growth and growth in revenue per user. Microsoft 365 Commercial products revenue grew 7% driven by the Windows Commercial on-premises components of Microsoft 365 suite sales.
- Microsoft 365 Consumer products and cloud services revenue increased $226 million or 7%. Microsoft 365 Consumer cloud revenue grew 7% with continued growth in Microsoft 365 Consumer subscribers.
- LinkedIn revenue increased $771 million or 10% driven by growth across all lines of business – Marketing Solutions, Talent Solutions, Premium Subscriptions, and Sales Solutions.
- Dynamics products and cloud services revenue increased $477 million or 15% driven by growth in Dynamics 365, offset in part by a decline in Dynamics on-premises products. Dynamics 365 revenue grew 19% driven by growth across all workloads.

Operating income increased $4.6 billion or 16%.

- Gross margin increased $5.1 billion or 12% driven by growth in Microsoft 365 Commercial cloud. Gross margin percentage decreased slightly driven by scaling our AI infrastructure.
- Operating expenses increased $491 million or 4% driven by investments in cloud engineering and commercial sales.

Intelligent Cloud

Revenue increased $8.1 billion or 19%.

- Server products and cloud services revenue increased $8.1 billion or 22% driven by Azure and other cloud services. Azure and other cloud services revenue grew 32% driven by demand for our portfolio of services, including 12 points from our AI services which grew 178%. Server products revenue decreased 2% driven by a decrease in transactional purchasing.
- Enterprise and partner services revenue decreased $41 million or 1% driven by a decline in Industry Solutions.

Operating income increased $2.9 billion or 16%.

- Gross margin increased $3.7 billion or 13% driven by growth in Azure. Gross margin percentage decreased driven by scaling our AI infrastructure.
- Operating expenses increased $854 million or 9% driven by investments in cloud engineering.

More Personal Computing

Revenue increased $1.9 billion or 7%.

- Windows and Devices revenue increased $138 million or 2%. Windows OEM and Devices revenue increased 3% as commercial inventory builds drove growth in Windows OEM, offset in part by a decline in Devices.
- Gaming revenue increased $1.2 billion or 11% driven by growth in Xbox content and services, offset in part by a decline in Xbox hardware. Xbox content and services revenue increased 24% driven by the impact of the Activision Blizzard acquisition. Xbox hardware revenue decreased 29% driven by lower volume of consoles sold.
- Search and news advertising revenue increased $597 million or 10%. Search and news advertising revenue excluding traffic acquisition costs increased 20% driven by higher search volume and higher revenue per search.

Operating income increased $798 million or 12%.

- Gross margin increased $1.9 billion or 15% driven by growth in Gaming, including the impact of the Activision Blizzard acquisition. Gross margin percentage increased driven by sales mix shift to higher margin businesses and improvement in Search and news advertising and Gaming.
- Operating expenses increased $1.1 billion or 17% driven by the impact of the Activision Blizzard acquisition.

OPERATING EXPENSES

Research and Development

(In millions, except percentages)	Three Months Ended December 31,		Percentage Change	Six Months Ended December 31,		Percentage Change
	2024	**2023**		**2024**	**2023**	
Research and development	**$ 7,917**	$ 7,142	11%	**$ 15,461**	$ 13,801	12%
As a percent of revenue	**11%**	12%	(1)ppt	**11%**	12%	(1)ppt

Research and development expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with product development. Research and development expenses also include third-party development and programming costs and the amortization of purchased software code and services content.

Three Months Ended December 31, 2024 Compared with Three Months Ended December 31, 2023

Research and development expenses increased $775 million or 11% driven by investments in cloud engineering.

Six Months Ended December 31, 2024 Compared with Six Months Ended December 31, 2023

Research and development expenses increased $1.7 billion or 12% driven by investments in cloud engineering and the impact of the Activision Blizzard acquisition.

Sales and Marketing

(In millions, except percentages)	Three Months Ended December 31,		Percentage Change	Six Months Ended December 31,		Percentage Change
	2024	**2023**		**2024**	**2023**	
Sales and marketing	**$ 6,440**	$ 6,246	3%	**$ 12,157**	$ 11,433	6%
As a percent of revenue	**9%**	10%	(1)ppt	**9%**	10%	(1)ppt

Sales and marketing expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with sales and marketing personnel, and the costs of advertising, promotions, trade shows, seminars, and other programs.

Three Months Ended December 31, 2024 Compared with Three Months Ended December 31, 2023

Sales and marketing expenses increased $194 million or 3% driven by investments in commercial sales.

Six Months Ended December 31, 2024 Compared with Six Months Ended December 31, 2023

Sales and marketing expenses increased $724 million or 6% driven by the impact of the Activision Blizzard acquisition and investments in commercial sales.

General and Administrative

(In millions, except percentages)	Three Months Ended December 31,		Percentage Change	Six Months Ended December 31,		Percentage Change
	2024	**2023**		**2024**	**2023**	
General and administrative	**$ 1,823**	$ 1,977	(8)%	**$ 3,496**	$ 3,451	1%
As a percent of revenue	**3%**	3%	0ppt	**3%**	3%	0ppt

General and administrative expenses include payroll, employee benefits, stock-based compensation expense, employee severance expense incurred as part of a corporate program, and other headcount-related expenses associated with finance, legal, facilities, certain human resources and other administrative personnel, certain taxes, and legal and other administrative fees.

Three Months Ended December 31, 2024 Compared with Three Months Ended December 31, 2023

General and administrative expenses decreased $154 million or 8% driven by Gaming, offset in part by investments in corporate functions.

Six Months Ended December 31, 2024 Compared with Six Months Ended December 31, 2023

General and administrative expenses increased $45 million or 1% primarily driven by investments in corporate functions, offset in part by the impact of the Activision Blizzard acquisition.

OTHER INCOME (EXPENSE), NET

The components of other income (expense), net were as follows:

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2024	2023	**2024**	2023
Interest and dividends income	**$ 600**	$ 734	**$ 1,281**	$ 1,900
Interest expense	**(594)**	(909)	**(1,176)**	(1,434)
Net recognized gains (losses) on investments	**(860)**	69	**(397)**	(38)
Net losses on derivatives	**(116)**	(267)	**(454)**	(174)
Net gains (losses) on foreign currency remeasurements	**(153)**	36	**23**	(65)
Other, net	**(1,165)**	(169)	**(1,848)**	(306)
Total	**$ (2,288)**	$ (506)	**$ (2,571)**	$ (117)

We use derivative instruments to manage risks related to foreign currencies, interest rates, equity prices, and credit; to enhance investment returns; and to facilitate portfolio diversification. Gains and losses from changes in fair values of derivatives that are not designated as hedging instruments are primarily recognized in other income (expense), net.

Three Months Ended December 31, 2024 Compared with Three Months Ended December 31, 2023

Interest and dividends income decreased primarily due to lower portfolio balances. Interest expense decreased primarily due to maturities of commercial paper, offset in part by higher finance lease interest expense. Net recognized losses on investments increased primarily due to higher impairments and lower gains on equity investments in the current period. Net losses on derivatives decreased primarily due to lower losses on equity derivatives in the current period. Other, net primarily reflects net recognized losses on equity method investments, including OpenAI.

Six Months Ended December 31, 2024 Compared with Six Months Ended December 31, 2023

Interest and dividends income decreased primarily due to lower portfolio balances. Interest expense decreased primarily due to maturities of commercial paper, offset in part by higher finance lease interest expense. Net recognized losses on investments increased primarily due to higher impairments, offset in part by higher gains on equity investments in the current period. Net losses on derivatives increased primarily due to higher losses on equity derivatives in the current period. Other, net primarily reflects net recognized losses on equity method investments, including OpenAI.

INCOME TAXES

Effective Tax Rate

Our effective tax rate was 18% for both the three months ended December 31, 2024 and 2023, and 18% for both the six months ended December 31, 2024 and 2023. Our effective tax rate for the three and six months ended December 31, 2024 was primarily impacted by tax benefits from tax law changes in the prior fiscal year, including the delay of the effective date of final foreign tax credit regulations, and changes in the mix of our earnings and tax expenses between the U.S. and foreign countries.

Our effective tax rate was lower than the U.S. federal statutory rate for the three and six months ended December 31, 2024, primarily due to earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations center in Ireland.

The Organisation for Economic Co-operation and Development (“OECD”) published its model rules “Tax Challenges Arising From the Digitalisation of the Economy - Global Anti-Base Erosion Model Rules (Pillar Two)” which established a global minimum corporate tax rate of 15% for certain multinational enterprises. Many countries have implemented or are in the process of implementing the Pillar Two legislation, which applies to Microsoft beginning in fiscal year 2025. While we do not currently estimate a material impact to our consolidated financial statements, we continue to monitor the impact as countries implement legislation and the OECD provides additional guidance.

Uncertain Tax Positions

We remain under audit by the IRS for tax years 2014 to 2017. With respect to the audit for tax years 2004 to 2013, on September 26, 2023, we received Notices of Proposed Adjustment (“NOPAs”) from the IRS. The primary issues in the NOPAs relate to intercompany transfer pricing. In the NOPAs, the IRS is seeking an additional tax payment of $28.9 billion plus penalties and interest. As of December 31, 2024, we believe our allowances for income tax contingencies are adequate. We disagree with the proposed adjustments and will vigorously contest the NOPAs through the IRS’s administrative appeals office and, if necessary, judicial proceedings. We do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our income tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2024, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

LIQUIDITY AND CAPITAL RESOURCES

We expect existing cash, cash equivalents, short-term investments, cash flows from operations, and access to capital markets to continue to be sufficient to fund our operating activities and cash commitments for investing and financing activities, such as dividends, share repurchases, debt maturities, material capital expenditures, and the transition tax related to the Tax Cuts and Jobs Act (“TCJA”), for at least the next 12 months and thereafter for the foreseeable future.

Cash, Cash Equivalents, and Investments

Cash, cash equivalents, and short-term investments totaled $71.6 billion and $75.5 billion as of December 31, 2024 and June 30, 2024, respectively. Equity and other investments were $15.6 billion and $14.6 billion as of December 31, 2024 and June 30, 2024, respectively. Our short-term investments are primarily intended to facilitate liquidity and capital preservation. They consist predominantly of highly liquid investment-grade fixed-income securities, diversified among industries and individual issuers. The investments are predominantly U.S. dollar-denominated securities, but also include foreign currency-denominated securities to diversify risk. Our fixed-income investments are exposed to interest rate risk and credit risk. The credit risk and average maturity of our fixed-income portfolio are managed to achieve economic returns that correlate to certain fixed-income indices. The settlement risk related to these investments is insignificant given that the short-term investments held are primarily highly liquid investment-grade fixed-income securities.

Valuation

In general, and where applicable, we use quoted prices in active markets for identical assets or liabilities to determine the fair value of our financial instruments. This pricing methodology applies to our Level 1 investments, such as U.S. government securities, common and preferred stock, and mutual funds. If quoted prices in active markets for identical assets or liabilities are not available to determine fair value, then we use quoted prices for similar assets and liabilities or inputs other than the quoted prices that are observable either directly or indirectly. This pricing methodology applies to our Level 2 investments, such as commercial paper, certificates of deposit, U.S. agency securities, foreign government bonds, mortgage- and asset-backed securities, corporate notes and bonds, and municipal securities. Level 3 investments are valued using internally-developed models with unobservable inputs. Assets and liabilities measured at fair value on a recurring basis using unobservable inputs are an immaterial portion of our portfolio.

A majority of our investments are priced by pricing vendors and are generally Level 1 or Level 2 investments as these vendors either provide a quoted market price in an active market or use observable inputs for their pricing without applying significant adjustments. Broker pricing is used mainly when a quoted price is not available, the investment is not priced by our pricing vendors, or when a broker price is more reflective of fair values in the market in which the investment trades. Our broker-priced investments are generally classified as Level 2 investments because the broker prices these investments based on similar assets without applying significant adjustments. In addition, all our broker-priced investments have a sufficient level of trading volume to demonstrate that the fair values used are appropriate for these investments. Our fair value processes include controls that are designed to ensure appropriate fair values are recorded. These controls include model validation, review of key model inputs, analysis of period-over-period fluctuations, and independent recalculation of prices where appropriate.

Cash Flows

Cash from operations increased $7.0 billion to $56.5 billion for the six months ended December 31, 2024, primarily due to an increase in cash received from customers, offset in part by an increase in cash paid to suppliers and employees and cash used to pay income taxes. Cash used in financing increased $32.4 billion to $27.8 billion for the six months ended December 31, 2024, primarily due to $6.7 billion in cash used for repayments of debt, net of proceeds in the current period compared to $23.6 billion in proceeds from the issuance of debt, net of repayments in the prior period. Cash used in investing decreased $42.1 billion to $29.3 billion for the six months ended December 31, 2024, primarily due to a $63.0 billion decrease in cash used for acquisitions of companies, net of cash acquired, and purchases of intangible and other assets, offset in part by an $11.1 billion increase in additions to property and equipment and an $8.5 billion decrease in cash from net investment purchases, sales, and maturities.

Debt Proceeds

We issue debt to take advantage of favorable pricing and liquidity in the debt markets, reflecting our credit rating. The proceeds of these issuances were or will be used for general corporate purposes, which may include, among other things, funding for working capital, capital expenditures, repurchases of capital stock, acquisitions, and repayment of existing debt. Refer to Note 10 – Debt of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

Unearned Revenue

Unearned revenue comprises mainly unearned revenue related to volume licensing programs, which may include Software Assurance (“SA”) and cloud services. Unearned revenue is generally invoiced annually at the beginning of each contract period for multi-year agreements and recognized ratably over the coverage period. Unearned revenue also includes payments for other offerings for which we have been paid in advance and earn the revenue when we transfer control of the product or service.

The following table outlines the expected future recognition of unearned revenue as of December 31, 2024:

(In millions)		
Three Months Ending		
March 31, 2025	$	**23,167**
June 30, 2025		**13,764**
September 30, 2025		**5,835**
December 31, 2025		**2,742**
Thereafter		**2,537**
Total	$	**48,045**

If our customers choose to license cloud-based versions of our products and services rather than licensing transaction-based products and services, the associated revenue will shift from being recognized at the time of the transaction to being recognized over the subscription period or upon consumption, as applicable. Refer to Note 12 – Unearned Revenue of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

Material Cash Requirements and Other Obligations

Income Taxes

As a result of the TCJA, we are required to pay a one-time transition tax on deferred foreign income not previously subject to U.S. income tax. Under the TCJA, the transition tax is payable in interest-free installments over eight years, with 8% due in each of the first five years, 15% in year six, 20% in year seven, and 25% in year eight. As of December 31, 2024, our eighth transition tax installment of $4.4 billion is short-term and payable in the first quarter of fiscal year 2026.

Share Repurchases

For the six months ended December 31, 2024 and 2023, we repurchased 15 million shares and 18 million shares of our common stock for $6.3 billion and $6.4 billion, respectively, through our share repurchase program. All repurchases were made using cash resources. As of December 31, 2024, $4.0 billion remained of our $60 billion share repurchase program. Refer to Note 15 – Stockholders' Equity of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

Dividends

For the six months ended December 31, 2024 and 2023, our Board of Directors declared dividends totaling $12.3 billion and $11.1 billion, respectively. We intend to continue returning capital to shareholders in the form of dividends, subject to declaration by our Board of Directors. Refer to Note 15 – Stockholders' Equity of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

Other Planned Uses of Capital

We will continue to invest in sales, marketing, product support infrastructure, and existing and advanced areas of technology, as well as acquisitions that align with our business strategy. Additions to property and equipment will continue, including new facilities, datacenters, and computer systems for research and development, sales and marketing, support, and administrative staff. We expect capital expenditures to increase in coming years to support growth in our cloud offerings and our investments in AI infrastructure and training. We have operating and finance leases for datacenters, corporate offices, research and development facilities, Microsoft Experience Centers, and certain equipment. We have not engaged in any related party transactions or arrangements with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of capital resources.

RECENT ACCOUNTING GUIDANCE

Refer to Note 1 – Accounting Policies of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

CRITICAL ACCOUNTING ESTIMATES

Our consolidated financial statements and accompanying notes are prepared in accordance with GAAP. Preparing consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Critical accounting estimates are those estimates that involve a significant level of estimation uncertainty and could have a material impact on our financial condition or results of operations. We have critical accounting estimates in the areas of revenue recognition, impairment of investment securities, goodwill, research and development costs, legal and other contingencies, income taxes, and business combinations – valuation of intangible assets.

Revenue Recognition

Our contracts with customers often include promises to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. When a cloud-based service includes both on-premises software licenses and cloud services, judgment is required to determine whether the software license is considered distinct and accounted for separately, or not distinct and accounted for together with the cloud service and recognized over time. Certain cloud services, primarily Office 365, depend on a significant level of integration, interdependency, and interrelation between the desktop applications and cloud services, and are accounted for together as one performance obligation. Revenue from Office 365 is recognized ratably over the period in which the cloud services are provided.

Judgment is required to determine the standalone selling price (“SSP") for each distinct performance obligation. We use a single amount to estimate SSP for items that are not sold separately, including on-premises licenses sold with SA or software updates provided at no additional charge. We use a range of amounts to estimate SSP when we sell each of the products and services separately and need to determine whether there is a discount to be allocated based on the relative SSP of the various products and services.

In instances where SSP is not directly observable, such as when we do not sell the product or service separately, we determine the SSP using information that may include market conditions and other observable inputs. We typically have more than one SSP for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, we may use information such as the size of the customer and geographic region in determining the SSP.

Due to the various benefits from and the nature of our SA program, judgment is required to assess the pattern of delivery, including the exercise pattern of certain benefits across our portfolio of customers.

Our products are generally sold with a right of return, we may provide other credits or incentives, and in certain instances we estimate customer usage of our products and services, which are accounted for as variable consideration when determining the amount of revenue to recognize. Returns and credits are estimated at contract inception and updated at the end of each reporting period if additional information becomes available. Changes to our estimated variable consideration were not material for the periods presented.

Impairment of Investment Securities

We review debt investments quarterly for credit losses and impairment. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, credit quality of debt instrument issuers, and the extent to which the fair value is less than cost. This determination requires significant judgment. In making this judgment, we employ a systematic methodology that considers available quantitative and qualitative evidence in evaluating potential impairment of our investments. In addition, we consider specific adverse conditions related to the financial health of, and business outlook for, the investee. If we have plans to sell the security or it is more likely than not that we will be required to sell the security before recovery, then a decline in fair value below cost is recorded as an impairment charge in other income (expense), net and a new cost basis in the investment is established. If market, industry, and/or investee conditions deteriorate, we may incur future impairments.

Equity investments without readily determinable fair values are written down to fair value if a qualitative assessment indicates that the investment is impaired and the fair value of the investment is less than carrying value. We perform a qualitative assessment on a periodic basis. We are required to estimate the fair value of the investment to determine the amount of the impairment loss. Once an investment is determined to be impaired, an impairment charge is recorded in other income (expense), net.

Goodwill

We allocate goodwill to reporting units based on the reporting unit expected to benefit from the business combination. We evaluate our reporting units on an annual basis and, if necessary, reassign goodwill using a relative fair value allocation approach. Goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis (May 1) and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. These events or circumstances could include a significant change in the business climate, legal factors, operating performance indicators, competition, or sale or disposition of a significant portion of a reporting unit.

Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. The fair value of each reporting unit is estimated primarily through the use of a discounted cash flow methodology. This analysis requires significant judgments, including estimation of future cash flows, which is dependent on internal forecasts, estimation of the long-term rate of growth for our business, estimation of the useful life over which cash flows will occur, and determination of our weighted average cost of capital.

The estimates used to calculate the fair value of a reporting unit change from year to year based on operating results, market conditions, and other factors. Changes in these estimates and assumptions could materially affect the determination of fair value and goodwill impairment for each reporting unit.

Research and Development Costs

Costs incurred internally in researching and developing a computer software product are charged to expense until technological feasibility has been established for the product. Once technological feasibility is established, software costs are capitalized until the product is available for general release to customers. Judgment is required in determining when technological feasibility of a product is established. We have determined that technological feasibility for our software products is reached after all high-risk development issues have been resolved through coding and testing. Generally, this occurs shortly before the products are released to production. The amortization of these costs is included in cost of revenue over the estimated life of the products.

Legal and Other Contingencies

The outcomes of legal proceedings and claims brought against us are subject to significant uncertainty. An estimated loss from a loss contingency such as a legal proceeding or claim is accrued by a charge to income if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. In determining whether a loss should be accrued we evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. Changes in these factors could materially impact our consolidated financial statements.

Income Taxes

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year, and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. We recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Accounting literature also provides guidance on derecognition of income tax assets and liabilities, classification of deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures. Judgment is required in assessing the future tax consequences of events that have been recognized in our consolidated financial statements or tax returns. Variations in the actual outcome of these future tax consequences could materially impact our consolidated financial statements.

Business Combinations – Valuation of Intangible Assets

Accounting for business combinations requires significant judgments when allocating the purchase price to the estimated fair values of assets acquired and liabilities assumed at the acquisition date. Determination of fair value involves estimates and assumptions which can be complex, most notably with respect to intangible assets. Critical estimates used in the valuation of intangible assets include, but are not limited to, the amount and timing of projected cash flows, useful lives, and discount rates. While management's estimates of fair value are based on assumptions that are believed to be reasonable, these assumptions are inherently uncertain as they pertain to forward-looking views of our business and market conditions. The judgments made in this valuation process could materially impact our consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

RISKS

We are exposed to economic risk from foreign exchange rates, interest rates, credit risk, and equity prices. We use derivatives instruments to manage these risks, however, they may still impact our consolidated financial statements.

Foreign Currencies

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily to maximize the economic effectiveness of our foreign currency positions, including hedges. Principal currency exposures include the Euro, Japanese yen, British pound, Canadian dollar, and Australian dollar.

Interest Rate

Securities held in our fixed-income portfolio are subject to different interest rate risks based on their maturities. We manage the average maturity of the fixed-income portfolio to achieve economic returns that correlate to certain global fixed-income indices.

Credit

Our fixed-income portfolio is diversified and consists primarily of investment-grade securities. We manage credit exposures relative to broad-based indices to facilitate portfolio diversification.

Equity

Securities held in our equity investments portfolio are subject to price risk.

SENSITIVITY ANALYSIS

The following table sets forth the potential loss in future earnings or fair values, including associated derivatives, resulting from hypothetical changes in relevant market rates or prices:

(In millions)

Risk Categories	**Hypothetical Change**	**December 31, 2024**	**Impact**
Foreign currency – Revenue	10% decrease in foreign exchange rates	$ **(9,903)**	Earnings
Foreign currency – Investments	10% decrease in foreign exchange rates	**(25)**	Fair Value
Interest rate	100 basis point increase in U.S. treasury interest rates	**(1,097)**	Fair Value
Credit	100 basis point increase in credit spreads	**(315)**	Fair Value
Equity	10% decrease in equity market prices	**(1,098)**	Earnings

ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective. There were no changes in our internal control over financial reporting during the quarter ended December 31, 2024 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Refer to Note 14 – Contingencies of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for information regarding legal proceedings in which we are involved.

ITEM 1A. RISK FACTORS

Our operations and financial results are subject to various risks and uncertainties, including those described below, that could adversely affect our business, operations, financial condition, results of operations, liquidity, and the trading price of our common stock.

STRATEGIC AND COMPETITIVE RISKS

We face intense competition across all markets for our products and services, which may adversely affect our results of operations.

Competition in the technology sector

Our competitors range in size from diversified global companies with significant research and development resources to small, specialized firms whose narrower product lines may let them be more effective in deploying technical, marketing, and financial resources. Barriers to entry in many of our businesses are low and many of the areas in which we compete evolve rapidly with changing and disruptive technologies, shifting user needs, and frequent introductions of new products and services. If we do not continue to innovate and provide products, devices, and services that appeal to businesses and consumers, we may not remain competitive, which may adversely affect our business, financial condition, and results of operations.

Competition among platform-based ecosystems

An important element of our business model has been to create platform-based ecosystems on which many participants can build diverse solutions. A well-established ecosystem creates beneficial network effects among users, application developers, and the platform provider that can accelerate growth. Establishing significant scale in the marketplace is necessary to achieve and maintain attractive margins. We face significant competition from firms that provide competing platforms.

- A competing vertically-integrated model, in which a single firm controls the hardware and software elements of a product and related services, has succeeded with some consumer products such as PCs, tablets, smartphones, gaming consoles, wearables, and other endpoint devices. Competitors pursuing this model also earn revenue from services integrated with the hardware and software platform, including applications and content sold through their integrated marketplaces. They may also be able to claim security and performance benefits from their vertically-integrated offer. We also offer some vertically-integrated hardware and software products and services. Shifting a portion of our business to a vertically-integrated model may increase our cost of revenue and reduce our operating margins.
- We derive substantial revenue from licenses of Windows operating systems on PCs. We face significant competition from competing platforms developed for new devices and form factors such as smartphones and tablets. These devices compete on multiple bases including price and the perceived utility of the device and its platform. Users continue to turn to these devices to perform functions that in the past were performed by PCs. Even if many users view these devices as complementary to a PC, the prevalence of these devices may make it more difficult to attract application developers to our PC operating system platforms. Competing with operating systems licensed at low or no cost may decrease our PC operating system margins. Popular products or services offered on competing platforms could increase their competitive strength. In addition, some of our devices compete with products made by our OEM partners, which may affect their commitment to our platform.

- Competing platforms have content and application marketplaces with scale and significant installed bases. The variety and utility of content and applications available on a platform are important to device purchasing decisions. Users may incur costs to move data and buy new content and applications when switching platforms. To compete, we must successfully enlist developers to write applications for our platform and ensure that these applications have high quality, security, customer appeal, and value. Efforts to compete with competitors' content and application marketplaces may increase our cost of revenue and lower our operating margins. Competitors' rules governing their content and applications marketplaces may restrict our ability to distribute products and services through them in accordance with our technical and business model objectives.

For all of these reasons, we may not be able to compete successfully against our current and future competitors, which may adversely affect our business, operations, financial condition, and results of operations.

Business model competition

Companies compete with us based on a growing variety of business models.

- A material part of our business involves cloud-based services available across the spectrum of computing devices. Our competitors continue to develop and deploy cloud-based services for consumers and business customers, and pricing and delivery models are evolving. We and our competitors are devoting significant resources to develop and deploy our cloud-based strategies.
- We are investing in artificial intelligence ("AI") across the entire company and infusing generative AI capabilities into our consumer and commercial offerings. AI technology and services are a highly competitive and rapidly evolving market, and new competitors continue to enter the market. We will bear significant development and operational costs to build and support the AI models, services, platforms, and infrastructure necessary to meet the needs of our customers. To compete effectively we must also be responsive to technological change, new and potential regulatory developments, and public scrutiny.
- Even as we transition more of our business to infrastructure-, platform-, and software-as-a-service business models, the license-based proprietary software model generates a substantial portion of our software revenue. We bear the costs of converting original ideas into software products through investments in research and development, offsetting these costs with the revenue received from licensing our products. Many of our competitors also develop and sell software to businesses and consumers under this model.
- Other competitors develop and offer free applications, online services, and content, and make money by selling third-party advertising. Advertising revenue funds development of products and services these competitors provide to users at little or no cost, competing directly with our revenue-generating products.
- Some companies compete with us by modifying and then distributing open source software at little or no cost to end users, developing, making available, or using AI models that are open, and earning revenue on advertising or integrated products and services. These firms do not bear the full costs of research and development for the open source products. Some open source products mimic the features and functionality of our products.

The competitive pressures described above may cause decreased sales volumes, price reductions, and/or increased operating costs, such as for research and development, marketing, and sales incentives, which may adversely affect our financial condition and results of operations.

Our focus on cloud-based and AI services presents execution and competitive risks. We are incurring significant costs to build and maintain infrastructure to support cloud-based and AI services. These costs will reduce the operating margins. Whether we succeed in cloud-based and AI services depends on our execution in several areas, including:

- Continuing to bring to market compelling cloud-based and AI services and products that generate increasing traffic and market share.
- Maintaining the utility, compatibility, and performance of our cloud-based and AI services on the growing array of computing devices, including PCs, smartphones, tablets, gaming consoles, and other devices.

- Continuing to enhance the attractiveness of our cloud platforms to third-party developers.
- Ensuring our cloud-based services meet the reliability expectations and specific requirements of our customers and maintain the security of their data as well as help them meet their own compliance needs.
- Making our suite of cloud-based services platform-agnostic, available on a wide range of devices and ecosystems, including those of our competitors.

It is uncertain whether our strategies will continue to attract users or generate the revenue required to succeed. If we are not effective in executing organizational and technical changes to increase efficiency and accelerate innovation, or if we fail to generate sufficient usage of our new products and services, we may not grow revenue in line with the infrastructure and development investments described above. This may adversely affect our operations, financial condition, and results of operations.

Our AI systems offer users powerful tools and capabilities. However, there may be instances where these systems are used in ways that are unintended or inappropriate. In addition, some users may also engage in fraudulent or abusive activities through our cloud-based and AI services, such as unauthorized account access, payment fraud, or terms of service violations including cryptocurrency mining or launching cyberattacks. While we are committed to detecting and controlling such misuse of our cloud-based and AI services, our efforts may not be effective, and we may incur reputational damage or experience adverse impacts to our business and results of operations.

RISKS RELATING TO THE EVOLUTION OF OUR BUSINESS

We make significant investments in products and services that may not achieve expected returns. We will continue to make significant investments in research, development, and marketing for existing products, services, and technologies. In addition, we are focused on developing new AI platform services and incorporating AI into existing products and services. We also invest in the development and acquisition of a variety of hardware for productivity, communication, and entertainment, including PCs, tablets, and gaming devices. Investments in new technology are speculative. Commercial success depends on many factors, including innovation, developer support, and effective distribution and marketing. If customers do not perceive our latest offerings as providing significant new functionality or other value, they may reduce their purchases of new software and hardware products or upgrades, unfavorably affecting revenue. We may not achieve significant revenue from new product, service, and distribution channel investments for several years, if at all. New products and services may not be profitable or may not achieve operating margins as high as we have experienced historically. We may not get engagement in certain features that drive post-sale monetization opportunities. Our data-handling practices across our products and services will continue to be under scrutiny. Perceptions of mismanagement, driven by regulatory activity or negative public reaction to our practices or product experiences, could negatively impact product and feature adoption. Developing new technologies is complex. It can require long development and testing periods. We could experience significant delays in new releases or significant problems in creating new products or services. These factors could adversely affect our business, financial condition, and results of operations.

Acquisitions, joint ventures, and strategic alliances may have an adverse effect on our business. We expect to continue making acquisitions and entering into joint ventures and strategic alliances as part of our long-term business strategy. For example, in March 2022 we completed our acquisition of Nuance Communications, Inc., and in October 2023 we completed our acquisition of Activision Blizzard, Inc. ("Activision Blizzard"). In January 2023 we announced the third phase of our OpenAI strategic partnership. Acquisitions and other transactions and arrangements involve significant challenges and risks, including that they do not advance our business strategy, that we get an unsatisfactory return on our investment, that they raise new compliance-related obligations and challenges, that we have difficulty integrating and retaining new employees, business systems, and technology, that they distract management from our other businesses, or that announced transactions may not be completed. If an arrangement fails to adequately anticipate changing circumstances and interests of a party, it may result in early termination or renegotiation of the arrangement. We also have limited ability to control or influence third parties with whom we have arrangements, which may impact our ability to realize the anticipated benefits. The success of these transactions and arrangements depend in part on our ability to leverage them to enhance our existing products and services or develop compelling new ones, as well as the acquired companies' ability to meet our policies and processes in areas such as data governance, privacy, and cybersecurity. It may take longer than expected to realize the full benefits from these transactions and arrangements, such as increased revenue or enhanced efficiencies, or the benefits may ultimately be smaller than we expected. In addition, an acquisition may be subject to challenge even after it has been completed. For example, the Federal Trade Commission continues to challenge our Activision Blizzard acquisition and could, if successful, alter or unwind the transaction. These events could adversely affect our business, operations, financial condition, and results of operations.

If our goodwill or amortizable intangible assets become impaired, we may be required to record a significant charge to earnings. We acquire other companies and intangible assets and may not realize all the economic benefit from those acquisitions, which could cause an impairment of goodwill or intangibles. We review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. We test goodwill for impairment at least annually. Factors that may be a change in circumstances, indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable, include a decline in our stock price and market capitalization, reduced future cash flow estimates, and slower growth rates in industry segments in which we participate. We have recorded, and may in the future be required to record, a significant charge in our consolidated financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, negatively affecting our results of operations.

CYBERSECURITY, DATA PRIVACY, AND PLATFORM ABUSE RISKS

Cyberattacks and security vulnerabilities could lead to reduced revenue, increased costs, liability claims, or harm to our reputation or competitive position.

Security of our information technology

Threats to security can take a variety of forms. Threat actors, including individual and groups of hackers and sophisticated organizations, including nation-states or state-sponsored organizations, continuously undertake attacks that pose threats to our customers and our internal infrastructure, and we have experienced cybersecurity incidents in which such actors have gained unauthorized access to our systems and data, including customer systems and data. These actors use a wide variety of methods, which include developing and deploying malicious software; exploiting known and potential vulnerabilities or intentionally designed processes in hardware, software, or other infrastructure to attack our products and services or gain access to our networks and datacenters; using social engineering techniques to induce our employees, users, partners, or customers to disclose sensitive information, such as passwords, or take other actions to gain access to our data or our users' or customers' data; or acting in a coordinated manner or conducting coordinated attacks. For example, as previously disclosed in our Form 8-K filed with the Securities and Exchange Commission on January 19, 2024 and amended on March 8, 2024, beginning in late November 2023, a nation-state associated threat actor used a password spray attack to compromise a legacy test account and, in turn, gain access to Microsoft email accounts. The threat actor used information it obtained to gain unauthorized access to some of our source code repositories and internal systems, and the threat actor may continue to utilize this and other information to attempt to gain access to our systems or otherwise adversely affect our business and results of operations. This incident has and may continue to result in harm to our reputation and customer relationships. Nation-state and state-sponsored actors can sustain malicious activities for extended periods and deploy significant resources to plan and carry out attacks. Nation-state attacks against us, our customers, or our partners have and may continue to intensify due to our transparency to our customers, other stakeholders, and the public about cyberattacks, and during elections or periods of intense diplomatic or armed conflict. Challenges or failures in applying security patches to all hardware and devices connected to our systems, including end-of-life and end-of-support equipment, have and may continue to result in unauthorized access to our systems and data in the future. Cyber incidents and attacks, individually or in the aggregate, could adversely affect our financial condition, results of operations, competitive position, and reputation, or expose us to legal or regulatory risk.

Inadequate account security or organizational security practices, including those of companies we have acquired or those of the third parties we utilize, have resulted and may result in unauthorized access to our systems and data, including customer systems and data, in the future. For example, system administrators may fail to timely remove employee account access when no longer appropriate. Employees or third parties may intentionally compromise our or our users' security or systems or reveal confidential information, and laws in foreign jurisdictions may compel actions by such parties against our interests and could limit our recourse. Malicious actors may employ the supply chain to introduce malware through software updates or compromised supplier accounts or hardware.

Cyberthreats are constantly evolving and becoming increasingly sophisticated and complex, increasing the difficulty of detecting and successfully defending against them. Threat actors may also utilize emerging technologies, such as AI and machine learning. We may have no current capability to detect certain vulnerabilities or new attack methods, which may allow them to persist in the environment over long periods of time. It may be difficult to determine the best way to investigate, mitigate, contain, and remediate the harm caused by a cyber incident. Such efforts may not be successful, and we may make errors or fail to take necessary actions. It is possible that threat actors may gain undetected access to other networks and systems after establishing a foothold on an internal system. Cyber incidents and attacks can have cascading impacts that unfold with increasing speed across our internal networks and systems, as well as those of our partners and customers. In addition, it may take considerable time for us to investigate and evaluate the full impact of incidents, particularly for sophisticated attacks. As a result of these and other factors, we may not be able to provide prompt, full, and reliable information about the incident to our customers, partners, regulators, and the public. Breaches of our facilities, network, or data security can disrupt the security of our systems and business applications, impair our ability to provide services to our customers and protect the privacy of their data, result in product development delays, compromise confidential or technical business information, result in theft or misuse of our intellectual property or other assets, subject us to ransomware attacks, require us to allocate more resources to improve technologies or remediate the impacts of attacks, or otherwise adversely affect our business. In addition, actions taken to remediate an incident could result in outages, data losses, and disruptions of our services.

Our internal environment continues to evolve. Often, we are early adopters of new devices and technologies. We embrace new ways of sharing data and communicating internally and with partners and customers using methods such as social networking and other consumer-oriented technologies. Increasing use of generative AI models in our internal systems may create new attack surfaces or methods for adversaries. Our business policies and internal security controls may not keep pace with these changes as new threats emerge or the emerging cybersecurity regulations in jurisdictions worldwide.

Security of our products, services, devices, and customers' data

The security of our products and services is important in our customers' decisions to purchase or use our products or services across cloud and on-premises environments. Security threats are a significant challenge to companies like us, whose business is providing technology products and services to others. Threats to or attacks on our own infrastructure, such as the nation-state attack described in the prior risk factor, have also affected our customers and may do so in the future. Customers using our cloud-based services rely on the security of our infrastructure, including hardware and other elements provided by third parties, to ensure the reliability of our services and the protection of their data. Adversaries tend to focus their efforts on the most popular operating systems, programs, and services, including many of ours, and we expect that to continue. In addition, adversaries can attack our customers' on-premises or cloud environments, sometimes exploiting previously unknown ("zero-day") vulnerabilities, such as the attack in early calendar year 2021 with several of our Exchange Server on-premises products. Vulnerabilities in these or any product can persist even after we have issued security patches if customers have not installed the most recent updates, or if the attackers exploited the vulnerabilities before patching to install additional malware to further compromise customers' systems. Adversaries will continue to attack customers using our cloud services as customers embrace digital transformation. Adversaries that acquire user account information can use that information to compromise our users' accounts, including where accounts share the same attributes such as passwords. Inadequate account security practices may also result in unauthorized access, and user activity may result in ransomware or other malicious software impacting a customer's use of our products or services. There may be vulnerabilities in open source software that may make our products susceptible to cyberattacks as we increasingly incorporate open source software into our products. Additionally, features that rely on generative AI may be susceptible to unanticipated security threats from adversaries as we add new generative AI features to our services while continuously developing our understanding of security risks and protection methods in the new field of generative AI.

Our customers operate complex systems with third-party hardware and software from multiple vendors that may include systems acquired over many years. They expect our products and services to support all these systems and products, including those that no longer incorporate the strongest current security advances or standards. As a result, we may not be able to discontinue support in our services for a product, service, standard, or feature solely because a more secure alternative is available. Failure to utilize the most current security advances and standards can increase our customers' vulnerability to attack. Further, customers of widely varied sizes and technical sophistication use our technology, and consequently may still have limited capabilities and resources to help them adopt and implement state-of-the-art cybersecurity practices and technologies. In addition, we must account for this wide variation of technical sophistication when defining default settings for our products and services, including security default settings, as these settings may limit or otherwise impact other aspects of operations and some customers may have limited capability to review and reset these defaults.

Cyberattacks may adversely impact our customers even if our production services are not directly compromised. We are committed to notifying our customers whose systems have been impacted as we become aware and have actionable information for customers to help protect themselves. We are also committed to providing guidance and support on detection, tracking, and remediation. We may not be able to detect the existence or extent of these attacks for all of our customers or have information on how to detect or track an attack, especially where an attack involves on-premises software such as Exchange Server where we may have no or limited visibility into our customers' computing environments.

Any of the foregoing events could result in reputational harm, loss of revenue, increased costs, or otherwise adversely affect our business, financial condition, and results of operations.

Development and deployment of defensive measures

To defend against security threats to our internal infrastructure, our cloud-based services, and our customers' systems, we must continuously engineer more secure products and services, enhance security, threat detection, and reliability features, escalate and improve the deployment of software updates to address security vulnerabilities in our own products as well as those provided by others in a timely manner, develop mitigation technologies that help to secure customers from attacks even when software updates are not deployed, maintain the digital security infrastructure that protects the integrity of our network, products, and services, and provide security tools such as firewalls, anti-virus software, and advanced security and information about the need to deploy security measures and the impact of doing so.

The cost of measures to protect products and customer-facing services could reduce our operating margins. If we fail to do these things well, actual or perceived security vulnerabilities in our products and services, data corruption issues, or reduced performance could harm our reputation and lead customers to reduce or delay future purchases of products or subscriptions to services, or to use competing products or services. Customers may also spend more on protecting their existing computer systems from attack, which could delay adoption of additional products or services. Customers in certain industries such as financial services, health care, and government may have enhanced or specialized expectations and requirements to which we must engineer our products and services. Customers and third parties granted access to their systems may fail to update their systems, continue to run software or operating systems we no longer support, or may fail to timely install or enable security patches, or may otherwise fail to adopt adequate security practices. Any of these could adversely affect our reputation and results of operations. Actual or perceived vulnerabilities may lead to claims against us. Our license agreements typically contain provisions that eliminate or limit our exposure to liability, but there is no assurance these provisions will withstand legal challenges. At times, to achieve commercial objectives, we may enter into agreements with larger liability exposure to customers.

Our products operate in conjunction with and are dependent on products and components across a broad ecosystem of third parties. If there is a security vulnerability in one of these components, and if there is a security exploit targeting it, we may experience adverse impacts to our results of operations, reputation, or competitive position.

Disclosure and misuse of personal data could result in liability and harm our reputation. As we continue to grow the number, breadth, and scale of our cloud-based offerings, we store and process increasingly large amounts of personal data of our customers and users. The continued occurrence of high-profile data breaches provides evidence of an external environment increasingly hostile to information security. Despite our efforts to improve the security controls across our business groups and geographies, it is possible our security controls over personal data, our training of employees and third parties on data security, and other practices we follow may not prevent the improper disclosure or misuse of customer or user data we or our vendors store and manage. Relatedly, despite our efforts to continuously improve security controls, it is possible that we may fail to identify or mitigate insider threat activities that could lead to the misuse of our systems or customer and user data. In addition, third parties who have limited access to our customer or user data may use this data in unauthorized ways. Improper disclosure or misuse could harm our reputation, lead to legal exposure to customers or users, or subject us to liability under laws that protect personal data, resulting in increased costs or loss of revenue. Our software products and services also enable our customers and users to store and process personal data on-premises or in a cloud-based environment we host. Government authorities can sometimes require us to produce customer or user data in response to valid legal orders. In the U.S. and elsewhere, we advocate for transparency concerning these requests and appropriate limitations on government authority to compel disclosure. Despite our efforts to protect customer and user data, perceptions that the collection, use, and retention of personal information is not satisfactorily protected could inhibit sales of our products or services and could limit adoption of our cloud-based solutions by consumers, businesses, and government entities. Additional security measures we take to address customer or user concerns, or constraints on our flexibility to determine where and how to operate datacenters in response to customer or user expectations or governmental rules or actions, may increase costs or hinder sales of our products and services.

We may not be able to protect information in our products and services from use by others. LinkedIn and other Microsoft products and services contain valuable information and content protected by contractual restrictions or technical measures. In certain cases, we have made commitments to our members and users to limit access to or use of this information. Changes in the law or interpretations of the law may weaken our ability to prevent third parties from scraping or gathering information or content through use of bots or other measures and using it for their own benefit which could adversely affect our business, financial condition, and results of operations.

Abuse of our platforms may harm our reputation or user engagement.

Advertising, professional, marketplace, and gaming platform abuses

For platform products and services that provide content or host ads that come from or can be influenced by third parties, our reputation or user engagement may be negatively affected by activity that is hostile or inappropriate. This activity may come from users impersonating other people or organizations, including through the use of AI technologies, dissemination of information that may be viewed as misleading or intended to manipulate the opinions of our users, or the use of our products or services that violates our terms of service or otherwise for objectionable or illegal ends. Preventing or responding to these actions may require us to make substantial investments in people and technology and these investments may not be successful, adversely affecting our business, financial condition, and results of operations.

Other digital safety abuses

Our consumer services as well as our enterprise services may be used to find, generate, store, or disseminate harmful or illegal content in violation of our terms or applicable law. We may not proactively discover such content due to scale, the limitations of existing technologies, and conflicting legal frameworks. When discovered by users and others, such content may negatively affect our reputation, our brands, and user engagement. Regulations and other initiatives to make platforms responsible for preventing or eliminating harmful content online have been enacted, and we expect this to continue. We may be subject to enhanced regulatory oversight, civil or criminal liability, or reputational damage if we fail to comply with content moderation regulations, adversely affecting our business, financial condition, and results of operations.

Our products and services, how they are used by customers, and how third-party products and services interact with them, may present security, privacy, and execution risks. Our products and services may contain defects in design, manufacture, or operation that make them insecure or ineffective for their intended purposes. For example, an Internet of Things solution may have multiple layers of hardware, sensors, processors, software, and firmware, several of which we may not develop or control, and may have limited ability to be updated or patched. Further, customers control our products and services, including our AI products, within their environments, and may deploy them in high-risk scenarios or utilize them inappropriately. As a result, our products and services may increasingly affect personal health and safety. Our products may also collect large amounts of data in manners which may not satisfy customers or regulatory requirements. Our customers also operate complex systems with third-party hardware and software from multiple vendors whose products or personnel may take or fail to take actions which impact the reliability or security of our products and services. If our products and services do not work as intended, are utilized in methods not intended, violate the law, or harm individuals or businesses, we may be subject to legal claims or enforcement actions. These risks, if realized, may increase our costs, damage our reputation, or adversely affect our results of operations.

Issues in the development and use of AI may result in reputational or competitive harm or liability. We are building AI into many of our offerings, including our productivity services, and we are also making AI available for our customers to use in solutions that they build. This AI may be developed by Microsoft or others, including our strategic partner, OpenAI. We expect these elements of our business to grow. We envision a future in which AI operating in devices, applications, and the cloud helps our customers be more productive in their work and personal lives. As with many innovations, AI presents risks and challenges that could affect its adoption, and therefore our business. AI algorithms or training methodologies may be flawed. Datasets may be overbroad, insufficient, or contain biased information. Content generated by AI systems may be offensive, illegal, inaccurate, or otherwise harmful. Ineffective or inadequate AI development or deployment practices by Microsoft or others could result in incidents that impair the acceptance of AI solutions, cause harm to individuals, customers, or society, or result in our products and services not working as intended. Human review of certain inputs and outputs may be required. Our implementation of AI systems could result in legal liability, regulatory action, brand, reputational, or competitive harm, or other adverse impacts. These risks may arise from current copyright infringement and other claims related to AI training and output, new and proposed legislation and regulations, such as the European Union's ("EU") AI Act and the U.S.'s AI Executive Order, and new applications of data protection, privacy, consumer protection, intellectual property, and other laws. Some AI scenarios present ethical issues or may have broad impacts on society. If we enable or offer AI solutions that have unintended consequences, unintended usage or customization by our customers and partners, are contrary to our responsible AI policies and practices, or are otherwise controversial because of their impact on human rights, privacy, employment, or other social, economic, or political issues, our reputation, competitive position, business, financial condition, and results of operations may be adversely affected.

OPERATIONAL RISKS

We may have excessive outages, data losses, and disruptions of our online services if we fail to maintain an adequate operations infrastructure. Our increasing user traffic, growth in services, and the complexity of our products and services demand more computing power. We spend substantial amounts to build, purchase, or lease datacenters and equipment and to upgrade our technology and network infrastructure to handle more traffic on our websites and in our datacenters. Our datacenters depend on the availability of permitted and buildable land, predictable energy, networking supplies, and servers, including graphics processing units and other components. The cost or availability of these dependencies could be adversely affected by a variety of factors, including the transition to a clean energy economy, local and regional environmental regulations, and geopolitical disruptions. These demands continue to increase as we introduce new products and services and support the growth and the augmentation of existing services, including through the incorporation of AI features and/or functionality. We are rapidly growing our business of providing a platform and back-end hosting for services provided by third parties to their end users. Maintaining, securing, and expanding this infrastructure is expensive and complex, and requires development of principles for datacenter builds in geographies with higher safety and reliability risks. It requires that we maintain an Internet connectivity infrastructure and storage and compute capacity that is robust and reliable within competitive and regulatory constraints that continue to evolve. Inefficiencies or operational failures, including temporary or permanent loss of customer data, outages, insufficient Internet connectivity, insufficient or unavailable power or water supply, or inadequate storage and compute capacity could diminish the quality of our products, services, and user experience, resulting in contractual liability, claims by customers and other third parties, regulatory actions, damage to our reputation, and loss of current and potential users, subscribers, and advertisers, each of which may adversely affect our business, operations, financial condition, and results of operations.

We may experience supply or quality problems. There are limited suppliers for certain device and datacenter components. We continue to identify and evaluate opportunities to expand our datacenter locations and increase our server capacity to meet the evolving needs of our customers, particularly given the growing demand for AI services. Capacity available to us may be affected as competitors use some of the same suppliers and materials for hardware components. If components are delayed or become unavailable, whether because of supplier capacity constraint, industry shortages, legal or regulatory changes that restrict supply sources, or other reasons, we may not obtain timely replacement supplies, resulting in reduced sales or inadequate datacenter capacity to support the delivery and continued development of our products and services. Component shortages, excess or obsolete inventory, or price reductions resulting in inventory adjustments may increase our cost of revenue. Datacenter servers, Xbox consoles, Surface devices, and other hardware are assembled in Asia and other geographies that may be subject to disruptions in the supply chain, resulting in shortages which may adversely affect our business, operations, financial condition, and results of operations.

Our software products and services also may experience quality or reliability problems. The highly sophisticated software we develop may contain bugs and other defects that interfere with their intended operation. Our customers increasingly rely on us for critical business functions and multiple workloads. Many of our products and services are interdependent on one another. Our products and services may be impacted by interaction with third-party products and services. Our customers may also utilize their own or third-party products and services whose reliability is dependent on interaction with our products and services. Each of these circumstances potentially magnifies the impact of quality or reliability issues. Any defects we do not detect and fix in pre-release testing could cause reduced sales, damage to our reputation, repair or remediation costs, delays in the release of new products or versions, or legal liability, which could adversely affect our business, financial condition, and results of operations. Although our license agreements typically contain provisions that eliminate or limit our exposure to liability, there is no assurance these provisions will withstand legal challenge.

Our hardware products such as Xbox consoles, Surface devices, and other devices we design and market are highly complex. Failure to prevent, detect, or address defects in design, manufacture, or associated software could result in recalls, safety alerts, or product liability claims, which could adversely affect our business and results of operations.

LEGAL, REGULATORY, AND LITIGATION RISKS

Government enforcement under competition laws and new market regulation may limit how we design and market our products. Government agencies closely scrutinize us under U.S. and foreign competition laws. Governments are actively enforcing competition laws and regulations and enacting new regulations to intervene in digital markets, and this includes markets such as the EU, the United Kingdom, the U.S., and China. Some jurisdictions also allow competitors or consumers to assert claims of anti-competitive conduct. U.S. and foreign antitrust authorities have previously brought enforcement actions and continue to scrutinize our business.

For example, the European Commission ("the Commission") has designated Windows and LinkedIn as core platform services subject to obligations under the EU Digital Markets Act, which prohibits certain self-preferencing behaviors and places limitations on certain data use among other obligations. The Commission also continues to closely scrutinize the design of high-volume Microsoft products and the terms on which we make certain technologies used in these products, such as file formats, programming interfaces, and protocols, available to other companies. Flagship product releases such as Microsoft 365 and Windows can receive significant scrutiny under EU or other competition laws.

Our portfolio of first-party devices continues to grow; at the same time, our OEM partners offer a large variety of devices for our platforms. As a result, we increasingly both cooperate and compete with our OEM partners, creating a risk that we fail to do so in compliance with competition rules. Regulatory scrutiny in this area may increase. Certain foreign governments, particularly in China and other countries in Asia, have advanced arguments under their competition laws that exert downward pressure on royalties for our intellectual property.

Competition law enforcement actions and court decisions along with new market regulations may result in fines or hinder our ability to provide the benefits of our software to consumers and businesses, reducing the attractiveness of our products and the revenue that comes from them. New competition law actions or obligations under market regulation schemes could be initiated, potentially using previous actions as precedent. The outcome of such actions, or steps taken to avoid them, could adversely affect us in a variety of ways, including causing us to withdraw products from or modify products for certain markets, decreasing the value of our assets, adversely affecting our ability to monetize our products, or inhibiting our ability to consummate acquisition or impose conditions on acquisitions that may reduce their value, which may adversely affect our business, financial condition, and results of operations.

Laws and regulations relating to anti-corruption and trade could result in increased costs, fines, criminal penalties, or reputational damage. The Foreign Corrupt Practices Act (“FCPA”) and other anti-corruption laws and regulations (“Anti-Corruption Laws”) prohibit corrupt payments by our employees, vendors, or agents, and the accounting provisions of the FCPA require us to maintain accurate books and records and adequate internal controls. From time to time, we receive inquiries from authorities in the U.S. and elsewhere which may be based on reports from employees and others about our business activities outside the U.S. and our compliance with Anti-Corruption Laws. Periodically, we receive such reports directly and investigate them, and also cooperate with investigations by U.S. and foreign law enforcement authorities. Most countries in which we operate also have competition laws that prohibit competitors from colluding or otherwise attempting to reduce competition between themselves. While we devote substantial resources to our U.S. and international compliance programs and have implemented policies, training, and internal controls designed to reduce the risk of corrupt payments and collusive activity, our employees, partners, vendors, or agents may violate our policies. Our failure to comply with Anti-Corruption Laws or competition laws could result in significant fines and penalties, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our business, and damage to our reputation, which could adversely affect our business, financial condition, and results of operations.

Increasing trade laws, policies, sanctions, and other regulatory requirements also affect our operations in and outside the U.S. relating to trade and investment. Economic sanctions in the U.S., the EU, and other countries prohibit most business with restricted entities or countries. U.S. export controls restrict Microsoft from offering many of its products and services to, or making investments in, certain entities in specified countries. U.S. import controls restrict us from integrating certain information and communication technologies into our supply chain and allow for government review of transactions involving information and communications technology from countries determined to be foreign adversaries. Supply chain regulations may impact the availability of goods or result in additional regulatory scrutiny. Periods of intense diplomatic or armed conflict, such as the ongoing conflict in Ukraine, may result in (1) new and rapidly evolving sanctions and trade restrictions, which may impair trade with sanctioned individuals and countries, and (2) negative impacts to regional trade ecosystems among our customers, partners, and us. Non-compliance with sanctions as well as general ecosystem disruptions could result in reputational harm, operational delays, monetary fines, loss of revenue, increased costs, loss of export privileges, or criminal sanctions, which could adversely affect our business, financial condition, and results of operations.

Laws and regulations relating to the handling of personal data may impede the adoption of our services or result in increased costs, legal claims, fines against us, or reputational damage. The growth of our Internet- and cloud-based services internationally relies increasingly on the movement of data across national boundaries. Legal requirements relating to the collection, storage, handling, and transfer of personal data continue to evolve. For example, while the EU-U.S. Data Privacy Framework (“DPF”) has been recognized as adequate under EU law to allow transfers of personal data from the EU to certified companies in the U.S., the DPF is subject to further legal challenge which could cause the legal requirements for data transfers from the EU to be uncertain. EU data protection authorities have and may again block the use of certain U.S.-based services that involve the transfer of data to the U.S. In the EU and other markets, potential new rules and restrictions on the flow of data across borders could increase the cost and complexity of delivering our products and services.

In addition, the EU General Data Protection Regulation ("GDPR"), which applies to all of our activities conducted from an establishment in the EU or related to products and services offered in the EU, imposes a range of compliance obligations regarding the handling of personal data. More recently, the EU has been developing new requirements related to the use of data, including in the Digital Markets Act, the Digital Services Act, and the Data Act, that add additional rules and restriction on the use of data in our products and services. Engineering efforts to build and maintain capabilities to facilitate compliance with these laws involve substantial expense and the diversion of engineering resources from other projects. We might experience reduced demand for our offerings if we are unable to engineer products that meet our legal duties or help our customers meet their obligations under these and other data regulations, or if our implementation to comply makes our offerings less attractive. Compliance with these obligations depends in part on how particular regulators interpret and apply them. If we fail to comply, or if regulators assert we have failed to comply (including in response to complaints made by customers), it may lead to regulatory enforcement actions, which can result in significant monetary penalties, private lawsuits, reputational damage, blockage of product offerings or of international data transfers, and loss of customers. The highest fines assessed under GDPR have recently been increasing, especially against large technology companies, and European data protection authorities have taken action to block or remove services from their markets. Jurisdictions around the world, such as China, India, and states in the U.S. have adopted, or are considering adopting or expanding, laws and regulations imposing obligations regarding the collection, handling, and transfer of personal data.

Our investment in gaining insights from data is becoming central to the value of the services we deliver to customers, including AI services, to operational efficiency and key opportunities in monetization, and to customer perceptions of quality. Our ability to use data in this way may be constrained by regulatory developments that impede realizing the expected return from this investment. Ongoing legal analyses, reviews, and inquiries by regulators of Microsoft practices, or relevant practices of other organizations, may result in burdensome or inconsistent requirements, including data sovereignty and localization requirements, affecting the location, movement, collection, and use of our customer and internal employee data as well as the management of that data. Compliance with applicable laws and regulations regarding personal data may require changes in services, business practices, or internal systems that result in increased costs, lower revenue, reduced efficiency, or greater difficulty in competing with foreign-based firms. Compliance with data regulations might limit our ability to innovate or offer certain features and functionality in some jurisdictions where we operate. Failure to comply with existing or new rules may result in significant penalties or orders to stop the alleged noncompliant activity, negative publicity, and diversion of management time and effort.

Existing and increasing legal and regulatory requirements could adversely affect our results of operations. We are subject to a wide range of laws, regulations, and legal requirements in the U.S. and globally, including those that may apply to our products and online services offerings, and those that impose requirements related to user privacy, telecommunications, data storage and protection, digital accessibility, advertising, and online content. Laws in several jurisdictions, including EU Member State laws under the European Electronic Communications Code and the Digital Services Act, increasingly define certain of our services as regulated services. This trend may continue and will result in these offerings being subject to additional data protection, security, digital safety, law enforcement surveillance, and other obligations. Regulators and private litigants may assert that our collection, use, and management of customer data and other information is inconsistent with their laws and regulations, including laws that apply to the tracking of users via technology such as cookies. In addition, laws requiring us to retrieve and produce customer data in response to compulsory legal demands from law enforcement and governmental authorities are expanding and the requests we are experiencing are increasing in volume and complexity. New environmental, social, and governance laws and regulations are expanding mandatory disclosure, reporting, and diligence requirements. Legislative or regulatory action relating to cybersecurity requirements may increase the costs to develop, implement, or secure our products and services. Legislative and regulatory action is emerging in the areas of AI and content moderation, which could increase costs or restrict opportunity. For example, the EU's AI Act may increase costs or impact the provision or operation of our AI models and services in the European market.

How these laws and regulations apply to our business is often unclear, subject to change over time, and sometimes may be inconsistent from jurisdiction to jurisdiction. In addition, governments' approach to enforcement, and our products and services, are continuing to evolve. Compliance with existing, expanding, or new laws and regulations may involve significant costs or require changes in products or business practices that could adversely affect our results of operations. Noncompliance could result in the imposition of penalties, criminal sanctions, or orders to cease the alleged noncompliant activity. In addition, there is increasing pressure from advocacy groups, regulators, competitors, customers, and other stakeholders across many of these areas. If our products do not meet customer expectations or legal requirements, we could face regulatory or legal actions, and our business, operations, financial condition, and results of operations could be adversely affected.

We have claims and lawsuits against us that may result in adverse outcomes. We are subject to a variety of claims and lawsuits. These claims may arise from a wide variety of business practices and initiatives, including major new product releases, AI services, significant business transactions, warranty or product claims, employment practices, and regulation. As we continue to expand our business and offerings, we may experience new and novel legal claims. Adverse outcomes in some or all of these claims may result in significant monetary damages or injunctive relief that could adversely affect our ability to conduct our business. Litigation and other claims are subject to inherent uncertainties and management's view of these matters may change in the future. A material adverse impact to our financial condition and results of operations could occur for the period in which the effect of an unfavorable outcome becomes probable and reasonably estimable.

Our business with government customers may present additional uncertainties. We derive substantial revenue from government contracts. Government contracts generally can present risks and challenges not present in private commercial agreements. For instance, we may be subject to government audits and investigations relating to these contracts, we could be suspended or debarred as a governmental contractor, we could incur civil and criminal fines and penalties, and under certain circumstances contracts may be rescinded. Some agreements may allow a government to terminate without cause and provide for higher liability limits for certain losses. Some contracts may be subject to periodic funding approval, reductions, cancellations, or delays which could adversely impact public-sector demand for our products and services. These events could negatively impact our financial condition, results of operations, and reputation.

We may have additional tax liabilities. We are subject to income taxes in the U.S. and many foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes. In the course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. We may recognize additional tax expense and be subject to additional tax liabilities due to changes in tax laws, regulations, and administrative practices and principles, including changes to the global tax framework, in various jurisdictions. In recent years, multiple domestic and international tax proposals were proposed to impose greater tax burdens on large multinational enterprises. For example, the Organisation for Economic Co-operation and Development continues to advance proposals or guidance in international taxation, including the establishment of a global minimum tax.

We are regularly under audit by tax authorities in different jurisdictions. Although we believe that our provision for income taxes and our tax estimates are reasonable, tax authorities may disagree with certain positions we have taken. In addition, economic and political pressures to increase tax revenue in various jurisdictions may make resolving tax disputes favorably more difficult. We are currently under Internal Revenue Service ("IRS") audit for prior tax years and have received Notices of Proposed Adjustment ("NOPAs") from the IRS for the tax years 2004 to 2013. The primary issues in the NOPAs relate to intercompany transfer pricing. In the NOPAs, the IRS is seeking an additional tax payment of $28.9 billion plus penalties and interest. The final resolution of the proposed adjustments, and other audits or litigation, may differ from the amounts recorded in our consolidated financial statements and adversely affect our results of operations in the period or periods in which that determination is made.

We earn a significant amount of our operating income outside the U.S. A change in the mix of earnings and losses in countries with differing statutory tax rates, changes in our business or structure, or the expiration of or disputes about certain tax agreements in a particular country may result in higher effective tax rates for the company. In addition, changes in U.S. federal and state or international tax laws applicable to corporate multinationals, other global fundamental law changes currently being considered by many countries, including in the U.S., and changes in taxing jurisdictions' administrative interpretations, decisions, policies, and positions may materially adversely affect our financial condition and results of operations.

We are subject to evolving sustainability regulatory requirements and expectations, which exposes us to increased costs and legal and reputational risks. Laws, regulations, and policies relating to environmental, social, and governance matters are being developed and formalized in Europe, the U.S., and elsewhere, which may include specific, target-driven frameworks and disclosure requirements. In addition, we have established and publicly announced goals and commitments to become carbon negative, water positive, zero waste, and protect more land than we use. Any failure or perceived failure to pursue or fulfill our sustainability goals and commitments or to satisfy various sustainability reporting standards or regulatory requirements within the timelines we announce, or at all, could result in claims and lawsuits, regulatory actions, or damage to our reputation, each of which may adversely affect our business, operations, financial condition, and results of operations.

INTELLECTUAL PROPERTY RISKS

We face risks related to the protection and utilization of our intellectual property that may result in our business and operating results being harmed. Protecting our intellectual property rights and combating unlicensed copying and use of our software, source code, and other intellectual property on a global basis is difficult. Similarly, the absence of harmonized patent laws makes it more difficult to ensure consistent respect for patent rights.

Changes in the law may continue to weaken our ability to prevent the use of patented technology. Our increasing engagement with open source software will also cause us to license our intellectual property rights broadly in certain situations. If we are unable to protect our intellectual property, our results of operations may be adversely affected.

Source code, the detailed program commands for our operating systems and other software programs, is critical to our business. If our source code leaks, we might lose future trade secret protection for that code. It may then become easier for third parties to compete with our products by copying functionality, which could adversely affect our results of operations. Unauthorized access to or disclosure of source code or other intellectual property also could increase the security risks described elsewhere in these risk factors.

Third parties may claim that we infringe their intellectual property. From time to time, others claim we infringe their intellectual property rights, including current copyright infringement and other claims arising from AI training and output. To resolve these claims, we may enter into royalty-bearing data access or licensing agreements on terms that are less favorable than currently available, stop selling or redesign affected products or services, or pay damages to satisfy indemnification commitments with our customers. Adverse outcomes could also include monetary damages or injunctive relief that may limit or prevent importing, marketing, and selling our products or services that have infringing technologies. We have paid significant amounts to settle claims related to the use of technology and intellectual property rights and to procure intellectual property rights as part of our strategy to manage this risk, and may continue to do so, which could adversely affect our results of operations.

GENERAL RISKS

If our reputation or our brands are damaged, our business and results of operations may be harmed. Our reputation and brands are globally recognized and are important to our business. Our reputation and brands affect our ability to attract and retain consumer, business, and public-sector customers. There are numerous ways our reputation or brands could be damaged. These include product safety or quality issues, our environmental impact and sustainability, supply chain practices, or human rights record. We may experience backlash from customers, government entities, advocacy groups, employees, and other stakeholders that disagree with our product offering decisions, public policy positions, or corporate philanthropic initiatives. Damage to our reputation or our brands may occur from, among other things:

- The introduction of new features, products, services, or terms of service that customers, users, or partners do not like.
- Public scrutiny of our decisions regarding user privacy, data practices, content, or development and deployment of AI.
- Data security breaches, cybersecurity incidents, responsible AI failures, compliance failures, or actions of partners or individual employees.

Social media may increase the likelihood, speed, and magnitude of negative brand events. If our brands or reputation are damaged, it could adversely affect our business, results of operations, or ability to attract the most highly qualified employees.

Adverse economic or market conditions may harm our business. Worsening economic conditions, including inflation, recession, pandemic, or other changes in economic conditions, may cause lower IT spending and adversely affect our results of operations. If demand for PCs, servers, and other computing devices declines, or consumer or business spending for those products declines, our results of operations may be adversely affected.

Our product distribution system relies on an extensive partner and retail network. OEMs building devices that run our software have also been a significant means of distribution. The impact of economic conditions on our partners, such as the bankruptcy of a major distributor, OEM, or retailer, could cause sales channel disruption.

Challenging economic conditions also may impair the ability of our customers to pay for products and services they have purchased. As a result, allowances for doubtful accounts and write-offs of accounts receivable may increase.

We maintain an investment portfolio of various holdings, types, and maturities. These investments are subject to general credit, liquidity, market, and interest rate risks, which may be exacerbated by market downturns or events that affect global financial markets. A significant part of our investment portfolio comprises U.S. government securities. If global financial markets decline for long periods, or if there is a downgrade of the U.S. government credit rating due to an actual or threatened default on government debt, our investment portfolio may be adversely affected and we could determine that more of our investments have experienced a decline in fair value, requiring impairment charges that could adversely affect our financial condition and results of operations.

Catastrophic events or geopolitical conditions may disrupt our business. A disruption or failure of our systems, operations, or supply chain because of a major earthquake, weather event, cyberattack, terrorist attack, pandemic, or other catastrophic event could cause delays in completing sales, providing services, or performing other critical functions. Our corporate headquarters, a significant portion of our research and development activities, and certain other essential business operations are in the Seattle, Washington area, and we have other business operations in the Silicon Valley area of California, both of which are seismically active regions. A catastrophic event that results in the destruction or disruption of any of our critical business or systems, or the infrastructure or systems they rely on, such as power grids, could harm our ability to conduct normal business operations or adversely affect our results of operations. Providing our customers with more services and solutions in the cloud puts a premium on the resilience of our systems and strength of our business continuity management plans and magnifies the potential negative consequences of prolonged service outages.

Abrupt political change, terrorist activity, and armed conflict, such as the ongoing conflict in Ukraine, pose economic and other risks, which may negatively impact our ability to sell to and collect from customers, increase our operating costs, or otherwise disrupt our operations in markets both directly and indirectly impacted by such events. These conditions also may add uncertainty to the timing and budget for technology investment decisions by our customers and may cause supply chain disruptions for hardware manufacturers. Geopolitical change may result in changing regulatory systems and requirements and market interventions that could impact our operating strategies, access to national, regional, and global markets, hiring, and profitability. Geopolitical instability may lead to sanctions and impact our ability to do business in some markets or with some public-sector customers. Any of these changes may negatively affect our results of operations.

The occurrence of regional epidemics or a global pandemic, such as COVID-19, may adversely affect our business, operations, financial condition, and results of operations. The extent to which global pandemics impact our business going forward will depend on factors such as the duration and scope of the pandemic; governmental, business, and individuals' actions in response to the pandemic; and the impact on economic activity, including the possibility of recession or financial market instability. Measures to contain a global pandemic may intensify other risks described in these Risk Factors.

The long-term effects of climate change on the global economy and the IT industry in particular are unclear. Environmental regulations or changes in the supply, demand, or available sources of energy or other resources may affect the availability or cost of goods and services, including natural resources, necessary to run our business. Changes in climate where we operate may increase the costs of powering and cooling computer hardware we use to develop software and provide cloud-based services.

Our global business exposes us to operational and economic risks. Our customers, employees, and infrastructure are located throughout the world and a significant part of our revenue comes from international sales. The global nature of our business creates operational, economic, and geopolitical risks. Global, regional, and local economic developments, monetary policy, restrictions on international trade, such as tariffs and other controls on imports or exports, inflation, and recession, as well as political and military disputes, may adversely affect our results of operations. In addition, our international growth strategy includes certain markets, the developing nature of which presents several risks, including deterioration of social, political, labor, or economic conditions in a country or region, and difficulties in staffing and managing foreign operations. Emerging nationalist and protectionist trends and concerns about human rights, the environment, and political expression in specific countries may significantly alter the trade and commercial environments. Changes to trade policy or agreements as a result of populism, protectionism, or economic nationalism may result in higher tariffs, local sourcing initiatives, and non-local sourcing restrictions, export controls, investment restrictions, or other developments that make it more difficult to operate and sell our products in foreign countries. Disruptions of these kinds in developed or emerging markets could negatively impact demand for our products and services, impair our ability to operate in certain regions, or increase operating costs. Although we hedge a portion of our international currency exposure, significant fluctuations in foreign exchange rates between the U.S. dollar and foreign currencies may adversely affect our results of operations.

Our business depends on our ability to attract and retain talented employees. Our business is based on successfully attracting, training, and retaining talented employees representing diverse backgrounds, experiences, and skill sets. The market for highly skilled workers and leaders in our industry is extremely competitive. Maintaining our brand and reputation, as well as a diverse and inclusive work environment that enables all our employees to thrive, are important to our ability to recruit and retain employees. We are also limited in our ability to recruit internationally by restrictive domestic immigration laws. Restraints on the flow of technical and professional talent, including as a result of changes to U.S. immigration policies or laws, may inhibit our ability to adequately staff our research and development efforts. If we are less successful in our recruiting efforts, or if we cannot retain highly skilled workers and key leaders, our ability to develop and deliver successful products and services may be adversely affected. Effective succession planning is also important to our long-term success. Failure to ensure effective transfer of knowledge and smooth transitions involving key employees could hinder our strategic planning and execution. How employment-related laws are interpreted and applied to our workforce practices may result in increased operating costs and less flexibility in how we meet our workforce needs. Our global workforce is predominantly non-unionized, although we do have some employees in the U.S. and internationally who are represented by unions or works councils. In the U.S., there has been a general increase in workers exercising their right to form or join a union. The unionization of significant employee populations could result in higher costs and other operational changes necessary to respond to changing conditions and to establish new relationships with worker representatives.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

SHARE REPURCHASES AND DIVIDENDS

Following are our monthly share repurchases for the second quarter of fiscal year 2025:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs
				(In millions)
October 1, 2024 – October 31, 2024	2,572,520	$ 419.95	2,572,520	$ 6,469
November 1, 2024 – November 30, 2024	2,886,539	418.02	2,886,539	5,262
December 1, 2024 – December 31, 2024	2,750,869	440.96	2,750,869	4,049
	8,209,928		8,209,928	

All share repurchases were made using cash resources. Our share repurchases may occur through open market purchases or pursuant to a Rule 10b5-1 trading plan. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards.

Our Board of Directors declared the following dividends during the second quarter of fiscal year 2025:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
				(In millions)
December 3, 2024	February 20, 2025	March 13, 2025	$ 0.83	$ 6,171

We returned $9.7 billion to shareholders in the form of share repurchases and dividends in the second quarter of fiscal year 2025. Refer to Note 15 – Stockholders' Equity of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion regarding share repurchases and dividends.

ITEM 5. OTHER INFORMATION

Insider Trading Arrangements

None of our officers or directors, as defined in Rule 16a-1(f) of the Securities Exchange Act of 1934, adopted, modified, or terminated a “Rule 10b5-1 trading arrangement” or a “non-Rule 10b5-1 trading arrangement,” as defined in Item 408 of Regulation S-K, during the three months ended December 31, 2024.

ITEM 6. EXHIBITS

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference			
			Form	Period Ending	Exhibit	Filing Date
15.1	Letter regarding unaudited interim financial information	X				
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
32.1*	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X				
32.2*	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X				
101.INS	Inline XBRL Instance Document–the instance document does not appear in the Interactive Data File as its XBRL tags are embedded within the Inline XBRL document	X				
101.SCH	Inline XBRL Taxonomy Extension Schema with Embedded Linkbase Documents	X				
104	Cover page formatted as Inline XBRL and contained in Exhibit 101	X				

* *Furnished, not filed.*

Items 3 and 4 are not applicable and have been omitted.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned; thereunto duly authorized.

MICROSOFT CORPORATION

/s/ ALICE L. JOLLA

Alice L. Jolla
Corporate Vice President and Chief Accounting Officer
(Duly Authorized Officer)

January 29, 2025