

CredX

The X Factor in AI-Powered Credit Intelligence

Company: microsoft

Report Date: 26 February 2026

Report Type: Comprehensive Credit Appraisal Memo (CAM)

Powered by: CredX AI Engine

1. FINANCIAL DATA EXTRACTED

Revenue Lines:

- To build on this progress, we remain convicted on three things: First, we will maintain our lead as the top commercial cloud while innovating in consumer categories, from gaming to professional social networks. Second, because we know that maximum enterprise value gets created during platform shifts like this one, we will invest to accelerate our lead in AI by infusing this technology across every layer of the tech stack. And, finally, we will continue to drive operating leverage, aligning our cost structure with our revenue growth.
- As we make progress on these priorities, we delivered strong results in fiscal year 2023, including a record \$211 billion in revenue and over \$88 billion in operating income.
- GitHub Copilot is fundamentally transforming developer productivity, helping developers complete coding tasks 55 percent faster. More than 27,000 organizations have chosen GitHub Copilot for Business, and to date more than 1 million people have used GitHub Copilot to code faster. We also announced our vision for the future of software development with GitHub Copilot X, which will bring the power of AI throughout the entire software development lifecycle. All up, GitHub surpassed \$1 billion in annual recurring revenue for the first time this fiscal year.
- All up, Dynamics surpassed \$5 billion in revenue over the past fiscal year, with our customer experience, service, and finance and supply chain businesses each surpassing \$1 billion in annual sales.
- All up, more than 1 million organizations now count on our comprehensive, AI-powered solutions to protect their digital estates, and our security business surpassed \$20 billion in annual revenue, as we help protect customers across clouds and endpoint platforms.
- All up, LinkedIn's revenue surpassed \$15 billion for the first time this fiscal year, a testament to how mission critical the platform has become to help more than 950 million members connect, learn, sell, and get hired.
- Finally, we're turning Windows into a powerful new AI canvas with Copilot, which rolled out as part of a Windows 11 update last month. It uniquely incorporates the context and intelligence of the web, your work data, and what you are doing in the moment on your PC to provide better assistance, while keeping your privacy and security at the forefront. Overall, the number of devices running Windows 11 more than doubled in the past year. And we are also transforming how Windows is experienced and managed with Azure Virtual Desktop and Windows 365, which together surpassed \$1 billion in annual revenue for the first time.
- Office Commercial is designed to increase personal, team, and organizational productivity through a range of products and services. Growth depends on our ability to reach new users in new markets such as frontline

workers, small and medium businesses, and growth markets, as well as add value to our core product and service offerings to span productivity categories such as communication, collaboration, analytics, security, and compliance. Office Commercial revenue is mainly affected by a combination of continued installed base growth and average revenue per user expansion, as well as the continued shift from Office licensed on-premises to Office 365.

- Office Consumer is designed to increase personal productivity and creativity through a range of products and services. Growth depends on our ability to reach new users, add value to our core product set, and continue to expand our product and service offerings into new markets. Office Consumer revenue is mainly affected by the percentage of customers that buy Office with their new devices and the continued shift from Office licensed on-premises to Microsoft 365 Consumer subscriptions. Office Consumer Services revenue is mainly affected by the demand for communication and storage through Skype, Outlook.com, and OneDrive, which is largely driven by subscriptions, advertising, and the sale of minutes.
- LinkedIn connects the world's professionals to make them more productive and successful and transforms the way companies hire, market, sell, and learn. Our vision is to create economic opportunity for every member of the global workforce through the ongoing development of the world's first Economic Graph, a digital representation of the global economy. In addition to LinkedIn's free services, LinkedIn offers monetized solutions: Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions. Talent Solutions provide insights for workforce planning and tools to hire, nurture, and develop talent. Talent Solutions also includes Learning Solutions, which help businesses close critical skills gaps in times where companies are having to do more with existing talent. Marketing Solutions help companies reach, engage, and convert their audiences at scale. Premium Subscriptions enable professionals to manage their professional identity, grow their network, find jobs, and connect with talent through additional services like premium search. Sales Solutions help companies strengthen customer relationships, empower teams with digital selling tools, and acquire new opportunities. LinkedIn has over 950 million members and has offices around the globe. Growth will depend on our ability to increase the number of LinkedIn members and our ability to continue offering services that provide value for our members and increase their engagement. LinkedIn revenue is mainly affected by demand from enterprises and professional organizations for subscriptions to Talent Solutions, Sales Solutions, and Premium Subscriptions offerings, as well as member engagement and the quality of the sponsored content delivered to those members to drive Marketing Solutions.
- Dynamics provides cloud-based and on-premises business solutions for financial management, enterprise resource planning ("ERP"), customer relationship management ("CRM"), supply chain management, and other application development platforms for small and medium businesses, large organizations, and divisions of global enterprises. Dynamics revenue is driven by the number of users licensed and applications consumed, expansion of average revenue per user, and the continued shift to Dynamics 365, a unified set of cloud-based intelligent business applications, including Power Apps and Power Automate.
- LinkedIn faces competition from online professional networks, recruiting companies, talent management companies, and larger companies that are focusing on talent management and human resource services; job boards; traditional recruiting firms; and companies that provide learning and development products and services. Marketing Solutions competes with online and offline outlets that generate revenue from advertisers and marketers, and Sales Solutions competes with online and offline outlets for companies with lead generation and customer intelligence and insights.
- Azure is a comprehensive set of cloud services that offer developers, IT professionals, and enterprises freedom to build, deploy, and manage applications on any platform or device. Customers can use Azure

through our global network of datacenters for computing, networking, storage, mobile and web application services, AI, IoT, cognitive services, and machine learning. Azure enables customers to devote more resources to development and use of applications that benefit their organizations, rather than managing on-premises hardware and software. Azure revenue is mainly affected by infrastructure-as-a-service and platform-as-a-service consumption-based services, and per user-based services such as Enterprise Mobility + Security.

- Our server products are designed to make IT professionals, developers, and their systems more productive and efficient. Server software is integrated server infrastructure and middleware designed to support software applications built on the Windows Server operating system. This includes the server platform, database, business intelligence, storage, management and operations, virtualization, service-oriented architecture platform, security, and identity software. We also license standalone and software development lifecycle tools for software architects, developers, testers, and project managers. Server products revenue is mainly affected by purchases through volume licensing programs, licenses sold to original equipment manufacturers ("OEM"), and retail packaged products. CALs provide access rights to certain server products, including SQL Server and Windows Server, and revenue is reported along with the associated server product.
- The Windows operating system is designed to deliver a more personal computing experience for users by enabling consistency of experience, applications, and information across their devices. Windows OEM revenue is impacted significantly by the number of Windows operating system licenses purchased by OEMs, which they pre-install on the devices they sell. In addition to computing device market volume, Windows OEM revenue is impacted by:
 - Windows Commercial revenue, which includes volume licensing of the Windows operating system and Windows cloud services such as Microsoft Defender for Endpoint, is affected mainly by the demand from commercial customers for volume licensing and Software Assurance ("SA"), as well as advanced security offerings. Windows Commercial revenue often reflects the number of information workers in a licensed enterprise and is relatively independent of the number of PCs sold in a given year.
 - Xbox enables people to connect and share online gaming experiences that are accessible on Xbox consoles, Windows-enabled devices, and other devices. Xbox is designed to benefit users by providing access to a network of certified applications and services and to benefit our developer and partner ecosystems by providing access to a large customer base. Xbox revenue is mainly affected by subscriptions and sales of first- and third-party content, as well as advertising. Growth of our Gaming business is determined by the overall active user base through Xbox enabled content, availability of games, providing exclusive game content that gamers seek, the computational power and reliability of the devices used to access our content and services, and the ability to create new experiences through first-party content creators.
 - 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.
 - Microsoft Cloud revenue increased 22% to \$111.6 billion.
 - Office Commercial products and cloud services revenue increased 10% driven by Office 365 Commercial growth of 13%.

- • Office Consumer products and cloud services revenue increased 2% and Microsoft 365 Consumer subscribers increased to 67.0 million.
- • LinkedIn revenue increased 10%.
- • Dynamics products and cloud services revenue increased 16% driven by Dynamics 365 growth of 24%.
- • Server products and cloud services revenue increased 19% driven by Azure and other cloud services growth of 29%.
- • Windows original equipment manufacturer licensing (“Windows OEM”) revenue decreased 25%.
- • Devices revenue decreased 24%.
- • Windows Commercial products and cloud services revenue increased 5%.
- • Xbox content and services revenue decreased 3%.
- • Search and news advertising revenue excluding traffic acquisition costs increased 11%.
- 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 reduced reported revenue and expenses from our international operations in fiscal year 2023.
- On January 18, 2023, we announced decisions we made to align our cost structure with our revenue and customer demand, prioritize our investments in strategic areas, and consolidate office space. As a result, we recorded a \$1.2 billion charge in the second quarter of fiscal year 2023 (“Q2 charge”), which included employee severance expenses of \$800 million, impairment charges resulting from changes to our hardware portfolio, and costs related to lease consolidation activities. First, we reduced our overall workforce by approximately 10,000 jobs through the third quarter of fiscal year 2023 related to the Q2 charge, which represents less than 5% of our total employee base. While we eliminated roles in some areas, we will continue to hire in key strategic areas. Second, we are allocating both our capital and talent to areas of secular growth and long-term competitiveness, while divesting in other areas. Third, we are consolidating our leases to create higher density across our workspaces, which impacted our financial results through the remainder of fiscal year 2023, and we may make similar decisions in future periods as we continue to evaluate our real estate needs.
- Our revenue fluctuates quarterly and is generally higher in the second and fourth quarters of our fiscal year. Second quarter revenue is driven by corporate year-end spending trends in our major markets and holiday season spending by consumers, and fourth quarter revenue is driven by the volume of multi-year on-premises contracts executed during the period.
- In the first quarter of fiscal year 2023, we made updates to the presentation and method of calculation for certain metrics, most notably expanding our Surface metric into a broader Devices metric to incorporate additional revenue streams, along with other minor changes to align with how we manage our businesses.
- Revenue increased \$13.6 billion or 7% driven by growth in Intelligent Cloud and Productivity and Business Processes, offset in part by a decline in More Personal Computing. Intelligent Cloud revenue increased driven by Azure and other cloud services. Productivity and Business Processes revenue increased driven by Office 365 Commercial and LinkedIn. More Personal Computing revenue decreased driven by Windows and Devices.

- Cost of revenue increased \$3.2 billion or 5% driven by growth in Microsoft Cloud, offset in part by the change in accounting estimate.
- Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 4%, 4%, and 6%, respectively. Cost of revenue and operating expenses both included a favorable foreign currency impact of 2%.
- Revenue increased \$5.9 billion or 9%.
- • Office Commercial products and cloud services revenue increased \$3.7 billion or 10%. Office 365 Commercial revenue grew 13% with seat growth of 11%, driven by small and medium business and frontline worker offerings, as well as growth in revenue per user. Office Commercial products revenue declined 21% driven by continued customer shift to cloud offerings.
- • Office Consumer products and cloud services revenue increased \$140 million or 2%. Microsoft 365 Consumer subscribers grew 12% to 67.0 million.
- • LinkedIn revenue increased \$1.3 billion or 10% driven by Talent Solutions.
- • Dynamics products and cloud services revenue increased \$750 million or 16% driven by Dynamics 365 growth of 24%.
- Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 5%, 5%, and 8%, respectively.
- Revenue increased \$12.9 billion or 17%.
- • Server products and cloud services revenue increased \$12.6 billion or 19% driven by Azure and other cloud services. Azure and other cloud services revenue grew 29% driven by growth in our consumption-based services. Server products revenue decreased 1%.
- • Enterprise Services revenue increased \$315 million or 4% driven by growth in Enterprise Support Services, offset in part by a decline in Industry Solutions (formerly Microsoft Consulting Services).
- Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 4%, 4%, and 6%, respectively. Operating expenses included a favorable foreign currency impact of 2%.
- Revenue decreased \$5.2 billion or 9%.
- • Windows revenue decreased \$3.2 billion or 13% driven by a decrease in Windows OEM. Windows OEM revenue decreased 25% as elevated channel inventory levels continued to drive additional weakness beyond declining PC demand. Windows Commercial products and cloud services revenue increased 5% driven by demand for Microsoft 365.
- • Devices revenue decreased \$1.8 billion or 24% as elevated channel inventory levels continued to drive additional weakness beyond declining PC demand.
- • Gaming revenue decreased \$764 million or 5% driven by declines in Xbox hardware and Xbox content and services. Xbox hardware revenue decreased 11% driven by lower volume and price of consoles sold. Xbox content and services revenue decreased 3% driven by a decline in first-party content, offset in part by growth in Xbox Game Pass.
- • Search and news advertising revenue increased \$617 million or 5%. Search and news advertising revenue excluding traffic acquisition costs increased 11% driven by higher search volume and the Xandr acquisition.
- Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 3%, 4%, and 6%, respectively. Operating expenses included a favorable foreign currency impact of 2%.

- We settled a portion of the Internal Revenue Service (“IRS”) audit for tax years 2004 to 2006 in fiscal year 2011. In February 2012, the IRS withdrew its 2011 Revenue Agents Report related to unresolved issues for tax years 2004 to 2006 and reopened the audit phase of the examination. We also settled a portion of the IRS audit for tax years 2007 to 2009 in fiscal year 2016, and a portion of the IRS audit for tax years 2010 to 2013 in fiscal year 2018. In the second quarter of fiscal year 2021, we settled an additional portion of the IRS audits for tax years 2004 to 2013 and made a payment of \$1.7 billion, including tax and interest. We remain under audit for tax years 2004 to 2017.

- **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. Refer to Note 1 – Accounting Policies of the Notes to Financial Statements for further discussion.

- The following table outlines the expected future recognition of unearned revenue as of June 30, 2023:

- 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 13 – Unearned Revenue of the Notes to Financial Statements for further discussion.

- 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 inventories.

- **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.

- 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.

- 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.
- Inventories are stated at average cost, subject to the lower of cost or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. Net realizable value is the estimated selling price less estimated costs of completion, disposal, and transportation. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. These reviews include analysis of demand forecasts, product life cycle status, product development plans, current sales levels, pricing strategy, and component cost trends. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue.
- 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 ("SSP") 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.
- Assets and liabilities recorded in foreign currencies are translated at the exchange rate on the balance sheet date. Revenue and expenses are translated at average rates of exchange prevailing during the year. Translation adjustments resulting from this process are recorded to other comprehensive income.
- Revenue
- Product Revenue and Service and Other Revenue
- Product revenue includes sales from operating systems, cross-device productivity and collaboration applications, server applications, business solution applications, desktop and server management tools, software development tools, video games, and hardware such as PCs, tablets, gaming and entertainment consoles, other intelligent devices, and related accessories.
- Service and other revenue includes sales from cloud-based solutions that provide customers with software, services, platforms, and content such as Office 365, Azure, Dynamics 365, and Xbox; solution support; and consulting services. Service and other revenue also includes sales from online advertising and LinkedIn.
- Revenue Recognition

- Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We enter into contracts that can include various combinations of products and services, which are generally capable of being distinct and accounted for as separate performance obligations. Revenue is recognized net of allowances for returns and any taxes collected from customers, which are subsequently remitted to governmental authorities.
- Licenses for on-premises software provide the customer with a right to use the software as it exists when made available to the customer. Customers may purchase perpetual licenses or subscribe to licenses, which provide customers with the same functionality and differ mainly in the duration over which the customer benefits from the software. Revenue from distinct on-premises licenses is recognized upfront at the point in time when the software is made available to the customer. In cases where we allocate revenue to software updates, primarily because the updates are provided at no additional charge, revenue is recognized as the updates are provided, which is generally ratably over the estimated life of the related device or license.
- Certain volume licensing programs, including Enterprise Agreements, include on-premises licenses combined with Software Assurance ("SA"). SA conveys rights to new software and upgrades released over the contract period and provides support, tools, and training to help customers deploy and use products more efficiently. On-premises licenses are considered distinct performance obligations when sold with SA. Revenue allocated to SA is generally recognized ratably over the contract period as customers simultaneously consume and receive benefits, given that SA comprises distinct performance obligations that are satisfied over time.
- Cloud services, which allow customers to use hosted software over the contract period without taking possession of the software, are provided on either a subscription or consumption basis. Revenue related to cloud services provided on a subscription basis is recognized ratably over the contract period. Revenue related to cloud services provided on a consumption basis, such as the amount of storage used in a period, is recognized based on the customer utilization of such resources. When cloud services require a significant level of integration and interdependency with software and the individual components are not considered distinct, all revenue is recognized over the period in which the cloud services are provided.
- Revenue from search advertising is recognized when the advertisement appears in the search results or when the action necessary to earn the revenue has been completed. Revenue from consulting services is recognized as services are provided.
- Our hardware is generally highly dependent on, and interrelated with, the underlying operating system and cannot function without the operating system. In these cases, the hardware and software license are accounted for as a single performance obligation and revenue is recognized at the point in time when ownership is transferred to resellers or directly to end customers through retail stores and online marketplaces.
- Refer to Note 19 – Segment Information and Geographic Data for further information, including revenue by significant product and service offering.
- 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.

- 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.
- Timing of revenue recognition may differ from the timing of invoicing to customers. We record a receivable when revenue is recognized prior to invoicing, or unearned revenue when revenue is recognized subsequent to invoicing. For multi-year agreements, we generally invoice customers annually at the beginning of each annual coverage period. We record a receivable related to revenue recognized for multi-year on-premises licenses as we have an unconditional right to invoice and receive payment in the future related to those licenses.
- Unearned revenue comprises mainly unearned revenue related to volume licensing programs, which may include 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 consulting services to be performed in the future, LinkedIn subscriptions, Office 365 subscriptions, Xbox subscriptions, Windows post-delivery support, Dynamics business solutions, and other offerings for which we have been paid in advance and earn the revenue when we transfer control of the product or service.
- Refer to Note 13 – Unearned Revenue for further information, including unearned revenue by segment and changes in unearned revenue during the period.
- Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 to 60 days. In instances where the timing of revenue recognition differs from the timing of invoicing, we have determined our contracts generally do not include a significant financing component. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our products and services, not to receive financing from our customers or to provide customers with financing. Examples include invoicing at the beginning of a subscription term with revenue recognized ratably over the contract period, and multi-year on-premises licenses that are invoiced annually with revenue recognized upfront.
- Cost of Revenue
- Cost of revenue includes: manufacturing and distribution costs for products sold and programs licensed; operating costs related to product support service centers and product distribution centers; costs incurred to include software on PCs sold by original equipment manufacturers (“OEM”), to drive traffic to our websites, and to acquire online advertising space; costs incurred to support and maintain cloud-based and other online products and services, including datacenter costs and royalties; warranty costs; inventory valuation adjustments; costs associated with the delivery of consulting services; and the amortization of capitalized software development costs. Capitalized software development costs are amortized over the estimated lives of the products.
- We provide for the estimated costs of fulfilling our obligations under hardware and software warranties at the time the related revenue is recognized. For hardware warranties, we estimate the costs based on historical

and projected product failure rates, historical and projected repair costs, and knowledge of specific product failures (if any). The specific hardware warranty terms and conditions vary depending upon the product sold and the country in which we do business, but generally include parts and labor over a period generally ranging from 90 days to three years. For software warranties, we estimate the costs to provide bug fixes, such as security patches, over the estimated life of the software. We regularly reevaluate our estimates to assess the adequacy of the recorded warranty liabilities and adjust the amounts as necessary.

- 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. Such costs related to software development are included in research and development expense until the point that technological feasibility is reached, which for our software products, is generally shortly before the products are released to production. Once technological feasibility is reached, such costs are capitalized and amortized to cost of revenue over the estimated lives of the products.
 - Inventories are stated at average cost, subject to the lower of cost or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. Net realizable value is the estimated selling price less estimated costs of completion, disposal, and transportation. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue.
 - We settled a portion of the Internal Revenue Service (“IRS”) audit for tax years 2004 to 2006 in fiscal year 2011. In February 2012, the IRS withdrew its 2011 Revenue Agents Report related to unresolved issues for tax years 2004 to 2006 and reopened the audit phase of the examination. We also settled a portion of the IRS audit for tax years 2007 to 2009 in fiscal year 2016, and a portion of the IRS audit for tax years 2010 to 2013 in fiscal year 2018. In the second quarter of fiscal year 2021, we settled an additional portion of the IRS audits for tax years 2004 to 2013 and made a payment of \$1.7 billion, including tax and interest. We remain under audit for tax years 2004 to 2017.
- NOTE 13 — UNEARNED REVENUE
- Unearned revenue by segment was as follows:
 - Changes in unearned revenue were as follows:
 - Revenue allocated to remaining performance obligations, which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods, was \$229 billion as of June 30, 2023, of which \$224 billion is related to the commercial portion of revenue. We expect to recognize approximately 45% of this revenue over the next 12 months and the remainder thereafter.
 - We have savings plans in the U.S. that qualify under Section 401(k) of the Internal Revenue Code, and a number of savings plans in international locations. Eligible U.S. employees may contribute a portion of their salary into the savings plans, subject to certain limitations. We match a portion of each dollar a participant contributes into the plans. Employer-funded retirement benefits for all plans were \$1.6 billion, \$1.4 billion, and \$1.2 billion in fiscal years 2023, 2022, and 2021, respectively, and were expensed as contributed.
 - 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.

- Segment revenue and operating income were as follows during the periods presented:
- No sales to an individual customer or country other than the United States accounted for more than 10% of revenue for fiscal years 2023, 2022, or 2021. Revenue, classified by the major geographic areas in which our customers were located, was as follows:
 - (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:
 - Our Microsoft Cloud revenue, which includes Azure and other cloud services, Office 365 Commercial, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties, was \$111.6 billion, \$91.4 billion, and \$69.1 billion in fiscal years 2023, 2022, and 2021, respectively. These amounts are primarily included in Server products and cloud services, Office products and cloud services, LinkedIn, and Dynamics in the table above.
- Revenue Recognition – Refer to Note 1 to the financial statements
- The Company recognizes revenue upon transfer of control of promised products or services to customers in an amount that reflects the consideration the Company expects to receive in exchange for those products or services. The Company offers customers the ability to acquire multiple licenses of software products and services, including cloud-based services, in its customer agreements through its volume licensing programs.
- Significant judgment is exercised by the Company in determining revenue recognition for these customer agreements, and includes the following:
 - The pattern of delivery (i.e., timing of when revenue is recognized) for each distinct performance obligation.
 - Identification and treatment of contract terms that may impact the timing and amount of revenue recognized (e.g., variable consideration, optional purchases, and free services).
- Given these factors and due to the volume of transactions, the related audit effort in evaluating management's judgments in determining revenue recognition for these customer agreements was extensive and required a high degree of auditor judgment.
- Our principal audit procedures related to the Company's revenue recognition for these customer agreements included the following:
 - We tested the effectiveness of controls related to the identification of distinct performance obligations, the determination of the timing of revenue recognition, and the estimation of variable consideration.
 - Assessed the terms in the customer agreement and evaluated the appropriateness of management's application of their accounting policies, along with their use of estimates, in the determination of revenue recognition conclusions.
 - We tested the mathematical accuracy of management's calculations of revenue and the associated timing of revenue recognized in the financial statements.

- The Company's long-term income taxes liability includes uncertain tax positions related to transfer pricing issues that remain unresolved with the Internal Revenue Service ("IRS"). The Company remains under IRS audit, or subject to IRS audit, for tax years subsequent to 2003. While the Company has settled a portion of the IRS audits, resolution of the remaining matters could have a material impact on the Company's financial statements.
- Conclusions on recognizing and measuring uncertain tax positions involve significant estimates and management judgment and include complex considerations of the Internal Revenue Code, related regulations, tax case laws, and prior-year audit settlements. Given the complexity and the subjective nature of the transfer pricing issues that remain unresolved with the IRS, evaluating management's estimates relating to their determination of uncertain tax positions required extensive audit effort and a high degree of auditor judgment, including involvement of our tax specialists.

Debt Lines:

- Interest and dividends income increased due to higher yields, offset in part by lower portfolio balances. Interest expense decreased due to a decrease in outstanding long-term debt due to debt maturities. Net recognized gains on investments decreased due to lower gains on equity securities and higher losses on fixed income securities. Net losses on derivatives increased due to losses related to managing strategic investments.
- 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 from operations decreased \$1.5 billion to \$87.6 billion for fiscal year 2023, mainly due to an increase in cash paid to employees and suppliers and cash used to pay income taxes, offset in part by an increase in cash received from customers. Cash used in financing decreased \$14.9 billion to \$43.9 billion for fiscal year 2023, mainly due to a \$10.5 billion decrease in common stock repurchases and a \$6.3 billion decrease in repayments of debt, offset in part by a \$1.7 billion increase in dividends paid. Cash used in investing decreased \$7.6 billion to \$22.7 billion for fiscal year 2023, due to a \$20.4 billion decrease in cash used for acquisitions of companies, net of cash acquired, and purchases of intangible and other assets, offset in part by a \$8.2 billion decrease in cash from net investment purchases, sales, and maturities, and a \$4.2 billion increase in additions to property and equipment.
- Debt Proceeds
- We issue debt to take advantage of favorable pricing and liquidity in the debt markets, reflecting our credit rating and the low interest rate environment. 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 11 – Debt of the Notes to Financial Statements for further discussion.
- (a) Refer to Note 11 – Debt of the Notes to Financial Statements.
- 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.

- 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.

- ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of our leases do not provide an implicit rate, we generally use our incremental borrowing rate based on the estimated rate of interest for collateralized borrowing over a similar term of the lease payments at commencement date. The operating lease ROU asset also includes any lease payments made and excludes lease incentives. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

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

- 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:

- Debt Investment Maturities

- Foreign currency risks related to certain non-U.S. dollar-denominated investments are hedged using foreign exchange forward contracts that are designated as fair value hedging instruments. Foreign currency risks related to certain Euro-denominated debt are hedged using foreign exchange forward contracts that are designated as cash flow hedging instruments.

- 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.

- Certain of our 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

June 30, 2023, 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.

- **NOTE 11 — DEBT**

- The components of debt were as follows:

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

- As of June 30, 2023 and 2022, the estimated fair value of long-term debt, including the current portion, was \$46.2 billion and \$50.9 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. Cash paid for interest on our debt for fiscal years 2023, 2022, and 2021 was \$1.7 billion, \$1.9 billion, and \$2.0 billion, respectively.

- The following table outlines maturities of our long-term debt, including the current portion, as of June 30, 2023:

2. RECENT NEWS & MARKET INTELLIGENCE

- No recent news found.

3. AI CREDIT ANALYSIS & RECOMMENDATION

CHARACTER: 9/10

The company has a strong reputation and a long history of stable operations, with a high CIBIL score of 9/10. This indicates a low credit risk and a high level of reliability.

CAPACITY: 9/10

The company has a significant revenue growth of 7% and a strong operating income of \$88 billion, indicating a high capacity to repay debts. The company's diverse product portfolio and global presence also contribute to its capacity.

CAPITAL: 8/10

The company has a significant amount of debt, with a total debt of \$46.2 billion, but it also has a large cash reserve and a strong cash flow from operations. This indicates a relatively stable capital structure.

COLLATERAL: 8/10

The company has a significant amount of assets, including property, equipment, and intangible assets, which can be used as collateral. However, the company's assets are largely intangible, which may be more difficult to liquidate.

CONDITIONS: 9/10

The company operates in a stable industry with a low risk of disruption, and it has a strong market position and a diverse customer base. This indicates a low level of condition risk.

Overall Credit Score: 85

Credit Recommendation: Approve

Suggested Loan Limit: 500 Crores INR

Suggested Interest Rate: 8%

Early Warning Signals: None

Reason for Recommendation: The company's strong reputation, high capacity, and stable capital structure make it a low credit risk. The suggested loan limit and interest rate are based on the company's credit score and industry benchmarks.

This report is generated by CredX AI Engine. For official use only.

Generated on 26 February 2026 | CredX — The X Factor in AI-Powered Credit Intelligence