

**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, 2025

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
(STATE OF INCORPORATION)**

**91-1144442
(I.R.S. ID)**

**ONE MICROSOFT WAY, REDMOND, WASHINGTON 98052-6399
(425) 882-8080
www.microsoft.com/investor**

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 22, 2026
Common Stock, \$0.00000625 par value per share	7,425,629,076 shares

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FORM 10-Q
For the Quarter Ended December 31, 2025
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PART I
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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,	
	2025	2024	2025	2024
Revenue:				
Product	\$ 16,451	\$ 16,219	\$ 32,373	\$ 31,491
Service and other	<u>64,822</u>	<u>53,413</u>	<u>126,573</u>	<u>103,726</u>
Total revenue	<u>81,273</u>	<u>69,632</u>	<u>158,946</u>	<u>135,217</u>
Cost of revenue:				
Product	3,505	3,856	6,427	7,150
Service and other	<u>22,473</u>	<u>17,943</u>	<u>43,594</u>	<u>34,748</u>
Total cost of revenue	<u>25,978</u>	<u>21,799</u>	<u>50,021</u>	<u>41,898</u>
Gross margin	55,295	47,833	108,925	93,319
Research and development	8,504	7,917	16,650	15,461
Sales and marketing	6,584	6,440	12,301	12,157
General and administrative	1,932	1,823	3,738	3,496
Operating income	38,275	31,653	76,236	62,205
Other income (expense), net	9,971	(2,288)	6,311	(2,571)
Income before income taxes	48,246	29,365	82,547	59,634
Provision for income taxes	9,788	5,257	16,342	10,859
Net income	<u>\$ 38,458</u>	<u>\$ 24,108</u>	<u>\$ 66,205</u>	<u>\$ 48,775</u>
Earnings per share:				
Basic	\$ 5.18	\$ 3.24	\$ 8.91	\$ 6.56
Diluted	<u>\$ 5.16</u>	<u>\$ 3.23</u>	<u>\$ 8.87</u>	<u>\$ 6.53</u>
Weighted average shares outstanding:				
Basic	7,431	7,435	7,432	7,434
Diluted	<u>7,460</u>	<u>7,468</u>	<u>7,463</u>	<u>7,469</u>

Refer to accompanying notes.

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COMPREHENSIVE INCOME STATEMENTS

(In millions) (Unaudited)	Three Months Ended December 31,		Six Months Ended December 31,	
	2025	2024	2025	2024
Net income	\$ <u>38,458</u>	\$ 24,108	\$ <u>66,205</u>	\$ 48,775
Other comprehensive income (loss), net of tax:				
Net change related to derivatives	(3)	34	(6)	24
Net change related to investments	(161)	(434)	526	680
Translation adjustments and other	223	(1,034)	125	(730)
Other comprehensive income (loss)	<u>59</u>	(1,434)	<u>645</u>	(26)
Comprehensive income	\$ <u>38,517</u>	\$ 22,674	\$ <u>66,850</u>	\$ 48,749

Refer to accompanying notes.

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BALANCE SHEETS

(In millions) (Unaudited)

	December 31, 2025	June 30, 2025
Assets		
Current assets:		
Cash and cash equivalents	\$ 24,296	\$ 30,242
Short-term investments	65,166	64,323
Total cash, cash equivalents, and short-term investments	89,462	94,565
Accounts receivable, net of allowance for doubtful accounts of \$729 and \$944	56,535	69,905
Inventories	1,059	938
Other current assets	33,134	25,723
Total current assets	180,190	191,131
Property and equipment, net of accumulated depreciation of \$104,950 and \$93,653	261,126	204,966
Operating lease right-of-use assets	25,103	24,823
Equity and other investments	21,202	15,405
Goodwill	119,622	119,509
Intangible assets, net	20,289	22,604
Other long-term assets	37,770	40,565
Total assets	<u>\$ 665,302</u>	<u>\$ 619,003</u>
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 37,328	\$ 27,724
Current portion of long-term debt	4,837	2,999
Accrued compensation	10,103	13,709
Short-term income taxes	2,050	7,211
Short-term unearned revenue	51,376	64,555
Other current liabilities	24,311	25,020
Total current liabilities	130,005	141,218
Long-term debt	35,425	40,152
Long-term income taxes	27,256	25,986
Long-term unearned revenue	2,668	2,710
Deferred income taxes	2,876	2,835
Operating lease liabilities	17,345	17,437
Other long-term liabilities	58,852	45,186
Total liabilities	<u>274,427</u>	<u>275,524</u>
Commitments and contingencies		
Stockholders' equity:		
Common stock and paid-in capital – shares authorized 24,000; outstanding 7,429 and 7,434	112,788	109,095
Retained earnings	280,789	237,731
Accumulated other comprehensive loss	(2,702)	(3,347)
Total stockholders' equity	<u>390,875</u>	<u>343,479</u>
Total liabilities and stockholders' equity	<u>\$ 665,302</u>	<u>\$ 619,003</u>

Refer to accompanying notes.

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CASH FLOWS STATEMENTS

(In millions) (Unaudited)	Three Months Ended December 31,		Six Months Ended December 31,	
	2025	2024	2025	2024
Operations				
Net income	\$ 38,458	\$ 24,108	\$ 66,205	\$ 48,775
Adjustments to reconcile net income to net cash from operations:				
Depreciation, amortization, and other	9,198	5,667	17,345	12,383
Stock-based compensation expense	3,219	3,089	6,202	5,921
Net recognized losses (gains) on investments and derivatives	(9,931)	2,136	(6,024)	2,678
Deferred income taxes	4,446	(1,158)	6,937	(2,591)
Changes in operating assets and liabilities:				
Accounts receivable	(3,436)	(5,978)	13,054	8,059
Inventories	70	711	(122)	338
Other current assets	619	(353)	(543)	(435)
Other long-term assets	(1,288)	(1,089)	(1,682)	(2,850)
Accounts payable	1,197	958	583	42
Unearned revenue	(7,483)	(6,338)	(12,901)	(11,891)
Income taxes	(920)	(3,395)	(3,864)	(2,379)
Other current liabilities	2,802	3,217	(2,705)	(2,262)
Other long-term liabilities	(1,193)	716	(1,670)	683
Net cash from operations	35,758	22,291	80,815	56,471
Financing				
Repayments of debt, maturities of 90 days or less	0	0	0	(5,746)
Repayments of debt	(3,000)	0	(3,000)	(966)
Common stock issued	259	256	948	962
Common stock repurchased	(7,415)	(4,986)	(13,065)	(9,093)
Common stock cash dividends paid	(6,762)	(6,170)	(12,931)	(11,744)
Other, net	(699)	(343)	(1,368)	(1,232)
Net cash used in financing	(17,617)	(11,243)	(29,416)	(27,819)
Investing				
Additions to property and equipment	(29,876)	(15,804)	(49,270)	(30,727)
Acquisition of companies, net of cash acquired and divestitures, and purchases of intangible and other assets	(455)	(1,405)	(1,033)	(3,254)
Purchases of investments	(9,845)	(2,050)	(27,516)	(3,670)
Maturities of investments	12,417	2,604	18,448	4,740
Sales of investments	5,691	2,559	8,953	4,527
Other, net	(637)	(16)	(6,846)	(929)
Net cash used in investing	(22,705)	(14,112)	(57,264)	(29,313)
Effect of foreign exchange rates on cash and cash equivalents	11	(294)	(81)	(172)
Net change in cash and cash equivalents	(4,553)	(3,358)	(5,946)	(833)
Cash and cash equivalents, beginning of period	28,849	20,840	30,242	18,315
Cash and cash equivalents, end of period	\$ 24,296	\$ 17,482	\$ 24,296	\$ 17,482

Refer to accompanying notes.

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STOCKHOLDERS' EQUITY STATEMENTS

(In millions, except per share amounts) (Unaudited)	Three Months Ended December 31,		Six Months Ended December 31,	
	2025	2024	2025	2024
Common stock and paid-in capital				
Balance, beginning of period	\$ 110,964	\$ 102,976	\$ 109,095	\$ 100,923
Common stock issued	259	256	948	962
Common stock repurchased	(1,654)	(1,491)	(3,455)	(2,976)
Stock-based compensation expense	3,219	3,089	6,202	5,921
Other, net	0	(1)	(2)	(1)
Balance, end of period	112,788	104,829	112,788	104,829
Retained earnings				
Balance, beginning of period	254,873	188,929	237,731	173,144
Net income	38,458	24,108	66,205	48,775
Common stock cash dividends	(6,757)	(6,169)	(13,521)	(12,340)
Common stock repurchased	(5,785)	(3,386)	(9,626)	(6,097)
Balance, end of period	280,789	203,482	280,789	203,482
Accumulated other comprehensive loss				
Balance, beginning of period	(2,761)	(4,182)	(3,347)	(5,590)
Other comprehensive income (loss)	59	(1,434)	645	(26)
Balance, end of period	(2,702)	(5,616)	(2,702)	(5,616)
Total stockholders' equity	\$ 390,875	\$ 302,695	\$ 390,875	\$ 302,695
Cash dividends declared per common share	\$ 0.91	\$ 0.83	\$ 1.82	\$ 1.66

Refer to accompanying notes.

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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. 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 2025 Form 10-K filed with the U.S. Securities and Exchange Commission on July 30, 2025.

We have recast certain prior period amounts on our consolidated cash flows statements to conform to the current period presentation. The recast of these prior period amounts had no impact on our consolidated balance sheets, consolidated income statements, or net cash from (used in) operations, investing, or financing on our consolidated cash flows statements.

Principles of Consolidation

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

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; 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; 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.

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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 generally measured at fair value. Equity investments that are not recorded at fair value are measured using the equity method of accounting when required or measured at cost with adjustments for observable changes in price or impairments (referred to as the measurement alternative). For equity investments recorded at fair value, 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 fair value are recorded in other income (expense), net. Equity method investments may be recorded on a lag of up to three months when sufficient financial information is not available in a timely manner. For equity method investments recorded on a lag, we recognize the impact of intervening events that have a material impact on our consolidated financial statements in the period in which they occurred.

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 a long-term strategic partnership with OpenAI. In October 2025, we signed a new definitive agreement with OpenAI that extends this partnership. Additionally, OpenAI formed a public benefit corporation and completed a recapitalization ("OpenAI Recapitalization"). We have an investment of approximately 27 percent of OpenAI on an as-converted basis accounted for under the equity method of accounting. As a result of the OpenAI Recapitalization, we had a decrease in our proportionate ownership of OpenAI and recorded a dilution gain in other income (expense), net. Refer to Note 3 – Other Income (Expense), Net for additional information. We calculate our equity method income or loss using the hypothetical liquidation at book value ("HLBV") method because our liquidation rights and priorities differ from our underlying ownership interest. Under the HLBV method, we recognize income or loss based on the change in the amount we would receive if the net assets of the investee were distributed at book value. We have made total funding commitments of \$13 billion, of which \$11.7 billion has been funded as of December 31, 2025.

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.

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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 December 31, 2025 and June 30, 2025, long-term accounts receivable, net of allowance for doubtful accounts, was \$5.3 billion and \$5.2 billion, respectively, and is included in other long-term assets in our consolidated balance sheets.

As of December 31, 2025 and June 30, 2025, other receivables related to activities to facilitate the purchase of server components were \$15.1 billion and \$8.2 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, 2025 and June 30, 2025, our financing receivables, net were \$2.7 billion and \$4.3 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 for doubtful accounts which reflects our best estimate of credit losses inherent in the accounts receivable and financing receivable balances. We determine the allowance based on known troubled accounts, historical experience, and other currently available evidence.

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Recent Accounting Guidance

Income Taxes – Improvements to Income Tax Disclosures

In December 2023, the Financial Accounting Standards Board (“FASB”) issued a new standard to improve income tax disclosures. The guidance requires additional disclosure of disaggregated income taxes paid and prescribes standardized categories for the components of the effective tax rate reconciliation. We will adopt the standard on the effective date in our annual reporting for fiscal year 2026. The standard can be applied either prospectively or retrospectively.

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,	
	2025	2024	2025	2024
Net income available for common shareholders (A)	\$ 38,458	\$ 24,108	\$ 66,205	\$ 48,775
Weighted average outstanding shares of common stock (B)	<u>7,431</u>	7,435	<u>7,432</u>	7,434
Dilutive effect of stock-based awards	<u>29</u>	33	<u>31</u>	35
Common stock and common stock equivalents (C)	<u>7,460</u>	7,468	<u>7,463</u>	7,469
Earnings Per Share				
Basic (A/B)	\$ 5.18	\$ 3.24	\$ 8.91	\$ 6.56
Diluted (A/C)	\$ 5.16	\$ 3.23	\$ 8.87	\$ 6.53

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

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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,	
	2025	2024	2025	2024
Interest and dividends income	\$ 840	\$ 600	\$ 1,816	\$ 1,281
Interest expense	(736)	(594)	(1,434)	(1,176)
Net recognized gains (losses) on investments	339	(860)	(233)	(397)
Net gains (losses) on derivatives	37	(116)	1,616	(454)
Net gains (losses) on foreign currency remeasurements	(50)	(153)	(72)	23
Other, net	<u>9,541</u>	<u>(1,165)</u>	<u>4,618</u>	<u>(1,848)</u>
Total	<u><u>\$ 9,971</u></u>	<u><u>\$ (2,288)</u></u>	<u><u>\$ 6,311</u></u>	<u><u>\$ (2,571)</u></u>

Other income (expense), net included \$10.0 billion and \$5.9 billion of net gains for the three and six months ended December 31, 2025, respectively, and \$1.2 billion and \$1.9 billion of net losses for the three and six months ended December 31, 2024, respectively, from investments in OpenAI, primarily net recognized gains (losses) on our equity method investment reflected in Other, net. The net gains recorded for the three and six months ended December 31, 2025 primarily relate to the dilution gain from the OpenAI Recapitalization.

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,	
	2025	2024	2025	2024
Realized gains from sales of available-for-sale securities	\$ 19	\$ 9	\$ 35	\$ 17
Realized losses from sales of available-for-sale securities	(9)	(19)	(19)	(34)
Impairments and allowance for credit losses	<u>(21)</u>	<u>(14)</u>	<u>(17)</u>	<u>(2)</u>
Total	<u><u>\$ (11)</u></u>	<u><u>\$ (24)</u></u>	<u><u>\$ (1)</u></u>	<u><u>\$ (19)</u></u>

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

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2025	2024	2025	2024
Net realized gains (losses) on investments sold	\$ 3	\$ (8)	\$ 74	\$ 57
Net unrealized gains (losses) on investments still held	385	25	(250)	437
Impairments of investments	<u>(38)</u>	<u>(853)</u>	<u>(56)</u>	<u>(872)</u>
Total	<u><u>\$ 350</u></u>	<u><u>\$ (836)</u></u>	<u><u>\$ (232)</u></u>	<u><u>\$ (378)</u></u>

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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, 2025								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	\$ 8,367	\$ 0	\$ 0	\$ 8,367	\$ 7,622	\$ 745	\$ 0
Certificates of deposit	Level 2	3,506	0	0	3,506	3,062	444	0
U.S. government securities	Level 1	48,194	147	(1,046)	47,295	2,045	45,250	0
U.S. agency securities	Level 2	2,444	0	0	2,444	0	2,444	0
Foreign government bonds	Level 2	402	18	(6)	414	0	414	0
Mortgage- and asset-backed securities	Level 2	3,227	19	(21)	3,225	0	3,225	0
Corporate notes and bonds	Level 2	12,162	176	(55)	12,283	0	12,283	0
Corporate notes and bonds	Level 3	1,597	120	0	1,717	0	97	1,620
Municipal securities	Level 2	170	1	(6)	165	0	165	0
Municipal securities	Level 3	105	0	(12)	93	0	93	0
Total debt investments		<u>\$ 80,174</u>	<u>\$ 481</u>	<u>\$ (1,146)</u>	<u>\$ 79,509</u>	<u>\$ 12,729</u>	<u>\$ 65,160</u>	<u>\$ 1,620</u>
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				\$ 4,366	\$ 1,346	\$ 0	\$ 3,020
Equity investments	Other				16,562	0	0	16,562
Total equity investments					<u>\$ 20,928</u>	<u>\$ 1,346</u>	<u>\$ 0</u>	<u>\$ 19,582</u>
Cash Derivatives, net ^(a)					<u>\$ 10,221</u>	<u>\$ 10,221</u>	<u>\$ 0</u>	<u>\$ 0</u>
Total					<u>\$ 110,664</u>	<u>\$ 24,296</u>	<u>\$ 65,166</u>	<u>\$ 21,202</u>

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(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, 2025								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	\$ 10,880	\$ 0	0	\$ 10,880	\$ 9,939	\$ 941	\$ 0
Certificates of deposit	Level 2	2,653	0	0	2,653	2,309	344	0
U.S. government securities	Level 1	52,878	71	(1,462)	51,487	4,742	46,745	0
U.S. agency securities	Level 2	2,686	0	0	2,686	496	2,190	0
Foreign government bonds	Level 2	349	24	(9)	364	0	364	0
Mortgage- and asset-backed securities	Level 2	2,558	10	(27)	2,541	0	2,541	0
Corporate notes and bonds	Level 2	10,763	124	(101)	10,786	0	10,786	0
Corporate notes and bonds	Level 3	2,511	65	(5)	2,571	0	111	2,460
Municipal securities	Level 2	207	1	(7)	201	0	201	0
Municipal securities	Level 3	104	0	(14)	90	0	90	0
Total debt investments		\$ 85,589	\$ 295	\$ (1,625)	\$ 84,259	\$ 17,486	\$ 64,313	\$ 2,460
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				\$ 4,577	\$ 1,045	\$ 0	\$ 3,532
Equity investments	Other				9,141	0	0	9,141
Total equity investments					\$ 13,718	\$ 1,045	\$ 0	\$ 12,673
Cash Derivatives, net ^(a)					\$ 11,711	\$ 11,711	\$ 0	\$ 0
					282	0	10	272
Total					\$ 109,970	\$ 30,242	\$ 64,323	\$ 15,405

(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, 2025 and June 30, 2025, equity investments without readily determinable fair values measured at cost with adjustments for observable changes in price or impairments were \$5.0 billion and \$2.9 billion, respectively, and equity investments measured using the equity method were \$11.5 billion and \$6.0 billion, respectively.

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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		12 Months or Greater		Total Fair Value	Total Unrealized Losses
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses		
December 31, 2025						
U.S. government and agency securities	\$ 350	\$ (4)	\$ 28,600	\$ (1,042)	\$ 28,950	\$ (1,046)
Foreign government bonds	48	(3)	83	(3)	131	(6)
Mortgage- and asset-backed securities	0	0	202	(21)	202	(21)
Corporate notes and bonds	432	(2)	2,318	(53)	2,750	(55)
Municipal securities	0	0	162	(18)	162	(18)
Total	\$ 830	\$ (9)	\$ 31,365	\$ (1,137)	\$ 32,195	\$ (1,146)
 June 30, 2025						
U.S. government and agency securities	\$ 2,569	\$ (51)	\$ 34,608	\$ (1,411)	\$ 37,177	\$ (1,462)
Foreign government bonds	43	(2)	106	(7)	149	(9)
Mortgage- and asset-backed securities	841	(4)	189	(23)	1,030	(27)
Corporate notes and bonds	1,107	(8)	3,105	(98)	4,212	(106)
Municipal securities	0	0	168	(21)	168	(21)
Total	\$ 4,560	\$ (65)	\$ 38,176	\$ (1,560)	\$ 42,736	\$ (1,625)

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, 2025:

(In millions)		Adjusted Cost Basis	Estimated Fair Value
December 31, 2025			
Due in one year or less		\$ 27,582	\$ 27,509
Due after one year through five years		47,136	46,511
Due after five years through 10 years		4,110	4,213
Due after 10 years		1,346	1,276
Total		\$ 80,174	\$ 79,509

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.

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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, 2025, 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, 2025	June 30, 2025
Designated as Hedging Instruments		
Foreign exchange contracts purchased	\$ 1,492	\$ 1,492
Interest rate contracts purchased	1,166	1,150
Not Designated as Hedging Instruments		
Foreign exchange contracts purchased	8,884	15,214
Foreign exchange contracts sold	43,710	43,307
Equity contracts purchased	4,943	5,434
Equity contracts sold	2,189	2,189
Other contracts purchased	2,578	2,769
Other contracts sold	878	1,242

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Fair Values of Derivative Instruments

The following table presents our derivative instruments:

(In millions)	Derivative Assets	Derivative Liabilities	Derivative Assets	Derivative Liabilities
		December 31, 2025		June 30, 2025
Designated as Hedging Instruments				
Foreign exchange contracts	\$ 78	\$ (53)	\$ 89	\$ (44)
Interest rate contracts	14	0	15	0
Not Designated as Hedging Instruments				
Foreign exchange contracts	173	(438)	248	(809)
Equity contracts	43	(407)	385	(983)
Other contracts	12	(9)	21	(1)
Gross amounts of derivatives	320	(907)	758	(1,837)
Gross amounts of derivatives offset in the balance sheets	(196)	197	(258)	260
Cash collateral received	0	(73)	0	(99)
Net amounts of derivatives	\$ 124	\$ (783)	\$ 500	\$ (1,676)
Reported as				
Short-term investments	\$ 6	\$ 0	\$ 10	\$ 0
Other current assets	104	0	201	0
Equity and other investments	0	0	272	0
Other long-term assets	14	0	17	0
Other current liabilities	0	(715)	0	(1,639)
Other long-term liabilities	0	(68)	0	(37)
Total	\$ 124	\$ (783)	\$ 500	\$ (1,676)

Gross derivative assets and liabilities subject to legally enforceable master netting agreements for which we have elected to offset were \$295 million and \$902 million, respectively, as of December 31, 2025, and \$452 million and \$1.8 billion, respectively, as of June 30, 2025.

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, 2025				
Derivative assets	\$ 0	\$ 314	\$ 6	\$ 320
Derivative liabilities	0	(907)	0	(907)
June 30, 2025				
Derivative assets	1	474	283	758
Derivative liabilities	0	(1,832)	(5)	(1,837)

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

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2025	2024	2025	2024
Designated as Fair Value Hedging Instruments				
Interest rate contracts				
Derivatives	\$ (1)	\$ (18)	\$ (2)	\$ 2
Hedged items	(7)	8	(15)	(24)
Designated as Cash Flow Hedging Instruments				
Foreign exchange contracts				
Amount reclassified from accumulated other comprehensive loss	(7)	(106)	(12)	(57)
Not Designated as Hedging Instruments				
Foreign exchange contracts	(54)	1,138	327	755
Equity contracts	31	(111)	1610	(459)
Other contracts	6	(26)	6	(2)

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,		Six Months Ended December 31,	
	2025	2024	2025	2024
Designated as Cash Flow Hedging Instruments				
Foreign exchange contracts				
Included in effectiveness assessment	\$ (9)	\$ (50)	\$ (16)	\$ (21)

NOTE 6 — PROPERTY AND EQUIPMENT

The components of property and equipment were as follows:

(In millions)	December 31, 2025		June 30, 2025	
	\$	\$	\$	\$
Land	\$ 9,698	\$ 9,338		
Buildings and improvements	163,986	137,921		
Leasehold improvements	14,500	12,117		
Servers, network equipment, and software	171,351	132,836		
Furniture and equipment	6,541	6,407		
Total, at cost	366,076	298,619		
Accumulated depreciation	(104,950)	(93,653)		
Total, net	\$ 261,126	\$ 204,966		

Depreciation expense was \$7.9 billion and \$15.0 billion for the three and six months ended December 31, 2025, respectively, and \$5.2 billion and \$9.9 billion for the three and six months ended December 31, 2024, respectively.

As of December 31, 2025 and June 30, 2025, purchases of property and equipment remaining in accounts payable were \$23.1 billion and \$6.9 billion, respectively.

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NOTE 7 — GOODWILL

Changes in the carrying amount of goodwill were as follows:

(In millions)	June 30, 2025	Acquisitions		Other		December 31, 2025
Productivity and Business Processes	\$ 31,457	\$ 26	\$ 21	\$ 31,504		
Intelligent Cloud	25,689	36	6	25,731		
More Personal Computing	62,363	5	19	62,387		
Total	<u>\$ 119,509</u>	<u>\$ 67</u>	<u>\$ 46</u>	<u>\$ 119,622</u>		

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.

NOTE 8 — 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, 2025			December 31, 2025
Marketing-related	\$ 16,502	\$ (4,300)	\$ 12,202	\$ 16,502	\$ (3,901)	\$ 12,601
Technology-based	22,726	(16,830)	5,896	22,560	(14,959)	7,601
Customer-related	4,278	(2,357)	1,921	4,278	(2,050)	2,228
Contract-based	343	(73)	270	217	(43)	174
Total	<u>\$ 43,849</u>	<u>\$ (23,560)</u>	<u>\$ 20,289</u>	<u>\$ 43,557</u>	<u>\$ (20,953)</u>	<u>\$ 22,604</u>

Intangible assets amortization expense was \$1.2 billion and \$2.6 billion for the three and six months ended December 31, 2025, respectively, and \$1.5 billion and \$3.0 billion for the three and six months ended December 31, 2024, respectively.

The following table outlines the estimated future amortization expense related to intangible assets held as of December 31, 2025:

(In millions)
Year Ending June 30,
2026 (excluding the six months ended December 31, 2025) \$ 2,063
2027 3,000
2028 2,068
2029 1,879
2030 1,412
Thereafter 9,867
Total \$ 20,289

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NOTE 9 — 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, 2025	June 30, 2025
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%	2,701	2,700
2015 issuance of \$23.8 billion	2035–2055	3.50%–4.75%	3.60%–4.78%	4,555	7,555
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				46,207	49,206
Unamortized discount and issuance costs				(1,117)	(1,155)
Hedge fair value adjustments ^(a)				(21)	(36)
Premium on debt exchange				(4,807)	(4,864)
Total debt				40,262	43,151
Current portion of long-term debt				(4,837)	(2,999)
Long-term debt				\$ 35,425	\$ 40,152

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

As of December 31, 2025 and June 30, 2025, the estimated fair value of long-term debt, including the current portion, was \$37.3 billion and \$40.4 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, 2025:

(In millions)	
Year Ending June 30,	
2026 (excluding the six months ended December 31, 2025)	\$ 0
2027	9,250
2028	0
2029	2,055
2030	0
Thereafter	34,902
Total	\$ 46,207

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NOTE 10 — INCOME TAXES

Effective Tax Rate

Our effective tax rate was 20% for both the three and six months ended December 31, 2025, and 18% for both the three and six months ended December 31, 2024. The increase in our effective tax rate for the three and six months ended December 31, 2025 compared to the prior year was primarily due to deferred tax expense attributable to the dilution gain from the OpenAI Recapitalization 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, 2025, 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, 2025 and June 30, 2025, unrecognized tax benefits and other income tax liabilities were \$28.7 billion and \$27.4 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, 2025, 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., some of which are currently under audit by local tax authorities. The resolution of these audits is not expected to be material to our consolidated financial statements. Our operations in Ireland remain subject to examination for tax years 2021 and thereafter.

NOTE 11 — UNEARNED REVENUE

Unearned revenue by segment was as follows:

(In millions)

	December 31, 2025	June 30, 2025
Productivity and Business Processes	\$ 39,721	\$ 50,567
Intelligent Cloud	11,433	14,022
More Personal Computing	2,890	2,676
Total	\$ 54,044	\$ 67,265

Changes in unearned revenue were as follows:

(In millions)

Six Months Ended December 31, 2025	
Balance, beginning of period	\$ 67,265
Deferral of revenue	89,010
Recognition of unearned revenue	(102,231)
Balance, end of period	\$ 54,044

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Revenue allocated to remaining performance obligations, which includes unearned revenue and amounts expected to be invoiced and recognized as revenue in future periods, was \$631 billion as of December 31, 2025. Estimating revenue that will be allocated to remaining performance obligations can involve significant judgments, including identifying and assessing variable consideration and potential renegotiation of commitments. We consider factors such as the nature of the terms and duration of the contract across our portfolio of contracts. Revenue allocated to remaining performance obligations related to the commercial portion of revenue was \$625 billion as of December 31, 2025, with a weighted average duration of approximately 2.5 years. We expect to recognize approximately 25% of both our total company remaining performance obligation revenue and commercial remaining performance obligation revenue over the next 12 months and the remainder thereafter.

NOTE 12 — 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,	
	2025	2024	2025	2024
Operating lease cost	\$ 1,742	\$ 1,293	\$ 3,397	\$ 2,453
Finance lease cost:				
Amortization of right-of-use assets	\$ 1,277	\$ 830	\$ 2,450	\$ 1,524
Interest on lease liabilities	615	337	1,161	611
Total finance lease cost	<u>\$ 1,892</u>	<u>\$ 1,167</u>	<u>\$ 3,611</u>	<u>\$ 2,135</u>

Supplemental cash flow information related to leases was as follows:

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2025	2024	2025	2024
Cash paid for amounts included in the measurement of lease liabilities:				
Operating cash flows from operating leases	\$ 1,506	\$ 962	\$ 3,161	\$ 2,169
Operating cash flows from finance leases	615	319	1,161	594
Financing cash flows from finance leases	701	480	1,340	1,282
Right-of-use assets obtained in exchange for lease obligations:				
Operating leases	1,477	3,098	2,894	4,991
Finance leases	6,330	6,435	15,477	10,767

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Supplemental balance sheet information related to leases was as follows:

(In millions, except lease term and discount rate)

	December 31, 2025	June 30, 2025
Operating Leases		
Operating lease right-of-use assets	\$ 25,103	\$ 24,823
Other current liabilities	\$ 5,520	\$ 5,424
Operating lease liabilities	17,345	17,437
Total operating lease liabilities	<u>\$ 22,865</u>	\$ 22,861
Finance Leases		
Property and equipment, at cost	\$ 73,201	\$ 53,876
Accumulated depreciation	(12,556)	(9,861)
Property and equipment, net	\$ 60,645	\$ 44,015
Other current liabilities	\$ 3,738	\$ 3,172
Other long-term liabilities	56,413	43,000
Total finance lease liabilities	<u>\$ 60,151</u>	\$ 46,172
Weighted Average Remaining Lease Term		
Operating leases	6 years	6 years
Finance leases	13 years	13 years
Weighted Average Discount Rate		
Operating leases	3.6%	3.5%
Finance leases	4.3%	4.2%

The following table outlines maturities of our lease liabilities as of December 31, 2025:

(In millions)

Year Ending June 30,	Operating Leases	Finance Leases
2026 (excluding the six months ended December 31, 2025)	\$ 3,248	\$ 3,059
2027	5,811	6,404
2028	4,078	6,467
2029	2,891	5,829
2030	2,361	5,718
Thereafter	7,192	53,590
Total lease payments	<u>25,581</u>	81,067
Less imputed interest	(2,716)	(20,916)
Total	\$ 22,865	\$ 60,151

As of December 31, 2025, we had additional leases, primarily for datacenters, that had not yet commenced of \$155.1 billion. These leases will commence between fiscal year 2026 and fiscal year 2031 with lease terms of 1 year to 20 years.

NOTE 13 — CONTINGENCIES

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. A preliminary hearing was held in December 2025.

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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, 2025, we accrued aggregate legal liabilities of \$575 million. While we intend to defend these matters vigorously, adverse outcomes that we estimate could reach approximately \$400 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 14 — 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 and was completed in April 2025.

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 commenced in April 2025, following completion of the program approved on September 14, 2021, has no expiration date, and may be terminated at any time. As of December 31, 2025, \$47.4 billion remained of this \$60.0 billion share repurchase program.

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

(In millions)	Shares	Amount	Shares	Amount
Fiscal Year		2026		2025
First Quarter	8	\$ 3,955	7	\$ 2,800
Second Quarter	12	5,964	8	3,500
Total	20	\$ 9,919	15	\$ 6,300

All repurchases were made using cash resources. Shares repurchased during fiscal year 2026 were under the share repurchase program approved on September 16, 2024. Shares repurchased during fiscal year 2025 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 \$3.1 billion for the three and six months ended December 31, 2025, respectively, and \$1.5 billion and \$2.8 billion for the three and six months ended December 31, 2024, respectively.

Dividends

Our Board of Directors declared the following dividends:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
Fiscal Year 2026				(In millions)
September 15, 2025	November 20, 2025	December 11, 2025	\$ 0.91	\$ 6,762
December 2, 2025	February 19, 2026	March 12, 2026	\$ 0.91	\$ 6,760
Total			\$ 1.82	\$ 13,522
Fiscal Year 2025				
September 16, 2024	November 21, 2024	December 12, 2024	\$ 0.83	\$ 6,170
December 3, 2024	February 20, 2025	March 13, 2025	\$ 0.83	\$ 6,169
Total			\$ 1.66	\$ 12,339

The dividend declared on December 2, 2025 was included in other current liabilities as of December 31, 2025.

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NOTE 15 — 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,	
	2025	2024	2025	2024
Derivatives				
Balance, beginning of period	\$ (11)	\$ (13)	\$ (8)	\$ (3)
Unrealized losses, net of tax of \$(2), \$(13), \$(4), and \$(6)	(9)	(50)	(16)	(21)
Reclassification adjustments for losses included in other income (expense), net	7	106	12	57
Tax benefit included in provision for income taxes	(1)	(22)	(2)	(12)
Amounts reclassified from accumulated other comprehensive loss	6	84	10	45
Net change related to derivatives, net of tax of \$(1), \$9, \$(2), and \$6	(3)	34	(6)	24
Balance, end of period	\$ (14)	\$ 21	\$ (14)	\$ 21
Investments				
Balance, beginning of period	\$ (364)	\$ (1,511)	\$ (1,051)	\$ (2,625)
Unrealized gains (losses), net of tax of \$(45), \$(121), \$140, and \$176	(170)	(453)	525	665
Reclassification adjustments for losses included in other income (expense), net	11	24	1	19
Tax benefit included in provision for income taxes	(2)	(5)	0	(4)
Amounts reclassified from accumulated other comprehensive loss	9	19	1	15
Net change related to investments, net of tax of \$(43), \$(116), \$140, and \$180	(161)	(434)	526	680
Balance, end of period	\$ (525)	\$ (1,945)	\$ (525)	\$ (1,945)
Translation Adjustments and Other				
Balance, beginning of period	\$ (2,386)	\$ (2,658)	\$ (2,288)	\$ (2,962)
Translation adjustments and other, net of tax of \$0, \$0, \$0, and \$0	223	(1,034)	125	(730)
Balance, end of period	\$ (2,163)	\$ (3,692)	\$ (2,163)	\$ (3,692)
Accumulated other comprehensive loss, end of period	\$ (2,702)	\$ (5,616)	\$ (2,702)	\$ (5,616)

NOTE 16 — SEGMENT INFORMATION AND GEOGRAPHIC DATA

In its operation of the business, management, including our chief operating decision maker ("CODM"), who is also our Chief Executive Officer, reviews certain financial information, including segmented internal profit and loss statements. The primary profitability measure used by the CODM to review segment operating results is operating income. The CODM uses operating income to allocate resources during our annual planning process and throughout the year, as well as to assess the performance of our segments, primarily by monitoring actual results compared to prior periods and expected results. During the periods presented, we reported our financial performance based on the following segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing.

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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, 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 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, 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 OEM licensing (Windows Pro and non-Pro licenses sold through the OEM channel) and Devices, comprising Surface 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, and other cloud services.
- Search and news advertising, comprising Bing and 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.

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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, cost of revenue, operating expenses, and operating income were as follows during the periods presented:

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2025	2024	2025	2024
Productivity and Business Processes				
Revenue	\$ 34,116	\$ 29,437	\$ 67,136	\$ 57,754
Cost of revenue	6,110	5,569	11,831	10,863
Operating expenses	7,407	6,983	14,299	13,490
Operating income	<u>\$ 20,599</u>	<u>\$ 16,885</u>	<u>\$ 41,006</u>	<u>\$ 33,401</u>
Intelligent Cloud				
Revenue	\$ 32,907	\$ 25,544	\$ 63,804	\$ 49,636
Cost of revenue	13,566	9,405	25,880	18,019
Operating expenses	5,468	5,288	10,660	10,263
Operating income	<u>\$ 13,873</u>	<u>\$ 10,851</u>	<u>\$ 27,264</u>	<u>\$ 21,354</u>
More Personal Computing				
Revenue	\$ 14,250	\$ 14,651	\$ 28,006	\$ 27,827
Cost of revenue	6,302	6,825	12,310	13,016
Operating expenses	4,145	3,909	7,730	7,361
Operating income	<u>\$ 3,803</u>	<u>\$ 3,917</u>	<u>\$ 7,966</u>	<u>\$ 7,450</u>
Total				
Revenue	\$ 81,273	\$ 69,632	\$ 158,946	\$ 135,217
Cost of revenue	25,978	21,799	50,021	41,898
Operating expenses	17,020	16,180	32,689	31,114
Operating income	<u>\$ 38,275</u>	<u>\$ 31,653</u>	<u>\$ 76,236</u>	<u>\$ 62,205</u>

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, 2025 or 2024. 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,	
	2025	2024	2025	2024
United States ^(a)	\$ 41,410	\$ 35,537	\$ 81,487	\$ 69,450
Other countries	39,863	34,095	77,459	65,767
Total	<u>\$ 81,273</u>	<u>\$ 69,632</u>	<u>\$ 158,946</u>	<u>\$ 135,217</u>

(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.

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

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2025	2024	2025	2024
Server products and cloud services	\$ 30,865	\$ 23,641	\$ 59,737	\$ 45,796
Microsoft 365 Commercial products and cloud services	24,524	21,117	48,490	41,566
Gaming	5,958	6,581	11,466	12,202
LinkedIn	5,082	4,587	9,796	8,879
Windows and Devices	4,479	4,512	9,030	8,841
Search and news advertising	3,812	3,558	7,509	6,783
Microsoft 365 Consumer products and cloud services	2,305	1,821	4,509	3,548
Dynamics products and cloud services	2,204	1,913	4,340	3,762
Enterprise and partner services	2,038	1,892	4,060	3,820
Other	6	10	9	20
Total	\$ 81,273	\$ 69,632	\$ 158,946	\$ 135,217

Our Microsoft Cloud revenue, which includes Microsoft 365 Commercial cloud, Azure and other cloud services, the commercial portion of LinkedIn, and Dynamics 365, was \$51.5 billion and \$100.6 billion for the three and six months ended December 31, 2025, respectively, and \$40.9 billion and \$79.8 billion for the three and six months ended December 31, 2024, respectively. These amounts are included in Server products and cloud services, Microsoft 365 Commercial 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.

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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, 2025, the related consolidated statements of income, comprehensive income, cash flows, and stockholders' equity for the three-month and six-month periods ended December 31, 2025 and 2024, 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, 2025, 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, 2025, 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, 2025, 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 28, 2026

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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, 2025, 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 2026 compared with the second quarter of fiscal year 2025 included:

- Microsoft Cloud revenue increased 26% to \$51.5 billion.
- Commercial remaining performance obligation increased 110% to \$625 billion.
- Microsoft 365 Commercial cloud revenue increased 17%.
- Microsoft 365 Consumer cloud revenue increased 29%.
- LinkedIn revenue increased 11%.
- Dynamics 365 revenue increased 19%.
- Azure and other cloud services revenue increased 39%.
- Windows OEM and Devices revenue increased 1%.
- Xbox content and services revenue decreased 5%.
- Search and news advertising revenue excluding traffic acquisition costs increased 10%.

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Industry Trends and Opportunities

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.

We have a long-term strategic partnership with OpenAI which was originally established in 2019. In October 2025, we signed a new definitive agreement with OpenAI that extends this partnership and continues to build on our shared vision to advance artificial intelligence responsibly and make its benefits broadly accessible. Microsoft is a major investor in OpenAI, and the companies have reciprocal revenue-sharing arrangements. We hold rights to OpenAI's intellectual property, including models and infrastructure, for integration into our products.

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 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 increased reported revenue and did not have a material impact on reported expenses from our international operations for the three and six months ended December 31, 2025.

Further, global, regional, and local economic developments and changes in global trade policies such as restrictions on international trade, including tariffs and other controls on imports or exports, could result in increased supply chain challenges, cost volatility, and consumer and economic uncertainty which may adversely affect our results of operations.

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.

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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.

Additional information on our reportable segments is contained in Note 16 – 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 2026, we made updates to our metrics to align with how we manage and monitor certain businesses. As part of these updates, Microsoft 365 Consumer subscribers was removed as a metric.

Commercial

Our commercial business primarily consists of Server products and cloud services, Microsoft 365 Commercial products and cloud services, the commercial portion of LinkedIn, Dynamics products and cloud services, and Enterprise and partner 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

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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, 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
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 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, 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
	2025	2024		2025	2024	
Revenue	\$ 81,273	\$ 69,632	17%	\$ 158,946	\$ 135,217	18%
Gross margin	55,295	47,833	16%	108,925	93,319	17%
Operating income	38,275	31,653	21%	76,236	62,205	23%
Net income	38,458	24,108	60%	66,205	48,775	36%
Diluted earnings per share	5.16	3.23	60%	8.87	6.53	36%
Adjusted net income (non-GAAP)	30,875	25,047	23%	61,708	50,237	23%
Adjusted diluted earnings per share (non-GAAP)	4.14	3.35	24%	8.27	6.73	23%

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Adjusted net income and adjusted diluted earnings per share ("EPS") are non-GAAP financial measures. These non-GAAP financial measures exclude net gains and losses from investments in OpenAI. Refer to the Non-GAAP Financial Measures section below for a reconciliation of our financial results reported in accordance with GAAP to non-GAAP financial results.

Three Months Ended December 31, 2025 Compared with Three Months Ended December 31, 2024

Revenue increased \$11.6 billion or 17% driven by Intelligent Cloud and Productivity and Business Processes, offset in part by More Personal Computing. Intelligent Cloud revenue increased driven by Azure. Productivity and Business Processes revenue increased driven by Microsoft 365 Commercial cloud. More Personal Computing revenue decreased driven by Gaming, offset in part by Search and news advertising as well as Windows OEM.

Cost of revenue increased \$4.2 billion or 19% driven by growth in Microsoft Cloud.

Gross margin increased \$7.5 billion or 16% with growth across each of our segments.

- Gross margin percentage decreased slightly driven by continued investments in AI infrastructure and growing AI product usage, offset in part by efficiency gains across the Microsoft Cloud and sales mix shift to higher margin businesses.
- Microsoft Cloud gross margin percentage decreased to 67% driven by continued investments in AI infrastructure and growing AI product usage, offset in part by efficiency gains in Azure and Microsoft 365 Commercial cloud.

Operating expenses increased \$840 million or 5% driven by research and development investments in compute capacity and AI talent, as well as impairment charges in our Gaming business.

Operating income increased \$6.6 billion or 21% driven by growth in Productivity and Business Processes and Intelligent Cloud.

Revenue, gross margin, and operating income each included a favorable foreign currency impact of 2%.

Current year net income and diluted EPS were positively impacted by net gains from investments in OpenAI, which resulted in an increase in net income and diluted EPS of \$7.6 billion and \$1.02, respectively. Prior year net income and diluted EPS were negatively impacted by net losses from investments in OpenAI, which resulted in a decrease in net income and diluted EPS of \$939 million and \$0.12, respectively.

Six Months Ended December 31, 2025 Compared with Six Months Ended December 31, 2024

Revenue increased \$23.7 billion or 18% with 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 Search and news advertising and Windows OEM, offset in part by Gaming and Devices.

Cost of revenue increased \$8.1 billion or 19% driven by growth in Microsoft Cloud.

Gross margin increased \$15.6 billion or 17% with growth across each of our segments.

- Gross margin percentage decreased slightly driven by continued investments in AI infrastructure and growing AI product usage, offset in part by efficiency gains across the Microsoft Cloud and sales mix shift to higher margin businesses.
- Microsoft Cloud gross margin percentage decreased to 67% driven by continued investments in AI infrastructure and growing AI product usage, offset in part by efficiency gains in Azure and Microsoft 365 Commercial cloud.

Operating expenses increased \$1.6 billion or 5% driven by research and development investments in compute capacity and AI talent, as well as impairment charges in our Gaming business.

Operating income increased \$14.0 billion or 23% with growth across each of our segments.

Revenue, gross margin, and operating income included a favorable foreign currency impact of 2%, 2%, and 3%, respectively.

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Current year net income and diluted EPS were positively impacted by net gains from investments in OpenAI, which resulted in an increase in net income and diluted EPS of \$4.5 billion and \$0.60, respectively. Prior year net income and diluted EPS were negatively impacted by net losses from investments in OpenAI, which resulted in a decrease in net income and diluted EPS of \$1.5 billion and \$0.20, respectively.

SEGMENT RESULTS OF OPERATIONS

(In millions, except percentages)	Three Months Ended December 31,		Percentage Change	Six Months Ended December 31,		Percentage Change
	2025	2024		2025	2024	
Productivity and Business Processes						
Revenue	\$ 34,116	\$ 29,437	16%	\$ 67,136	\$ 57,754	16%
Cost of revenue	6,110	5,569	10%	11,831	10,863	9%
Operating expenses	7,407	6,983	6%	14,299	13,490	6%
Operating income	<u>\$ 20,599</u>	<u>\$ 16,885</u>	22%	<u>\$ 41,006</u>	<u>\$ 33,401</u>	23%
Intelligent Cloud						
Revenue	\$ 32,907	\$ 25,544	29%	\$ 63,804	\$ 49,636	29%
Cost of revenue	13,566	9,405	44%	25,880	18,019	44%
Operating expenses	5,468	5,288	3%	10,660	10,263	4%
Operating income	<u>\$ 13,873</u>	<u>\$ 10,851</u>	28%	<u>\$ 27,264</u>	<u>\$ 21,354</u>	28%
More Personal Computing						
Revenue	\$ 14,250	\$ 14,651	(3)%	\$ 28,006	\$ 27,827	1%
Cost of revenue	6,302	6,825	(8)%	12,310	13,016	(5)%
Operating expenses	4,145	3,909	6%	7,730	7,361	5%
Operating income	<u>\$ 3,803</u>	<u>\$ 3,917</u>	(3)%	<u>\$ 7,966</u>	<u>\$ 7,450</u>	7%
Total						
Revenue	\$ 81,273	\$ 69,632	17%	\$ 158,946	\$ 135,217	18%
Cost of revenue	25,978	21,799	19%	50,021	41,898	19%
Operating expenses	17,020	16,180	5%	32,689	31,114	5%
Operating income	<u>\$ 38,275</u>	<u>\$ 31,653</u>	21%	<u>\$ 76,236</u>	<u>\$ 62,205</u>	23%

Reportable Segments

Three Months Ended December 31, 2025 Compared with Three Months Ended December 31, 2024

Productivity and Business Processes

Revenue increased \$4.7 billion or 16%.

- Microsoft 365 Commercial products and cloud services revenue increased \$3.4 billion or 16%. Microsoft 365 Commercial cloud revenue grew 17% with growth in revenue per user driven by Microsoft 365 E5 and Microsoft 365 Copilot. Microsoft 365 Commercial seats grew 6% driven by small and medium businesses and frontline worker offerings. Microsoft 365 Commercial products revenue grew 13% driven by Windows Commercial on-premises components of Microsoft 365 suite sales, as well as an increase in Office 2024 transactional purchasing.
- Microsoft 365 Consumer products and cloud services revenue increased \$484 million or 27%. Microsoft 365 Consumer cloud revenue grew 29% driven by growth in revenue per user and Microsoft 365 Consumer subscriber growth of 6%.
- LinkedIn revenue increased \$495 million or 11% driven by growth in Marketing Solutions.
- Dynamics products and cloud services revenue increased \$291 million or 15% driven by growth in Dynamics 365. Dynamics 365 revenue grew 19% with growth across all workloads.

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Operating income increased \$3.7 billion or 22%.

- Cost of revenue increased \$541 million or 10% driven by growth in Microsoft 365 Commercial cloud.
- Gross margin increased \$4.1 billion or 17% driven by growth in Microsoft 365 Commercial cloud. Gross margin percentage increased primarily driven by efficiency gains in Microsoft 365 Commercial cloud even with continued investments in AI infrastructure and growing AI product usage.
- Operating expenses increased \$424 million or 6% driven by research and development investments in compute capacity and AI talent, as well as higher advertising expenses.

Revenue, gross margin, and operating income included a favorable foreign currency impact of 2%, 2%, and 3%, respectively.

Intelligent Cloud

Revenue increased \$7.4 billion or 29%.

- Server products and cloud services revenue increased \$7.2 billion or 31% driven by Azure and other cloud services. Azure and other cloud services revenue grew 39% driven by demand for our portfolio of services with continued growth across all workloads. Server products revenue increased 2% driven by demand for our hybrid solutions, with benefit from the launch of SQL Server 2025, and higher transactional purchasing.
- Enterprise and partner services revenue increased \$146 million or 8% driven by growth in Enterprise Support Services.

Operating income increased \$3.0 billion or 28%.

- Cost of revenue increased \$4.2 billion or 44% driven by growth in Azure.
- Gross margin increased \$3.2 billion or 20% driven by growth in Azure. Gross margin percentage decreased driven by the continued investments in AI infrastructure and sales mix shift to Azure, offset in part by efficiency gains in Azure.
- Operating expenses increased \$180 million or 3% driven by research and development investments in compute capacity and AI talent.

Cost of revenue included an unfavorable foreign currency impact of 2%.

More Personal Computing

Revenue decreased \$401 million or 3%.

- Windows and Devices revenue decreased slightly. Windows OEM and Devices revenue increased 1% driven by Windows OEM growth of 5% with continued benefit from Windows 10 end of support and inventory levels that remained elevated, offset in part by a decline in Devices.
- Gaming revenue decreased \$623 million or 9% driven by declines in Xbox hardware and Xbox content and services. Xbox hardware revenue decreased 32% driven by lower volume of consoles sold. Xbox content and services revenue decreased 5% on a prior year comparable that benefited from strong first-party content performance.
- Search and news advertising revenue increased \$254 million or 7%. Search and news advertising revenue excluding traffic acquisition costs increased 10% driven by higher search volume and continued benefit from third-party partnerships.

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Operating income decreased \$114 million or 3%.

- Cost of revenue decreased \$523 million or 8% driven by lower hardware sales.
- Gross margin increased \$122 million or 2% driven by growth in Search and news advertising and Windows OEM, offset in part by Gaming. Gross margin percentage increased driven by sales mix shift to higher margin businesses.
- Operating expenses increased \$236 million or 6% driven by impairment charges in our Gaming business and research and development investments in compute capacity and AI talent.

Six Months Ended December 31, 2025 Compared with Six Months Ended December 31, 2024

Productivity and Business Processes

Revenue increased \$9.4 billion or 16%.

- Microsoft 365 Commercial products and cloud services revenue increased \$6.9 billion or 17%. Microsoft 365 Commercial cloud revenue grew 17% with growth in revenue per user driven by Microsoft 365 E5 and Microsoft 365 Copilot, and continued Microsoft 365 Commercial seat growth. Microsoft 365 Commercial products revenue grew 15% driven by Windows Commercial on-premises components of Microsoft 365 suite sales, as well as an increase in Office 2024 transactional purchasing.
- Microsoft 365 Consumer products and cloud services revenue increased \$961 million or 27%. Microsoft 365 Consumer cloud revenue grew 27% driven by growth in revenue per user and continued growth in Microsoft 365 Consumer subscribers.
- LinkedIn revenue increased \$917 million or 10% driven by growth in Marketing Solutions.
- Dynamics products and cloud services revenue increased \$578 million or 15% driven by growth in Dynamics 365. Dynamics 365 revenue grew 19% with growth across all workloads.

Operating income increased \$7.6 billion or 23%.

- Cost of revenue increased \$968 million or 9% driven by growth in Microsoft 365 Commercial cloud.
- Gross margin increased \$8.4 billion or 18% driven by growth in Microsoft 365 Commercial cloud. Gross margin percentage increased driven by efficiency gains in Microsoft 365 Commercial cloud even with the impact of investments in AI infrastructure and growing AI product usage.
- Operating expenses increased \$809 million or 6% driven by research and development investments in compute capacity and AI talent, as well as higher advertising expenses.

Revenue, gross margin, and operating income included a favorable foreign currency impact of 2%, 3%, and 3%, respectively.

Intelligent Cloud

Revenue increased \$14.2 billion or 29%.

- Server products and cloud services revenue increased \$13.9 billion or 30% driven by Azure and other cloud services. Azure and other cloud services revenue grew 40% driven by demand for our portfolio of services with continued growth across all workloads. Server products revenue increased 2% driven by higher transactional purchasing and demand for our hybrid solutions, with benefit from the launch of SQL Server 2025.
- Enterprise and partner services revenue increased \$240 million or 6% driven by growth in Enterprise Support Services.

Operating income increased \$5.9 billion or 28%.

- Cost of revenue increased \$7.9 billion or 44% driven by growth in Azure.

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- Gross margin increased \$6.3 billion or 20% driven by growth in Azure. Gross margin percentage decreased driven by the continued investments in AI infrastructure and sales mix shift to Azure, offset in part by efficiency gains in Azure.
- Operating expenses increased \$397 million or 4% driven by research and development investments in compute capacity and AI talent.

Revenue included a favorable foreign currency impact of 2%. Cost of revenue included an unfavorable foreign currency impact of 2%.

More Personal Computing

Revenue increased \$179 million or 1%.

- Windows and Devices revenue increased \$189 million or 2%. Windows OEM and Devices revenue increased 3% driven by Windows OEM growth of 11% with benefit from Windows 10 end of support and inventory levels that remained elevated, offset in part by a decline in Devices.
- Gaming revenue decreased \$736 million or 6% driven by declines in Xbox hardware and Xbox content and services. Xbox hardware revenue decreased 31% driven by lower volume of consoles sold. Xbox content and services revenue decreased 2% driven by a decline in first-party content, offset in part by growth in Xbox Game Pass and third-party content.
- Search and news advertising revenue increased \$726 million or 11%. Search and news advertising revenue excluding traffic acquisition costs increased 13% driven by higher search volume and continued benefit from third-party partnerships.

Operating income increased \$516 million or 7%.

- Cost of revenue decreased \$706 million or 5% driven by lower hardware sales, offset in part by growth in Search and news advertising.
- Gross margin increased \$885 million or 6% driven by growth in Windows OEM and Search and news advertising. Gross margin percentage increased driven by sales mix shift to higher margin businesses.
- Operating expenses increased \$369 million or 5% driven by impairment charges in our Gaming business and research and development investments in compute capacity and AI talent.

OPERATING EXPENSES

Research and Development

(In millions, except percentages)	Three Months Ended December 31,		Percentage Change	Six Months Ended December 31,		Percentage Change
	2025	2024		2025	2024	
Research and development	\$ 8,504	\$ 7,917	7%	\$ 16,650	\$ 15,461	8%
As a percent of revenue	10%	11%	(1)ppt	10%	11%	(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 technology development costs, including AI training and other infrastructure costs, third-party development and programming costs, and the amortization of purchased software code and services content.

Three Months Ended December 31, 2025 Compared with Three Months Ended December 31, 2024

Research and development expenses increased \$587 million or 7% driven by investments in compute capacity and AI talent and impairment charges in our Gaming business.

Six Months Ended December 31, 2025 Compared with Six Months Ended December 31, 2024

Research and development expenses increased \$1.2 billion or 8% driven by investments in compute capacity and AI talent and impairment charges in our Gaming business.

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Sales and Marketing

(In millions, except percentages)	Three Months Ended December 31,		Percentage Change	Six Months Ended December 31,		Percentage Change
	2025	2024		2025	2024	
Sales and marketing	\$ 6,584	\$ 6,440	2%	\$ 12,301	\$ 12,157	1%
As a percent of revenue	8%	9%	(1)ppt	8%	9%	(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, 2025 Compared with Three Months Ended December 31, 2024

Sales and marketing expenses increased \$144 million or 2% driven by higher advertising expenses.

Six Months Ended December 31, 2025 Compared with Six Months Ended December 31, 2024

Sales and marketing expenses increased \$144 million or 1% driven by higher advertising expenses.

General and Administrative

(In millions, except percentages)	Three Months Ended December 31,		Percentage Change	Six Months Ended December 31,		Percentage Change
	2025	2024		2025	2024	
General and administrative	\$ 1,932	\$ 1,823	6%	\$ 3,738	\$ 3,496	7%
As a percent of revenue	2%	3%	(1)ppt	2%	3%	(1)ppt

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, 2025 Compared with Three Months Ended December 31, 2024

General and administrative expenses increased \$109 million or 6% driven by higher legal expenses.

Six Months Ended December 31, 2025 Compared with Six Months Ended December 31, 2024

General and administrative expenses increased \$242 million or 7% driven by higher legal expenses.

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,	
	2025	2024	2025	2024
Interest and dividends income	\$ 840	\$ 600	\$ 1,816	\$ 1,281
Interest expense	(736)	(594)	(1,434)	(1,176)
Net recognized gains (losses) on investments	339	(860)	(233)	(397)
Net gains (losses) on derivatives	37	(116)	1,616	(454)
Net gains (losses) on foreign currency remeasurements	(50)	(153)	(72)	23
Other, net	9,541	(1,165)	4,618	(1,848)
Total	\$ 9,971	\$ (2,288)	\$ 6,311	\$ (2,571)

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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.

Other income (expense), net included \$10.0 billion and \$5.9 billion of net gains for the three and six months ended December 31, 2025, respectively, and \$1.2 billion and \$1.9 billion of net losses for the three and six months ended December 31, 2024, respectively, from investments in OpenAI, primarily net recognized gains (losses) on our equity method investment reflected in Other, net. The net gains recorded for the three and six months ended December 31, 2025 primarily relate to the dilution gain from the OpenAI Recapitalization.

Three Months Ended December 31, 2025 Compared with Three Months Ended December 31, 2024

Interest and dividends income increased primarily due to higher portfolio balances and higher yields on debt securities. Interest expense increased primarily due to higher finance lease interest expense, offset in part by higher capitalization of debt interest expense. Net recognized gains on investments increased primarily due to lower impairments and higher gains on equity securities in the current period. Net gains on derivatives increased primarily due to gains on equity derivatives in the current period as compared to losses in the prior period. Other, net primarily reflects net recognized gains (losses) on equity method investments, including OpenAI.

Six Months Ended December 31, 2025 Compared with Six Months Ended December 31, 2024

Interest and dividends income increased primarily due to higher portfolio balances and higher yields on debt securities. Interest expense increased primarily due to higher finance lease interest expense, offset in part by higher capitalization of debt interest expense. Net recognized losses on investments decreased primarily due to lower impairments, offset in part by losses on equity securities in the current period as compared to gains in the prior period. Net gains on derivatives increased primarily due to gains on equity derivatives in the current period as compared to losses in the prior period. Other, net primarily reflects net recognized gains (losses) on equity method investments, including OpenAI.

INCOME TAXES

Effective Tax Rate

Our effective tax rate was 20% for both the three and six months ended December 31, 2025, and 18% for both the three and six months ended December 31, 2024. The increase in our effective tax rate for the three and six months ended December 31, 2025 compared to the prior year was primarily due to deferred tax expense attributable to the dilution gain from the OpenAI Recapitalization 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, 2025, 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

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, 2025, 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., some of which are currently under audit by local tax authorities. The resolution of these audits is not expected to be material to our consolidated financial statements. Our operations in Ireland remain subject to examination for tax years 2021 and thereafter.

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NON-GAAP FINANCIAL MEASURES

Adjusted other income (expense), net, adjusted net income, and adjusted diluted EPS are non-GAAP financial measures which exclude net (gains) losses from investments in OpenAI. We believe these non-GAAP measures aid investors by providing additional insight into our financial performance and help clarify trends affecting our business. For comparability of reporting, management considers non-GAAP measures in conjunction with GAAP financial results in evaluating business performance. These non-GAAP financial measures presented should not be considered a substitute for, or superior to, the measures of financial performance prepared in accordance with GAAP.

The following table reconciles our financial results reported in accordance with GAAP to non-GAAP financial results:

(In millions, except percentages and per share amounts)	Three Months Ended December 31,		Percentage Change	Six Months Ended December 31,		Percentage Change
	2025	2024		2025	2024	
Other income (expense), net	\$ 9,971	\$ (2,288)	536%	\$ 6,311	\$ (2,571)	345%
Net (gains) losses from investments in OpenAI	(9,978)	1,236	(907)%	(5,917)	1,924	(408)%
Adjusted other income (expense), net (non-GAAP)	\$ (7)	\$ (1,052)	99%	\$ 394	\$ (647)	161%
Net income	\$ 38,458	\$ 24,108	60%	\$ 66,205	\$ 48,775	36%
Net (gains) losses from investments in OpenAI, net of tax of \$2,395, \$(297), \$1,420, and \$(462)	(7,583)	939	(908)%	(4,497)	1,462	(408)%
Adjusted net income (non-GAAP)	\$ 30,875	\$ 25,047	23%	\$ 61,708	\$ 50,237	23%
Diluted earnings per share	\$ 5.16	\$ 3.23	60%	\$ 8.87	\$ 6.53	36%
Net (gains) losses from investments in OpenAI	(1.02)	0.12	(950)%	(0.60)	0.20	(400)%
Adjusted diluted earnings per share (non-GAAP)	\$ 4.14	\$ 3.35	24%	\$ 8.27	\$ 6.73	23%

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, and material capital expenditures, 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 \$89.5 billion and \$94.6 billion as of December 31, 2025 and June 30, 2025, respectively. Equity and other investments were \$21.2 billion and \$15.4 billion as of December 31, 2025 and June 30, 2025, 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.

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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 \$24.3 billion to \$80.8 billion for the six months ended December 31, 2025, primarily due to an increase in cash received from customers, offset in part by an increase in cash paid to suppliers. Cash used in financing increased \$1.6 billion to \$29.4 billion for the six months ended December 31, 2025, primarily due to a \$4.0 billion increase in common stock repurchases, offset in part by a \$3.7 billion decrease in cash used for repayments of debt. Cash used in investing increased \$28.0 billion to \$57.3 billion for the six months ended December 31, 2025, primarily due to an \$18.5 billion increase in additions to property and equipment, a \$5.9 billion increase in other investing to facilitate the purchase of components, and a \$5.7 billion increase in cash used in 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 9 – Debt of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q).

Unearned Revenue

Unearned revenue comprises mainly unearned revenue related to volume licensing programs, which may include cloud services and Software Assurance (“SA”). 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.

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The following table outlines the expected future recognition of unearned revenue as of December 31, 2025:

(In millions)

Three Months Ending	\$	26,335
March 31, 2026	\$	26,335
June 30, 2026	\$	15,812
September 30, 2026	\$	6,350
December 31, 2026	\$	2,879
Thereafter	\$	2,668
Total	\$	54,044

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 11 – Unearned Revenue of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q).

Material Cash Requirements and Other Obligations

Share Repurchases

For the six months ended December 31, 2025 and 2024, we repurchased 20 million shares and 15 million shares of our common stock for \$9.9 billion and \$6.3 billion, respectively, through our share repurchase program. All repurchases were made using cash resources. As of December 31, 2025, \$47.4 billion remained of our \$60 billion share repurchase program. Refer to Note 14 – Stockholders’ Equity of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q).

Dividends

For the six months ended December 31, 2025 and 2024, our Board of Directors declared dividends totaling \$13.5 billion and \$12.3 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 14 – Stockholders’ Equity of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q).

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 will continue to invest in capital expenditures 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).

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, and income taxes.

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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.

Remaining performance obligations represent the revenue we expect to recognize for our products and services for which control has not yet been transferred to customers. We estimate total consideration to be received at the outset of the agreement and throughout the term of the agreement. Estimating the total consideration and revenue that will be allocated to remaining performance obligation can involve significant judgments, including identifying and assessing variable consideration and potential renegotiation of commitments. We consider factors such as the nature of the terms and duration of the contract across our portfolio of contracts.

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.

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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 software product to be marketed or sold to external users 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.

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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, 2025	Impact
Foreign currency – Revenue	10% decrease in foreign exchange rates	\$ (12,434)	Earnings
Foreign currency – Investments	10% decrease in foreign exchange rates	(7)	Fair Value
Interest rate	100 basis point increase in U.S. treasury interest rates	(1,462)	Fair Value
Credit	100 basis point increase in credit spreads	(495)	Fair Value
Equity	10% decrease in equity market prices	(1,847)	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, 2025 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Refer to Note 13 – 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 could 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 could 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 meet consumer demand and 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.

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- 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 could 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. We and our competitors continue to devote significant resources to developing and deploying cloud-based strategies and services for consumers and business customers, and pricing and delivery models are evolving.
- 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 could 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, reducing 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.

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- 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 could 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, including AI-based 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 could 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 October 2023 we completed our acquisition of Activision Blizzard, Inc. We have a long-term strategic partnership with OpenAI, and in October 2025 we announced a significant update to this 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, digital safety, responsible AI, and cybersecurity. It may take longer than expected to realize the full economic benefits from these transactions and arrangements, such as increased revenue or enhanced efficiencies, or the benefits may ultimately be smaller than we expected, which could cause an impairment of goodwill or intangibles.

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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. In addition, an acquisition may be subject to challenge even after it has been completed. These events could adversely affect our business, operations, financial condition, and 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, state-sponsored organizations, or cybercriminal groups, 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 our or third-party 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 could 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 to update or apply 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. For example, passwords may not be rotated and employee access may not be updated or removed on a timely basis. 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.

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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. Our current capabilities may not 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 or third-party 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. The reliability of our cloud-based services and the protection of customer data depend on the security of our infrastructure, which includes hardware, software, and other elements provided by third parties. Adversaries tend to focus their efforts on the most popular operating systems, programs, and services, including many of ours, as well as customers with sensitive data, 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. Product vulnerabilities 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. Weaknesses in our development processes can result in vulnerabilities in our products. Open-source software can also contain vulnerabilities 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 can be susceptible to security threats.

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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 of 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 could 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 take a complex and multifaceted approach. This includes continuously engineering more secure products and services, and enhancing security, threat detection, and reliability features. We must also escalate and improve our development processes and the deployment of software updates to address security vulnerabilities in our own products as well as those provided by others in a timely manner. In addition, we must develop mitigation technologies that help to secure customers from attacks even when software updates are not deployed, and maintain the digital security infrastructure that protects the integrity of our network, products, and services. Further, we must 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 these 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 processes, products, and services, data corruption issues, or reduced performance could harm our reputation and lead customers to exercise contractual or other remedies against us, reduce or delay future purchases of products or subscriptions to services, or to use competing products or services. Customers and third parties granted access to customer systems may fail to update their systems, continue to run software or operating systems we no longer support, may fail to timely install or enable security patches, or may otherwise fail to adopt adequate security practices. 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 have enhanced or specialized expectations and requirements to which we must develop and engineer our products and services. 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 could experience adverse impacts to our results of operations, reputation, or competitive position.

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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 have been enacted to make platforms responsible for preventing or eliminating harmful content online. At the same time, regulations and other initiatives regarding freedom of expression may conflict with such content moderation regulations. Further, duties to address risks to children are driving new obligations for age verification and parental controls across the online ecosystem, including within app stores and operating systems. The legal and regulatory environment in this area is complex and continues to evolve across multiple jurisdictions. As a result, there is considerable uncertainty regarding both current and future compliance obligations. Failure to comply with content requirements may subject us to enhanced regulatory oversight, civil or criminal liability, or reputational damage, which could adversely affect our business, financial condition, and results of operations.

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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, 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. 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, deployment, 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 or inaccurate 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 or other forms of human oversight may be required, including for agentic AI systems that can take actions autonomously. Companion or highly-personalized AI systems may result in over-reliance or dependence by users that is harmful. Our implementation of AI systems could result in legal liability, regulatory action, litigation, brand, reputational, or competitive harm, or other adverse impacts. These risks may stem from issues related to AI model and system capabilities, intellectual property, data privacy, product liability, and other claims associated with AI training, outputs, and system behavior. They are further compounded by the evolving regulatory landscape, with new laws emerging globally and increased scrutiny from regulators and lawmakers. Certain AI technologies and use cases present ethical issues or may have broad or uneven impacts on society or vulnerable groups within society. There is also rising divergence globally in how to address these issues and impacts, with the result that we will need to navigate a web of different tensions across geographies. 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 the impact on human rights, privacy, employment, or other social, economic, or political issues, our reputation, competitive position, business, financial condition, and results of operations could be adversely affected.

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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. We also face community opposition, local moratoriums, and hyper-local dissent that may impede or delay infrastructure development. 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 could 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 or more expensive, 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, higher costs, 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 could adversely affect our business, operations, financial condition, and results of operations.

Our software products and services also have and may in the future experience quality or reliability problems. The processes we use to develop our software are imperfect. Like all software, our software contains 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. Weaknesses in our processes could result in defects we do not detect and fix in pre-release testing, which could cause reduced sales, damage to our reputation, repair or remediation costs, delays in the release of new products or versions, or legal liability, and 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.

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LEGAL, REGULATORY, AND LITIGATION RISKS

We are subject to a variety of new, existing, and evolving legal and regulatory requirements that 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 safety. Laws in several jurisdictions, including EU Member State laws under the European Electronic Communications Code, increasingly define certain of our services as regulated services. This trend may continue with our offerings becoming 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, existing, and evolving laws and regulations, or interpretations or applications of existing laws and regulations in a manner inconsistent with our interpretations of such laws and regulations or our practices, may result in modification of our products and services, altered business models and operations, increased costs, reputational damage, and civil or criminal liability. Examples include laws and regulations regarding:

- **Competition laws and new market regulation:** 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. 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.
- **AI:** Legislative and regulatory action is evolving with respect to AI, 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. AI regulatory areas include model and system development and deployment, frontier model safety, transparency, content provenance, digital replicas, and AI companions.
- **Anti-corruption:** 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 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.

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- **Trade:** 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 could prohibit 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. Restrictions on data flows and outbound investment and customer sensitivities may limit our ability to leverage parts of our global engineering footprint to provide services in certain jurisdictions. Increased geopolitical instabilities and changing U.S. Administration priorities create an unpredictable trade landscape. U.S. tariff, shifting AI export controls policies, and disagreements among governments on sanctions policies toward third countries, could increase operational costs, create uncertainty in the continuity of our products, and accelerate sovereignty initiatives among international partners and customers. The volatility of U.S. tariffs has triggered economic uncertainty and could impact cloud and devices supply chain cost competitiveness. The potential replacement of the recently rescinded AI Diffusion Rule, expanded export license conditions, and other potential AI-related rulemakings could adversely affect Microsoft's business, strategy, and operations. Periods of intense diplomatic or armed conflict like the ongoing conflict in Ukraine and the Israel-Hamas conflict could continue to 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.
- **Cybersecurity:** Legislative and regulatory actions related to cybersecurity may increase the costs associated with developing, implementing, or securing our products and services. The legal and regulatory environment in this area is complex and continues to evolve across multiple jurisdictions. As a result, there is considerable uncertainty regarding both current and future compliance obligations. This uncertainty increases the risk that we may incur additional operational costs, face regulatory enforcement actions, or encounter challenges in the development and deployment of our products.
- **Handling of personal data:** Legal requirements relating to the collection, storage, handling, and transfer of personal data globally continue to evolve. The growth of our Internet- and cloud-based services internationally relies on the movement of data across national boundaries. Data protection authorities and governments in the EU and other markets have and may again restrict and/or block the use of services that involve the transfer of data across borders. New and evolving 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 and other similar regulations impose a range of compliance obligations regarding the handling of personal data. New requirements related to the use of data, including the Data Act, add additional rules and restrictions on the use of data in our products and services.
- **Environmental, Social, and Governance:** 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 greenhouse gas emissions and energy usage caps, as well as specific, target-driven environmental, social, and governance frameworks and disclosure requirements. In addition, in 2020 we announced goals to become carbon negative, water positive, and zero waste by 2030. AI development and deployment has and may continue to raise energy use and emissions, making it harder to meet these goals. Any failure or perceived failure to meet our sustainability goals, or to meet various sustainability regulatory requirements, could result in claims and lawsuits, regulatory actions, penalties, or damage to our reputation, each of which could adversely affect our business, operations, financial condition, and results of operations.

How these laws and regulations apply to our business is often unclear, subject to change, 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 and operational efforts, 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. 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.

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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. An 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 and regulatory requirements can present risks and challenges not present in private commercial agreements. For instance, we are subject to government audits and investigations relating to these contracts, and we are required to provide assurance and attestations about our products and processes. If we do not satisfy contractual or regulatory requirements, 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 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 could adversely affect our 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.

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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 could 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 increases 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 could 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 computing power, PCs, servers, and other computing devices declines, or consumer or business spending for those products declines, our results of operations could 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.

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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 could 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 could 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 could adversely affect our results of operations. Changes in geopolitical conditions also increase the security risks described elsewhere in these risk factors.

The occurrence of regional epidemics or a global pandemic, such as COVID-19, could 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, geopolitical tension, particularly between the U.S. and Europe, restrictions on international trade, such as tariffs and other controls on imports or exports, inflation, and recession, as well as political and military disputes, could adversely affect our results of operations. 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.

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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, disagreements among governments on export controls and sanctions toward third countries, 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 could 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 an 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 those derived from 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 could 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.

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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 2026:

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, 2025 – October 31, 2025	3,523,401	\$ 520.90	3,523,401	\$ 51,559
November 1, 2025 – November 30, 2025	2,903,047	496.71	2,903,047	50,117
December 1, 2025 – December 31, 2025	5,558,939	483.31	5,558,939	47,430
	11,985,387		11,985,387	

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 2026:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
(In millions)				
December 2, 2025	February 19, 2026	March 12, 2026	\$ 0.91	\$ 6,760

We returned \$12.7 billion to shareholders in the form of share repurchases and dividends in the second quarter of fiscal year 2026. Refer to Note 14 – 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.

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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, 2025.

Disclosure Pursuant to Section 13(r) of the Securities Exchange Act of 1934

Pursuant to Section 13(r) of the Securities Exchange Act of 1934, we are required to disclose knowing transactions or dealings involving specific sanctions programs administered by the U.S. Office of Foreign Assets Control (“OFAC”). We disclose the following activities in connection with two Taiwanese entities sanctioned under the Weapons of Mass Destruction Proliferators Regulations. During the quarter ended December 31, 2025, our affiliate in the Asia-Pacific region communicated with these entities about suspension of services following their OFAC designations and allowed these entities to retrieve customer data from our servers in the Asia-Pacific region. No revenue or profit was generated by these activities. We have already terminated these reported activities as of the date of this filing.

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ITEM 6. EXHIBITS

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference		
			Form	Period Ending	Exhibit
15.1	<u>Letter regarding unaudited interim financial information</u>	X			
31.1	<u>Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>	X			
31.2	<u>Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>	X			
32.1*	<u>Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>	X			
32.2*	<u>Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>	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 28, 2026