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, 2022

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 19, 2023**
Common Stock, $0.00000625 par value per share	7,443,803,533 shares

MICROSOFT CORPORATION
FORM 10-Q
For the Quarter Ended December 31, 2022

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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,	
	2022	2021	2022	2021
Revenue:				
Product	$ 16,517	$ 20,779	$ 32,258	$ 37,410
Service and other	36,230	30,949	70,611	59,635
Total revenue	52,747	51,728	102,869	97,045
Cost of revenue:				
Product	5,690	6,331	9,992	10,123
Service and other	11,798	10,629	22,948	20,483
Total cost of revenue	17,488	16,960	32,940	30,606
Gross margin	35,259	34,768	69,929	66,439
Research and development	6,844	5,758	13,472	11,357
Sales and marketing	5,679	5,379	10,805	9,926
General and administrative	2,337	1,384	3,735	2,671
Operating income	20,399	22,247	41,917	42,485
Other income (expense), net	(60)	268	(6)	554
Income before income taxes	20,339	22,515	41,911	43,039
Provision for income taxes	3,914	3,750	7,930	3,769
Net income	$ 16,425	$ 18,765	$ 33,981	$ 39,270
Earnings per share:				
Basic	$ 2.20	$ 2.50	$ 4.56	$ 5.23
Diluted	$ 2.20	$ 2.48	$ 4.54	$ 5.19
Weighted average shares outstanding:				
Basic	7,451	7,505	7,454	7,509
Diluted	7,473	7,555	7,479	7,561

Refer to accompanying notes.

COMPREHENSIVE INCOME STATEMENTS

(In millions) (Unaudited)	Three Months Ended December 31,		Six Months Ended December 31,	
	2022	2021	**2022**	2021
Net income	**$ 16,425**	$ 18,765	**$ 33,981**	$ 39,270
Other comprehensive income (loss), net of tax:				
Net change related to derivatives	**(32)**	0	**(25)**	2
Net change related to investments	**348**	(743)	**(1,549)**	(1,165)
Translation adjustments and other	**570**	(103)	**(205)**	(222)
Other comprehensive income (loss)	**886**	(846)	**(1,779)**	(1,385)
Comprehensive income	**$ 17,311**	$ 17,919	**$ 32,202**	$ 37,885

Refer to accompanying notes.

BALANCE SHEETS

(In millions) (Unaudited)

	December 31, 2022	June 30, 2022
Assets		
Current assets:		
Cash and cash equivalents	**$ 15,646**	$ 13,931
Short-term investments	**83,862**	90,826
Total cash, cash equivalents, and short-term investments	**99,508**	104,757
Accounts receivable, net of allowance for doubtful accounts of **$485** and $633	**35,833**	44,261
Inventories	**2,980**	3,742
Other current assets	**19,502**	16,924
Total current assets	**157,823**	169,684
Property and equipment, net of accumulated depreciation of **$63,459** and $59,660	**82,755**	74,398
Operating lease right-of-use assets	**13,624**	13,148
Equity investments	**7,097**	6,891
Goodwill	**67,905**	67,524
Intangible assets, net	**10,354**	11,298
Other long-term assets	**24,994**	21,897
Total assets	**$ 364,552**	$ 364,840
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	**$ 15,354**	$ 19,000
Current portion of long-term debt	**3,997**	2,749
Accrued compensation	**9,030**	10,661
Short-term income taxes	**3,553**	4,067
Short-term unearned revenue	**36,982**	45,538
Other current liabilities	**12,802**	13,067
Total current liabilities	**81,718**	95,082
Long-term debt	**44,119**	47,032
Long-term income taxes	**24,169**	26,069
Long-term unearned revenue	**2,644**	2,870
Deferred income taxes	**289**	230
Operating lease liabilities	**11,998**	11,489
Other long-term liabilities	**16,479**	15,526
Total liabilities	**181,416**	198,298
Commitments and contingencies		
Stockholders' equity:		
Common stock and paid-in capital – shares authorized 24,000; outstanding **7,447** and 7,464	**90,225**	86,939
Retained earnings	**99,368**	84,281
Accumulated other comprehensive loss	**(6,457)**	(4,678)
Total stockholders' equity	**183,136**	166,542
Total liabilities and stockholders' equity	**$ 364,552**	$ 364,840

Refer to accompanying notes.

CASH FLOWS STATEMENTS

(In millions) (Unaudited)	Three Months Ended December 31,		Six Months Ended December 31,	
	2022	2021	**2022**	2021
Operations				
Net income	**$ 16,425**	$ 18,765	**$ 33,981**	$ 39,270
Adjustments to reconcile net income to net cash from operations:				
Depreciation, amortization, and other	**3,648**	3,496	**6,438**	6,708
Stock-based compensation expense	**2,538**	1,897	**4,730**	3,599
Net recognized losses (gains) on investments and derivatives	**214**	(307)	**192**	(671)
Deferred income taxes	**(1,305)**	183	**(2,496)**	(5,787)
Changes in operating assets and liabilities:				
Accounts receivable	**(3,164)**	(5,543)	**8,565**	4,943
Inventories	**1,305**	394	**762**	(383)
Other current assets	**(392)**	830	**(724)**	1,770
Other long-term assets	**(65)**	(908)	**(731)**	(1,506)
Accounts payable	**(2,058)**	235	**(3,625)**	(236)
Unearned revenue	**(5,186)**	(4,343)	**(8,508)**	(7,228)
Income taxes	**(2,863)**	(2,057)	**(2,453)**	596
Other current liabilities	**1,819**	1,745	**(2,205)**	(2,398)
Other long-term liabilities	**257**	93	**445**	343
Net cash from operations	**11,173**	14,480	**34,371**	39,020
Financing				
Repayments of debt	**(750)**	0	**(1,750)**	(4,826)
Common stock issued	**243**	291	**818**	903
Common stock repurchased	**(5,459)**	(7,433)	**(11,032)**	(15,117)
Common stock cash dividends paid	**(5,066)**	(4,652)	**(9,687)**	(8,858)
Other, net	**(317)**	(192)	**(581)**	(364)
Net cash used in financing	**(11,349)**	(11,986)	**(22,232)**	(28,262)
Investing				
Additions to property and equipment	**(6,274)**	(5,865)	**(12,557)**	(11,675)
Acquisition of companies, net of cash acquired, and purchases of intangible and other assets	**(679)**	(850)	**(1,028)**	(2,056)
Purchases of investments	**(11,599)**	(2,505)	**(16,612)**	(12,814)
Maturities of investments	**6,928**	5,253	**13,590**	14,115
Sales of investments	**4,775**	2,895	**7,486**	8,525
Other, net	**(301)**	(89)	**(1,161)**	(506)
Net cash used in investing	**(7,150)**	(1,161)	**(10,282)**	(4,411)
Effect of foreign exchange rates on cash and cash equivalents	**88**	106	**(142)**	33
Net change in cash and cash equivalents	**(7,238)**	1,439	**1,715**	6,380
Cash and cash equivalents, beginning of period	**22,884**	19,165	**13,931**	14,224
Cash and cash equivalents, end of period	**$ 15,646**	$ 20,604	**$ 15,646**	$ 20,604

Refer to accompanying notes.

STOCKHOLDERS' EQUITY STATEMENTS

(In millions, except per share amounts) (Unaudited)	Three Months Ended December 31,		Six Months Ended December 31,	
	2022	**2021**	**2022**	**2021**
Common stock and paid-in capital				
Balance, beginning of period	**$ 88,535**	$ 83,751	**$ 86,939**	$ 83,111
Common stock issued	**243**	291	**818**	903
Common stock repurchased	**(1,090)**	(1,411)	**(2,261)**	(3,088)
Stock-based compensation expense	**2,538**	1,897	**4,730**	3,599
Other, net	**(1)**	0	**(1)**	3
Balance, end of period	**90,225**	84,528	**90,225**	84,528
Retained earnings				
Balance, beginning of period	**92,374**	66,944	**84,281**	57,055
Net income	**16,425**	18,765	**33,981**	39,270
Common stock cash dividends	**(5,059)**	(4,646)	**(10,123)**	(9,297)
Common stock repurchased	**(4,372)**	(6,018)	**(8,771)**	(11,983)
Balance, end of period	**99,368**	75,045	**99,368**	75,045
Accumulated other comprehensive income (loss)				
Balance, beginning of period	**(7,343)**	1,283	**(4,678)**	1,822
Other comprehensive income (loss)	**886**	(846)	**(1,779)**	(1,385)
Balance, end of period	**(6,457)**	437	**(6,457)**	437
Total stockholders' equity	**$ 183,136**	$ 160,010	**$ 183,136**	$ 160,010
Cash dividends declared per common share	**$ 0.68**	$ 0.62	**$ 1.36**	$ 1.24

Refer to accompanying notes.

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 — ACCOUNTING POLICIES

Accounting Principles

Our unaudited interim consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). In the opinion of management, the unaudited interim consolidated financial statements reflect all adjustments of a normal recurring nature that are necessary for a fair presentation of the results for the interim periods presented. Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with information included in the Microsoft Corporation fiscal year 2022 Form 10-K filed with the U.S. Securities and Exchange Commission on July 28, 2022.

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 (“SSP”) of performance obligations, variable consideration, and other obligations such as product returns and refunds; loss contingencies; product warranties; the fair value of and/or potential impairment of goodwill and intangible assets for our reporting units; product life cycles; useful lives of our tangible and intangible assets; allowances for doubtful accounts; the market value of, and demand for, our inventory; stock-based compensation forfeiture rates; when technological feasibility is achieved for our products; the potential outcome of uncertain tax positions that have been recognized in our consolidated financial statements or tax returns; and determining the timing and amount of impairments for investments. Actual results and outcomes may differ from management’s estimates and assumptions due to risks and uncertainties.

In July 2022, we completed an assessment of the useful lives of our server and network equipment. Due to investments in software that increased efficiencies in how we operate our server and network equipment, as well as advances in technology, we determined we should increase the estimated useful lives of both server and network equipment from four years to six years. This change in accounting estimate was effective beginning fiscal year 2023. Based on the carrying amount of server and network equipment included in property and equipment, net as of June 30, 2022, the effect of this change in estimate for the three months ended December 31, 2022 was an increase in operating income of $945 million and net income of $768 million, or $0.10 per both basic and diluted share. The effect of this change for the six months ended December 31, 2022 was an increase in operating income of $2.0 billion and net income of $1.6 billion, or $0.22 per both basic and diluted share.

Financial Instruments

Investments

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

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

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

Derivatives

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

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

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

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

Fair Value Measurements

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

- *Level 1* – inputs are based upon unadjusted quoted prices for identical instruments in active markets. Our Level 1 investments include U.S. government securities, common and preferred stock, and mutual funds. Our Level 1 derivative assets and liabilities include those actively traded on exchanges.
- *Level 2* – inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques (e.g. the Black-Scholes model) for which all significant inputs are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, credit spreads, foreign exchange rates, and forward and spot prices for currencies. Our Level 2 investments include commercial paper, certificates of deposit, U.S. agency securities, foreign government bonds, mortgage- and asset-backed securities, corporate notes and bonds, and municipal securities. Our Level 2 derivative assets and liabilities include certain 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, 2022 and June 30, 2022, other receivables due from suppliers were $545 million and $1.0 billion, respectively, and are included in accounts receivable, net in our consolidated balance sheets.

As of both December 31, 2022 and June 30, 2022, long-term accounts receivable, net of allowance for doubtful accounts, was $4.2 billion and $3.8 billion, respectively, and is included in other long-term assets in our consolidated balance sheets.

We record financing receivables when we offer certain of our 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, 2022 and June 30, 2022, our financing receivables, net were $3.1 billion and $4.1 billion, respectively, for short-term and long-term financing receivables, which are included in other current assets and other long-term assets in our consolidated balance sheets. We record an allowance to cover expected losses based on troubled accounts, historical experience, and other currently available evidence.

Employee Severance

On January 18, 2023, we announced a decision to reduce our overall workforce by approximately 10,000 jobs through the third quarter of fiscal year 2023. During the three months ended December 31, 2022, we recorded $800 million of employee severance expenses related to these job eliminations as part of an ongoing employee benefit plan. These employee severance expenses were included in general and administrative expenses in our consolidated income statements and allocated to our segments based on relative gross margin. Refer to Note 17 – Segment Information and Geographic Data for further information.

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 earnings per share)	Three Months Ended December 31,		Six Months Ended December 31,	
	2022	2021	2022	2021
Net income available for common shareholders (A)	$ 16,425	$ 18,765	$ 33,981	$ 39,270
Weighted average outstanding shares of common stock (B)	7,451	7,505	7,454	7,509
Dilutive effect of stock-based awards	22	50	25	52
Common stock and common stock equivalents (C)	7,473	7,555	7,479	7,561
Earnings Per Share				
Basic (A/B)	$ 2.20	$ 2.50	$ 4.56	$ 5.23
Diluted (A/C)	$ 2.20	$ 2.48	$ 4.54	$ 5.19

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

NOTE 3 — OTHER INCOME (EXPENSE), NET

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

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2022	2021	2022	2021
Interest and dividends income	$ 700	$ 503	$ 1,341	$ 1,023
Interest expense	(490)	(525)	(990)	(1,064)
Net recognized gains (losses) on investments	(15)	300	(2)	671
Net gains (losses) on derivatives	(199)	7	(190)	0
Net losses on foreign currency remeasurements	(18)	(13)	(96)	(78)
Other, net	(38)	(4)	(69)	2
Total	$ (60)	$ 268	$ (6)	$ 554

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,	
	2022	2021	2022	2021
Realized gains from sales of available-for-sale securities	$ 27	$ 12	$ 30	$ 31
Realized losses from sales of available-for-sale securities	(23)	(6)	(43)	(13)
Impairments and allowance for credit losses	5	(5)	(13)	(8)
Total	$ 9	$ 1	$ (26)	$ 10

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

(In millions)	Three Months Ended December 31, 2022	Three Months Ended December 31, 2021	Six Months Ended December 31, 2022	Six Months Ended December 31, 2021
Net realized gains (losses) on investments sold	**$ (8)**	$ 31	**$ 75**	$ 68
Net unrealized gains (losses) on investments still held	**(7)**	268	**(35)**	593
Impairments of investments	**(9)**	0	**(16)**	0
Total	**$ (24)**	$ 299	**$ 24**	$ 661

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 Investments
December 31, 2022								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	**$ 6,423**	**$ 0**	**$ 0**	**$ 6,423**	**$ 3,307**	**$ 3,116**	**$ 0**
Certificates of deposit	Level 2	**2,694**	**0**	**0**	**2,694**	**2,250**	**444**	**0**
U.S. government securities	Level 1	**67,941**	**0**	**(3,963)**	**63,978**	**1,029**	**62,949**	**0**
U.S. agency securities	Level 2	**5,525**	**0**	**(6)**	**5,519**	**674**	**4,845**	**0**
Foreign government bonds	Level 2	**491**	**1**	**(27)**	**465**	**0**	**465**	**0**
Mortgage- and asset-backed securities	Level 2	**883**	**1**	**(43)**	**841**	**0**	**841**	**0**
Corporate notes and bonds	Level 2	**11,310**	**8**	**(676)**	**10,642**	**0**	**10,642**	**0**
Corporate notes and bonds	Level 3	**88**	**1**	**0**	**89**	**0**	**89**	**0**
Municipal securities	Level 2	**370**	**8**	**(17)**	**361**	**0**	**361**	**0**
Municipal securities	Level 3	**104**	**0**	**(7)**	**97**	**0**	**97**	**0**
Total debt investments		**$ 95,829**	**$ 19**	**$ (4,739)**	**$ 91,109**	**$ 7,260**	**$ 83,849**	**$ 0**
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				**$ 1,521**	**$ 1,082**	**$ 0**	**$ 439**
Equity investments	Other				**6,658**	**0**	**0**	**6,658**
Total equity investments					**$ 8,179**	**$ 1,082**	**$ 0**	**$ 7,097**
Cash					**$ 7,304**	**$ 7,304**	**$ 0**	**$ 0**
Derivatives, net (a)					**13**	**0**	**13**	**0**
Total					**$ 106,605**	**$ 15,646**	**$ 83,862**	**$ 7,097**

(In millions)	Fair Value Level	Adjusted Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity Investments
June 30, 2022								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 2,500	$ 0	$ 0	$ 2,500	$ 2,498	$ 2	$ 0
Certificates of deposit	Level 2	2,071	0	0	2,071	2,032	39	0
U.S. government securities	Level 1	79,696	29	(2,178)	77,547	9	77,538	0
U.S. agency securities	Level 2	419	0	(9)	410	0	410	0
Foreign government bonds	Level 2	506	0	(24)	482	0	482	0
Mortgage- and asset-backed securities	Level 2	727	1	(30)	698	0	698	0
Corporate notes and bonds	Level 2	11,661	4	(554)	11,111	0	11,111	0
Corporate notes and bonds	Level 3	67	0	0	67	0	67	0
Municipal securities	Level 2	368	19	(13)	374	0	374	0
Municipal securities	Level 3	103	0	(6)	97	0	97	0
Total debt investments		$ 98,118	$ 53	$ (2,814)	$ 95,357	$ 4,539	$ 90,818	$ 0
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				$ 1,590	$ 1,134	$ 0	$ 456
Equity investments	Other				6,435	0	0	6,435
Total equity investments					$ 8,025	$ 1,134	$ 0	$ 6,891
Cash					$ 8,258	$ 8,258	$ 0	$ 0
Derivatives, net (a)					8	0	8	0
Total					$ 111,648	$ 13,931	$ 90,826	$ 6,891

(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 using the equity method or measured at cost with adjustments for observable changes in price or impairments, and investments measured at fair value using net asset value as a practical expedient which are not categorized in the fair value hierarchy. As of both December 31, 2022 and June 30, 2022, equity investments without readily determinable fair values measured at cost with adjustments for observable changes in price or impairments were $3.8 billion.

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:

	Less than 12 Months		12 Months or Greater			
(In millions)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Total Fair Value	Total Unrealized Losses
December 31, 2022						
U.S. government and agency securities	**$ 40,516**	**$ (2,586)**	**$ 8,890**	**$ (1,383)**	**$ 49,406**	**$ (3,969)**
Foreign government bonds	**365**	**(14)**	**94**	**(13)**	**459**	**(27)**
Mortgage- and asset-backed securities	**396**	**(22)**	**148**	**(21)**	**544**	**(43)**
Corporate notes and bonds	**6,908**	**(337)**	**3,204**	**(339)**	**10,112**	**(676)**
Municipal securities	**125**	**(5)**	**149**	**(19)**	**274**	**(24)**
Total	**$ 48,310**	**$ (2,964)**	**$ 12,485**	**$ (1,775)**	**$ 60,795**	**$ (4,739)**

(In millions)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses	Total Fair Value	Total Unrealized Losses
June 30, 2022						
U.S. government and agency securities	$ 59,092	$ (1,835)	$ 2,210	$ (352)	$ 61,302	$ (2,187)
Foreign government bonds	418	(18)	27	(6)	445	(24)
Mortgage- and asset-backed securities	510	(26)	41	(4)	551	(30)
Corporate notes and bonds	9,443	(477)	786	(77)	10,229	(554)
Municipal securities	178	(12)	74	(7)	252	(19)
Total	$ 69,641	$ (2,368)	$ 3,138	$ (446)	$ 72,779	$ (2,814)

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

(In millions)	Adjusted Cost Basis	Estimated Fair Value
December 31, 2022		
Due in one year or less	**$ 28,885**	**$ 28,758**
Due after one year through five years	**50,751**	**48,134**
Due after five years through 10 years	**14,845**	**13,012**
Due after 10 years	**1,348**	**1,205**
Total	**$ 95,829**	**$ 91,109**

NOTE 5 — DERIVATIVES

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

Foreign Currencies

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

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

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 exchange-traded option and futures contracts and over-the-counter swap and option 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 and are included in "Other contracts" in the tables below.

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 of our counterparty agreements for derivative instruments contain provisions that require our issued and outstanding long-term unsecured debt to maintain an investment grade credit rating and require us to maintain minimum liquidity of $1.0 billion. To the extent we fail to meet these requirements, we will be required to post collateral, similar to the standard convention related to over-the-counter derivatives. As of December 31, 2022, 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, 2022	June 30, 2022
Designated as Hedging Instruments		
Foreign exchange contracts purchased	**$ 1,492**	$ 635
Interest rate contracts purchased	**1,089**	1,139
Not Designated as Hedging Instruments		
Foreign exchange contracts purchased	**7,042**	10,322
Foreign exchange contracts sold	**17,653**	21,606
Other contracts purchased	**4,803**	2,773
Other contracts sold	**1,023**	544

Fair Values of Derivative Instruments

The following table presents our derivative instruments:

(In millions)	Derivative Assets	Derivative Liabilities	Derivative Assets	Derivative Liabilities
		December 31, 2022		June 30, 2022
Designated as Hedging Instruments				
Foreign exchange contracts	**$ 13**	**$ (79)**	$ 0	$ (77)
Interest rate contracts	**0**	**(3)**	3	0
Not Designated as Hedging Instruments				
Foreign exchange contracts	**195**	**(599)**	333	(362)
Other contracts	**41**	**(305)**	20	(112)
Gross amounts of derivatives	**249**	**(986)**	356	(551)
Gross amounts of derivatives offset in the balance sheet	**(203)**	**206**	(130)	133
Cash collateral received	**0**	**(12)**	0	(75)
Net amounts of derivatives	**$ 46**	**$ (792)**	$ 226	$ (493)
Reported as				
Short-term investments	**$ 13**	**$ 0**	$ 8	$ 0
Other current assets	**27**	**0**	218	0
Other long-term assets	**6**	**0**	0	0
Other current liabilities	**0**	**(607)**	0	(298)
Other long-term liabilities	**0**	**(185)**	0	(195)
Total	**$ 46**	**$ (792)**	$ 226	$ (493)

Gross derivative assets and liabilities subject to legally enforceable master netting agreements for which we have elected to offset were $239 million and $793 million, respectively, as of December 31, 2022, and $343 million and $550 million, respectively, as of June 30, 2022.

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, 2022				
Derivative assets	**$ 0**	**$ 241**	**$ 8**	**$ 249**
Derivative liabilities	**0**	**(986)**	**0**	**(986)**
June 30, 2022				
Derivative assets	1	349	6	356
Derivative liabilities	0	(551)	0	(551)

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,	
	2022	2021	2022	2021
Designated as Fair Value Hedging Instruments				
Foreign exchange contracts				
Derivatives	**$ 0**	$ 46	**$ 0**	$ 49
Hedged items	**0**	(45)	**0**	(50)
Excluded from effectiveness assessment	**0**	0	**0**	4
Interest rate contracts				
Derivatives	**5**	(11)	**(38)**	(14)
Hedged items	**(8)**	15	**35**	22
Designated as Cash Flow Hedging Instruments				
Foreign exchange contracts				
Amount reclassified from accumulated other comprehensive income (loss)	**103**	(14)	**44**	(29)
Not Designated as Hedging Instruments				
Foreign exchange contracts	**(250)**	96	**(10)**	273
Other contracts	**(206)**	6	**(204)**	(12)

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,	
	2022	2021	2022	2021
Designated as Cash Flow Hedging Instruments				
Foreign exchange contracts				
Included in effectiveness assessment	**$ 49**	$ (11)	**$ 9**	$ (21)

NOTE 6 — INVENTORIES

The components of inventories were as follows:

(In millions)	December 31, 2022	June 30, 2022
Raw materials	**$ 1,060**	$ 1,144
Work in process	**38**	82
Finished goods	**1,882**	2,516
Total	**$ 2,980**	$ 3,742

NOTE 7 — BUSINESS COMBINATIONS

Nuance Communications, Inc.

On March 4, 2022, we completed our acquisition of Nuance Communications, Inc. (“Nuance”) for a total purchase price of $18.8 billion, consisting primarily of cash. Nuance is a cloud and artificial intelligence (“AI”) software provider with healthcare and enterprise AI experience, and the acquisition will build on our industry-specific cloud offerings. The financial results of Nuance have been included in our consolidated financial statements since the date of the acquisition. Nuance is reported as part of our Intelligent Cloud segment.

The allocation of the purchase price to goodwill was completed as of December 31, 2022. The major classes of assets and liabilities to which we have allocated the purchase price were as follows:

(In millions)		
Goodwill (a)	$	16,326
Intangible assets		4,365
Other assets		42
Other liabilities (b)		(1,972)
Total	$	18,761

(a) *Goodwill was assigned to our Intelligent Cloud segment and was primarily attributed to increased synergies that are expected to be achieved from the integration of Nuance. None of the goodwill is expected to be deductible for income tax purposes.*
(b) *Includes $986 million of convertible senior notes issued by Nuance in 2015 and 2017, substantially all of which have been redeemed.*

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

(In millions, except average life)		Amount	Weighted Average Life
Customer-related	$	2,610	9 years
Technology-based		1,540	5 years
Marketing-related		215	4 years
Total	$	4,365	7 years

Activision Blizzard, Inc.

On January 18, 2022, we entered into a definitive agreement to acquire Activision Blizzard, Inc. (“Activision Blizzard”) for $95.00 per share in an all-cash transaction valued at $68.7 billion, inclusive of Activision Blizzard’s net cash. Activision Blizzard is a leader in game development and an interactive entertainment content publisher. The acquisition will accelerate the growth in our gaming business across mobile, PC, console, and cloud gaming. The acquisition has been approved by Activision Blizzard’s shareholders. We are continuing to engage with regulators reviewing the transaction and are working toward closing it in fiscal year 2023, subject to obtaining required regulatory approvals and satisfaction of other customary closing conditions.

NOTE 8 — GOODWILL

Changes in the carrying amount of goodwill were as follows:

(In millions)		June 30, 2022		Acquisitions		Other		December 31, 2022
Productivity and Business Processes	$	**24,811**	$	**11**	$	**(15)**	$	**24,807**
Intelligent Cloud		**30,182**		**183**		**87**		**30,452**
More Personal Computing		**12,531**		**0**		**115**		**12,646**
Total	$	**67,524**	$	**194**	$	**187**	$	**67,905**

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 9 — INTANGIBLE ASSETS

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

(In millions)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
			December 31, 2022			June 30, 2022
Technology-based	**$ 11,093**	**$ (7,073)**	**$ 4,020**	$ 11,277	$ (6,958)	$ 4,319
Customer-related	**7,352**	**(3,646)**	**3,706**	7,342	(3,171)	4,171
Marketing-related	**4,942**	**(2,324)**	**2,618**	4,942	(2,143)	2,799
Contract-based	**21**	**(11)**	**10**	16	(7)	9
Total	**$ 23,408**	**$ (13,054)**	**$ 10,354**	$ 23,577	$ (12,279)	$ 11,298

Intangible assets amortization expense was $632 million and $1.3 billion for the three and six months ended December 31, 2022, respectively, and $446 million and $885 million for the three and six months ended December 31, 2021, respectively.

The following table outlines the estimated future amortization expense related to intangible assets held as of December 31, 2022:

(In millions)	
Year Ending June 30,	
2023 (excluding the six months ended December 31, 2022)	**$ 1,256**
2024	**2,377**
2025	**1,826**
2026	**1,309**
2027	**874**
Thereafter	**2,712**
Total	**$ 10,354**

NOTE 10 — DEBT

The components of debt were as follows:

(In millions, issuance by calendar year)	Maturities (calendar year)	Stated Interest Rate	Effective Interest Rate	December 31, 2022	June 30, 2022
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	**2022–2042**	**2.13%–3.50%**	**2.24%–3.57%**	**454**	1,204
2013 issuance of $5.2 billion	**2023–2043**	**2.38%–4.88%**	**2.47%–4.92%**	**2,814**	2,814
2013 issuance of €4.1 billion	**2028–2033**	**2.63%–3.13%**	**2.69%–3.22%**	**2,455**	2,404
2015 issuance of $23.8 billion	**2025–2055**	**2.70%–4.75%**	**2.77%–4.78%**	**9,805**	10,805
2016 issuance of $19.8 billion	**2023–2056**	**2.00%–3.95%**	**2.10%–4.03%**	**9,430**	9,430
2017 issuance of $17.0 billion	**2024–2057**	**2.88%–4.50%**	**3.04%–4.53%**	**8,945**	8,945
2020 issuance of $10.0 billion	**2050–2060**	**2.53%–2.68%**	**2.53%–2.68%**	**10,000**	10,000
2021 issuance of $8.2 billion	**2052–2062**	**2.92%–3.04%**	**2.92%–3.04%**	**8,185**	8,185
Total face value				**53,812**	55,511
Unamortized discount and issuance costs				**(455)**	(471)
Hedge fair value adjustments (a)				**(103)**	(68)
Premium on debt exchange				**(5,138)**	(5,191)
Total debt				**48,116**	49,781
Current portion of long-term debt				**(3,997)**	(2,749)
Long-term debt				**$ 44,119**	$ 47,032

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

As of December 31, 2022 and June 30, 2022, the estimated fair value of long-term debt, including the current portion, was $46.4 billion and $50.9 billion, respectively. The estimated fair values are based on Level 2 inputs.

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

The following table outlines maturities of our long-term debt, including the current portion, as of December 31, 2022:

(In millions) Year Ending June 30,	
2023 (excluding the six months ended December 31, 2022)	**$ 1,000**
2024	**5,250**
2025	**2,250**
2026	**3,000**
2027	**8,000**
Thereafter	**34,312**
Total	**$ 53,812**

NOTE 11 — INCOME TAXES

Effective Tax Rate

Our effective tax rate was 19% and 17% for the three months ended December 31, 2022 and 2021, respectively, and 19% and 9% for the six months ended December 31, 2022 and 2021, respectively. The increase in our effective tax rate for the three months ended December 31, 2022 compared to the prior year was primarily due to a decrease in tax benefits relating to stock-based compensation. The increase in our effective tax rate for the six months ended December 31, 2022 compared to the prior year was primarily due to a $3.3 billion net income tax benefit in the first quarter of fiscal year 2022 related to the transfer of intangible properties and a decrease in tax benefits relating to stock-based compensation.

In the first quarter of fiscal year 2022, we transferred certain intangible properties from our Puerto Rico subsidiary to the U.S. The transfer of intangible properties resulted in a $3.3 billion net income tax benefit in the first quarter of fiscal year 2022, as the value of future U.S. tax deductions exceeded the current tax liability from the U.S. global intangible low-taxed income tax.

Our effective tax rate was lower than the U.S. federal statutory rate for the three and six months ended December 31, 2022, 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, 2022 and June 30, 2022, unrecognized tax benefits and other income tax liabilities were $17.1 billion and $16.3 billion, respectively, and are included in long-term income taxes in our consolidated balance sheets.

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

As of December 31, 2022, the primary unresolved issues for the IRS audits relate to transfer pricing, which could have a material impact in our consolidated financial statements when the matters are resolved. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved key transfer pricing issues and 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 tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2022, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NOTE 12 — UNEARNED REVENUE

Unearned revenue by segment was as follows:

(In millions)

	December 31, 2022	June 30, 2022
Productivity and Business Processes	**$ 20,120**	$ 24,558
Intelligent Cloud	**15,822**	19,371
More Personal Computing	**3,684**	4,479
Total	**$ 39,626**	$ 48,408

Changes in unearned revenue were as follows:

(In millions)		
Six Months Ended December 31, 2022		
Balance, beginning of period	**$**	**48,408**
Deferral of revenue		**48,188**
Recognition of unearned revenue		**(56,970)**
Balance, end of period	**$**	**39,626**

Revenue allocated to remaining performance obligations, which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods, was $193 billion as of December 31, 2022, of which $189 billion is related to the commercial portion of revenue. We expect to recognize approximately 45% of this revenue over the next 12 months and the remainder thereafter.

NOTE 13 — LEASES

We have operating and finance leases for datacenters, corporate offices, research and development facilities, Microsoft Experience Centers, and certain equipment. Our leases have remaining lease terms of less than 1 year to 19 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,	
	2022	**2021**	**2022**	**2021**
Operating lease cost	**$ 684**	$ 469	**$ 1,346**	$ 1,057
Finance lease cost:				
Amortization of right-of-use assets	**$ 457**	$ 264	**$ 646**	$ 490
Interest on lease liabilities	**119**	107	**232**	211
Total finance lease cost	**$ 576**	$ 371	**$ 878**	$ 701

Supplemental cash flow information related to leases was as follows:

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2022	**2021**	**2022**	**2021**
Cash paid for amounts included in the measurement of lease liabilities:				
Operating cash flows from operating leases	**$ 645**	$ 441	**$ 1,299**	$ 1,007
Operating cash flows from finance leases	**119**	107	**232**	211
Financing cash flows from finance leases	**262**	222	**518**	422
Right-of-use assets obtained in exchange for lease obligations:				
Operating leases	**525**	1,559	**1,714**	2,730
Finance leases	**598**	985	**1,209**	2,374

Supplemental balance sheet information related to leases was as follows:

(In millions, except lease term and discount rate)

	December 31, 2022	June 30, 2022
Operating Leases		
Operating lease right-of-use assets	**$ 13,624**	$ 13,148
Other current liabilities	**$ 2,287**	$ 2,228
Operating lease liabilities	**11,998**	11,489
Total operating lease liabilities	**$ 14,285**	$ 13,717
Finance Leases		
Property and equipment, at cost	**$ 18,514**	$ 17,388
Accumulated depreciation	**(3,920)**	(3,285)
Property and equipment, net	**$ 14,594**	$ 14,103
Other current liabilities	**$ 1,105**	$ 1,060
Other long-term liabilities	**14,479**	13,842
Total finance lease liabilities	**$ 15,584**	$ 14,902
Weighted Average Remaining Lease Term		
Operating leases	**8 years**	8 years
Finance leases	**11 years**	12 years
Weighted Average Discount Rate		
Operating leases	**2.5%**	2.1%
Finance leases	**3.2%**	3.1%

The following table outlines maturities of our lease liabilities as of December 31, 2022:

(In millions)

Year Ending June 30,	Operating Leases	Finance Leases
2023 (excluding the six months ended December 31, 2022)	**$ 1,320**	**$ 790**
2024	**2,498**	**1,598**
2025	**2,217**	**1,912**
2026	**1,847**	**1,595**
2027	**1,533**	**1,603**
Thereafter	**6,528**	**11,196**
Total lease payments	**15,943**	**18,694**
Less imputed interest	**(1,658)**	**(3,110)**
Total	**$ 14,285**	**$ 15,584**

As of December 31, 2022, we have additional operating and finance leases, primarily for datacenters, that have not yet commenced of $6.3 billion and $19.7 billion, respectively. These operating and finance leases will commence between fiscal year 2023 and fiscal year 2028 with lease terms of less than 1 year to 18 years.

NOTE 14 — CONTINGENCIES

U.S. Cell Phone Litigation

Microsoft Mobile Oy, a subsidiary of Microsoft, along with other handset manufacturers and network operators, is a defendant in 46 lawsuits, including 45 lawsuits filed in the Superior Court for the District of Columbia by individual plaintiffs who allege that radio emissions from cellular handsets caused their brain tumors and other adverse health effects. We assumed responsibility for these claims in our agreement to acquire Nokia's Devices and Services business and have been substituted for the Nokia defendants. Nine of these cases were filed in 2002 and are consolidated for certain pre-trial proceedings; the remaining cases are stayed. In a separate 2009 decision, the Court of Appeals for the District of Columbia held that adverse health effect claims arising from the use of cellular handsets that operate within the U.S. Federal Communications Commission radio frequency emission guidelines ("FCC Guidelines") are pre-empted by federal law. The plaintiffs allege that their handsets either operated outside the FCC Guidelines or were manufactured before the FCC Guidelines went into effect. The lawsuits also allege an industry-wide conspiracy to manipulate the science and testing around emission guidelines.

In 2013, the defendants in the consolidated cases moved to exclude the plaintiffs' expert evidence of general causation on the basis of flawed scientific methodologies. In 2014, the trial court granted in part and denied in part the defendants' motion to exclude the plaintiffs' general causation experts. The defendants filed an interlocutory appeal to the District of Columbia Court of Appeals challenging the standard for evaluating expert scientific evidence. In October 2016, the Court of Appeals issued its decision adopting the standard advocated by the defendants and remanding the cases to the trial court for further proceedings under that standard. The plaintiffs have filed supplemental expert evidence, portions of which were stricken by the court. A hearing on general causation took place in September of 2022.

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, 2022, we accrued aggregate legal liabilities of $181 million. While we intend to defend these matters vigorously, adverse outcomes that we estimate could reach approximately $500 million in aggregate beyond recorded amounts are reasonably possible. Were unfavorable final outcomes to occur, there exists the possibility of a material adverse impact in our consolidated financial statements for the period in which the effects become reasonably estimable.

NOTE 15 — STOCKHOLDERS' EQUITY

Share Repurchases

On September 18, 2019, our Board of Directors approved a share repurchase program authorizing up to $40.0 billion in share repurchases. This share repurchase program commenced in February 2020 and was completed in November 2021.

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, following completion of the program approved on September 18, 2019, has no expiration date, and may be terminated at any time. As of December 31, 2022, $31.5 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		2023		2022
First Quarter	**17**	**$ 4,600**	21	$ 6,200
Second Quarter	**20**	**4,600**	20	6,233
Total	**37**	**$ 9,200**	41	$ 12,433

All repurchases were made using cash resources. Shares repurchased during fiscal year 2023 were under the share repurchase program approved on September 14, 2021. Shares repurchased during the second quarter of fiscal year 2022 were under the share repurchase programs approved on both September 14, 2021 and September 18, 2019. Shares repurchased during the first quarter of fiscal year 2022 were under the share repurchase program approved on September 18, 2019. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards of $859 million and $1.8 billion for the three and six months ended December 31, 2022, respectively, and $1.2 billion and $2.7 billion for the three and six months ended December 31, 2021, respectively.

Dividends

Our Board of Directors declared the following dividends:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
Fiscal Year 2023				(In millions)
September 20, 2022	**November 17, 2022**	**December 8, 2022**	**$ 0.68**	**$ 5,066**
November 29, 2022	**February 16, 2023**	**March 9, 2023**	**0.68**	**5,064**
Total			**$ 1.36**	**$ 10,130**
Fiscal Year 2022				
September 14, 2021	November 18, 2021	December 9, 2021	$ 0.62	$ 4,652
December 7, 2021	February 17, 2022	March 10, 2022	0.62	4,645
Total			$ 1.24	$ 9,297

The dividend declared on November 29, 2022 was included in other current liabilities as of December 31, 2022.

NOTE 16 — ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

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

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2022	**2021**	**2022**	**2021**
Derivatives				
Balance, beginning of period	**$ (6)**	$ (17)	**$ (13)**	$ (19)
Unrealized gains (losses), net of tax of **$13**, $(3), **$2**, and $(6)	**49**	(11)	**9**	(21)
Reclassification adjustments for (gains) losses included in other income (expense), net	**(103)**	14	**(44)**	29
Tax expense (benefit) included in provision for income taxes	**22**	(3)	**10**	(6)
Amounts reclassified from accumulated other comprehensive income (loss)	**(81)**	11	**(34)**	23
Net change related to derivatives, net of tax of **$(9)**, $0, **$(8)**, and $0	**(32)**	0	**(25)**	2
Balance, end of period	**$ (38)**	$ (17)	**$ (38)**	$ (17)
Investments				
Balance, beginning of period	**$ (4,035)**	$ 2,800	**$ (2,138)**	$ 3,222
Unrealized gains (losses), net of tax of **$89**, $(197), **$(421)**, and $(307)	**340**	(742)	**(1,585)**	(1,157)
Reclassification adjustments for (gains) losses included in other income (expense), net	**10**	(1)	**45**	(10)
Tax expense (benefit) included in provision for income taxes	**(2)**	0	**(9)**	2
Amounts reclassified from accumulated other comprehensive income (loss)	**8**	(1)	**36**	(8)
Net change related to investments, net of tax of **$91**, $(197), **$(412)**, and $(309)	**348**	(743)	**(1,549)**	(1,165)
Balance, end of period	**$ (3,687)**	$ 2,057	**$ (3,687)**	$ 2,057
Translation Adjustments and Other				
Balance, beginning of period	**$ (3,302)**	$ (1,500)	**$ (2,527)**	$ (1,381)
Translation adjustments and other, net of tax of **$0**, $0, **$0**, and $0	**570**	(103)	**(205)**	(222)
Balance, end of period	**$ (2,732)**	$ (1,603)	**$ (2,732)**	$ (1,603)
Accumulated other comprehensive income (loss), end of period	**$ (6,457)**	$ 437	**$ (6,457)**	$ 437

NOTE 17 — SEGMENT INFORMATION AND GEOGRAPHIC DATA

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

We have recast certain prior period amounts to conform to the way we internally manage and monitor our business.

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:

- Office Commercial (Office 365 subscriptions, the Office 365 portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises), comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, and Microsoft Viva.
- Office Consumer, including Microsoft 365 Consumer subscriptions, Office licensed on-premises, and other Office services.
- LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions.
- Dynamics business solutions, including Dynamics 365, comprising a set of intelligent, cloud-based applications across ERP, CRM, Customer Insights, Power Apps, and Power Automate; and on-premises ERP and CRM applications.

Intelligent Cloud

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

- Server products and cloud services, including Azure and other cloud services; SQL Server, Windows Server, Visual Studio, System Center, and related Client Access Licenses (“CALs”); and Nuance and GitHub.
- Enterprise Services, including Enterprise Support Services, Microsoft Consulting Services, and Nuance professional services.

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, including Windows original equipment manufacturer (“OEM”) licensing and other non-volume licensing of the Windows operating system; Windows Commercial, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings; patent licensing; and Windows Internet of Things.
- Devices, including Surface, HoloLens, and PC accessories.
- Gaming, including Xbox hardware and Xbox content and services, comprising first- and third-party content (including games and in-game content), Xbox Game Pass and other subscriptions, Xbox Cloud Gaming, third-party disc royalties, advertising, and other cloud services.
- Search and news advertising.

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

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

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

(In millions)	**Three Months Ended December 31,**		**Six Months Ended December 31,**	
	2022	**2021**	**2022**	**2021**
Revenue				
Productivity and Business Processes	**$ 17,002**	$ 15,936	**$ 33,467**	$ 30,975
Intelligent Cloud	**21,508**	18,262	**41,833**	35,174
More Personal Computing	**14,237**	17,530	**27,569**	30,896
Total	**$ 52,747**	$ 51,728	**$ 102,869**	$ 97,045
Operating Income				
Productivity and Business Processes	**$ 8,175**	$ 7,688	**$ 16,498**	$ 15,269
Intelligent Cloud	**8,904**	8,323	**17,882**	16,004
More Personal Computing	**3,320**	6,236	**7,537**	11,212
Total	**$ 20,399**	$ 22,247	**$ 41,917**	$ 42,485

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, 2022 or 2021. 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,**	
	2022	**2021**	**2022**	**2021**
United States (a)	**$ 26,976**	$ 26,463	**$ 52,843**	$ 49,293
Other countries	**25,771**	25,265	**50,026**	47,752
Total	**$ 52,747**	$ 51,728	**$ 102,869**	$ 97,045

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

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

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2022	2021	**2022**	2021
Server products and cloud services	**$ 19,594**	$ 16,382	**$ 37,982**	$ 31,452
Office products and cloud services	**11,837**	11,251	**23,385**	22,059
Windows	**4,808**	6,594	**10,121**	12,268
Gaming	**4,758**	5,442	**8,368**	9,035
LinkedIn	**3,876**	3,531	**7,539**	6,667
Search and news advertising	**3,223**	3,064	**6,151**	5,720
Enterprise Services	**1,862**	1,823	**3,738**	3,614
Devices	**1,430**	2,357	**2,878**	3,771
Other	**1,359**	1,284	**2,707**	2,459
Total	**$ 52,747**	$ 51,728	**$ 102,869**	$ 97,045

Our Microsoft Cloud revenue, which includes Azure and other cloud services, Office 365 Commercial, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties, was $27.1 billion and $52.8 billion for the three and six months ended December 31, 2022, respectively, and $22.2 billion and $42.9 billion for the three and six months ended December 31, 2021, respectively. These amounts are primarily included in Server products and cloud services, Office products and cloud services, and LinkedIn in the table above.

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

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Microsoft Corporation

Results of Review of Interim Financial Information

We have reviewed the accompanying consolidated balance sheet of Microsoft Corporation and subsidiaries (the "Company") as of December 31, 2022, the related consolidated statements of income, comprehensive income, cash flows, and stockholders' equity for the three-month and six-month periods ended December 31, 2022 and 2021, 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, 2022, 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 28, 2022, 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, 2022, 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 24, 2023

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, 2022, and our financial statements and the accompanying Notes to Financial Statements (Part I, Item 1 of this Form 10-Q).

OVERVIEW

Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. Our platforms and tools help drive small business productivity, large business competitiveness, and public-sector efficiency. We are creating the platforms and tools that deliver better, faster, and more effective solutions to support new startups, improve educational and health outcomes, and empower human ingenuity.

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

Highlights from the second quarter of fiscal year 2023 compared with the second quarter of fiscal year 2022 included:

- Microsoft Cloud revenue increased 22% to $27.1 billion.
- Office Commercial products and cloud services revenue increased 7% driven by Office 365 Commercial growth of 11%.
- Office Consumer products and cloud services revenue decreased 2% and Microsoft 365 Consumer subscribers increased to 63.2 million.
- LinkedIn revenue increased 10%.
- Dynamics products and cloud services revenue increased 13% driven by Dynamics 365 growth of 21%.
- Server products and cloud services revenue increased 20% driven by Azure and other cloud services growth of 31%.
- Windows original equipment manufacturer licensing (“Windows OEM”) revenue decreased 39%.
- Windows Commercial products and cloud services revenue decreased 3%.
- Xbox content and services revenue decreased 12%.
- Search and news advertising revenue excluding traffic acquisition costs increased 10%.
- Devices revenue decreased 39%.

Industry Trends

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

Economic Conditions, Challenges, and Risks

The markets for software, devices, and cloud-based services are dynamic and highly competitive. Our competitors are developing new software and devices, while also deploying competing cloud-based services for consumers and businesses. The devices and form factors customers prefer evolve rapidly, and influence how users access services in the cloud, and in some cases, the user's choice of which suite of cloud-based services to use. We must continue to evolve and adapt over an extended time in pace with this changing environment. The investments we are making in infrastructure and devices will continue to increase our operating costs and may decrease our operating margins.

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. Aggregate demand for our software, services, and devices is correlated to global macroeconomic and geopolitical factors, which remain dynamic.

Our devices are primarily manufactured by third-party contract manufacturers, some of which contain certain components for which there are very few qualified suppliers. For these components, we have limited near-term flexibility to use other manufacturers if a current vendor becomes unavailable or is unable to meet our requirements. Extended disruptions at these suppliers and/or manufacturers could lead to a similar disruption in our ability to manufacture devices on time to meet consumer demand.

Our international operations provide a significant portion of our total revenue and expenses. Many of these revenue and expenses are denominated in currencies other than the U.S. dollar. As a result, changes in foreign exchange rates may significantly affect revenue and expenses. Fluctuations in the U.S. dollar relative to certain foreign currencies reduced reported revenue and expenses from our international operations for the three and six months ended December 31, 2022.

On January 18, 2023, we announced decisions we made to align our cost structure with our revenue and customer demand, prioritize our investments in strategic areas, and consolidate office space. As a result, we recorded a $1.2 billion charge in the second quarter of fiscal year 2023 ("Q2 charge"), which included employee severance expenses of $800 million, impairment charges resulting from changes to our hardware portfolio, and costs related to lease consolidation activities. First, we are reducing our overall workforce by approximately 10,000 jobs through the third quarter of fiscal year 2023, which represents less than 5% of our total employee base. While we are eliminating roles in some areas, we will continue to hire in key strategic areas. Second, we are allocating both our capital and talent to areas of secular growth and long-term competitiveness, while divesting in other areas. Third, we are consolidating our leases to create higher density across our workspaces, which will also impact our financial results through the remainder of fiscal year 2023, and we may make similar decisions in future periods as we continue to evaluate our real estate needs.

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 second and fourth quarters of our fiscal year. Second quarter revenue is driven by corporate year-end spending trends in our major markets and holiday season spending by consumers, and fourth quarter revenue is driven by the volume of multi-year on-premises contracts executed during the period.

Change in Accounting Estimate

In July 2022, we completed an assessment of the useful lives of our server and network equipment. Due to investments in software that increased efficiencies in how we operate our server and network equipment, as well as advances in technology, we determined we should increase the estimated useful lives of both server and network equipment from four years to six years. This change in accounting estimate was effective beginning fiscal year 2023. Based on the carrying amount of server and network equipment included in property and equipment, net as of June 30, 2022, the effect of this change in estimate for the three months ended December 31, 2022 was an increase in operating income of $945 million and net income of $768 million, or $0.10 per both basic and diluted share. The effect of this change for the six months ended December 31, 2022 was an increase in operating income of $2.0 billion and net income of $1.6 billion, or $0.22 per both basic and diluted share. It is estimated this change will increase our fiscal year 2023 annual operating income by $3.7 billion.

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. We have recast certain prior period amounts to conform to the way we internally manage and monitor our business.

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

Metrics

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

In the first quarter of fiscal year 2023, we made updates to the presentation and method of calculation for certain metrics, most notably expanding our Surface metric into a broader Devices metric to incorporate additional revenue streams, along with other minor changes to align with how we manage our businesses.

Commercial

Our commercial business primarily consists of Server products and cloud services, Office Commercial, Windows Commercial, the commercial portion of LinkedIn, Enterprise Services, and Dynamics. 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	Revenue from Azure and other cloud services, Office 365 Commercial, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties
Microsoft Cloud gross margin percentage	Gross margin percentage for our Microsoft Cloud business

Productivity and Business Processes and Intelligent Cloud

Metrics related to our Productivity and Business Processes and Intelligent Cloud segments assess the health of our core businesses within these segments. The metrics reflect our cloud and on-premises product strategies and trends.

Office Commercial products and cloud services revenue growth	Revenue from Office Commercial products and cloud services (Office 365 subscriptions, the Office 365 portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises), comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, and Microsoft Viva
Office Consumer products and cloud services revenue growth	Revenue from Office Consumer products and cloud services, including Microsoft 365 Consumer subscriptions, Office licensed on-premises, and other Office services
Office 365 Commercial seat growth	The number of Office 365 Commercial seats at end of period where seats are paid users covered by an Office 365 Commercial subscription
Microsoft 365 Consumer subscribers	The number of Microsoft 365 Consumer subscribers at end of period
Dynamics products and cloud services revenue growth	Revenue from Dynamics products and cloud services, including Dynamics 365, comprising a set of intelligent, cloud-based applications across ERP, CRM, Customer Insights, Power Apps, and Power Automate; and on-premises ERP and CRM applications
LinkedIn revenue growth	Revenue from LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions
Server products and cloud services revenue growth	Revenue from Server products and cloud services, including Azure and other cloud services; SQL Server, Windows Server, Visual Studio, System Center, and related Client Access Licenses (“CALs”); and Nuance and GitHub

More Personal Computing

Metrics related to our More Personal Computing segment assess the performance of key lines of business within this segment. These metrics provide strategic product insights which allow us to assess the performance across our commercial and consumer businesses. As we have diversity of target audiences and sales motions within the Windows business, we monitor metrics that are reflective of those varying motions.

Windows OEM revenue growth	Revenue from sales of Windows Pro and non-Pro licenses sold through the OEM channel
Windows Commercial products and cloud services revenue growth	Revenue from Windows Commercial products and cloud services, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings
Devices revenue growth	Revenue from Devices, including Surface, HoloLens, and PC accessories
Xbox content and services revenue growth	Revenue from Xbox content and services, comprising first- and third-party content (including games and in-game content), Xbox Game Pass and other subscriptions, Xbox Cloud Gaming, third-party disc royalties, 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
	2022	**2021**		**2022**	**2021**	
Revenue	**$ 52,747**	$ 51,728	2%	**$ 102,869**	$ 97,045	6%
Gross margin	**35,259**	34,768	1%	**69,929**	66,439	5%
Operating income	**20,399**	22,247	(8)%	**41,917**	42,485	(1)%
Net income	**16,425**	18,765	(12)%	**33,981**	39,270	(13)%
Diluted earnings per share	**2.20**	2.48	(11)%	**4.54**	5.19	(13)%
Adjusted gross margin (non-GAAP)	**35,411**	34,768	2%	**70,081**	66,439	5%
Adjusted operating income (non-GAAP)	**21,570**	22,247	(3)%	**43,088**	42,485	1%
Adjusted net income (non-GAAP)	**17,371**	18,765	(7)%	**34,927**	35,979	(3)%
Adjusted diluted earnings per share (non-GAAP)	**2.32**	2.48	(6)%	**4.67**	4.76	(2)%

Adjusted gross margin, operating income, net income, and diluted earnings per share (“EPS”) are non-GAAP financial measures. Current year non-GAAP financial measures exclude the impact of the Q2 charge, which includes employee severance expenses, impairment charges resulting from changes to our hardware portfolio, and costs related to lease consolidation activities. Prior year non-GAAP financial measures exclude the net income tax benefit related to transfer of intangible properties in the first quarter of fiscal year 2022. Refer to Note 11 – Income Taxes of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion. 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, 2022 Compared with Three Months Ended December 31, 2021

Revenue increased $1.0 billion or 2% driven by growth in Intelligent Cloud and Productivity and Business Processes, offset in part by a decline in More Personal Computing. Intelligent Cloud revenue increased driven by Azure and other cloud services. Productivity and Business Processes revenue increased driven by Office 365 Commercial. More Personal Computing revenue decreased driven by declines in Windows, Devices, and Gaming.

Cost of revenue increased $528 million or 3% driven by growth in Microsoft Cloud, offset in part by a reduction in depreciation expense due to the change in accounting estimate for the useful lives of our server and network equipment.

Gross margin increased $491 million or 1% driven by growth in Intelligent Cloud and Productivity and Business Processes and the change in accounting estimate, offset in part by a decline in More Personal Computing.

- Gross margin percentage decreased slightly. Excluding the impact of the change in accounting estimate, gross margin percentage decreased 2 points driven by reductions in More Personal Computing and Intelligent Cloud, offset in part by sales mix shift.
- Microsoft Cloud gross margin percentage increased 2 points to 72%. Excluding the impact of the change in accounting estimate, Microsoft Cloud gross margin percentage decreased 1 point driven by sales mix shift to Azure and other cloud services and higher energy costs.

Operating expenses increased $2.3 billion or 19% driven by employee severance expenses, investments in cloud engineering, the Nuance acquisition, and LinkedIn.

Key changes in operating expenses were:

- Research and development expenses increased $1.1 billion or 19% driven by investments in cloud engineering, impairment charges resulting from changes to our hardware portfolio, and LinkedIn. Research and development included a favorable foreign currency impact of 2%.
- Sales and marketing expenses increased $300 million or 6% driven by the Nuance acquisition and investments in commercial sales. Sales and marketing included a favorable foreign currency impact of 3%.
- General and administrative expenses increased $953 million or 69% driven by employee severance expenses. General and administrative included a favorable foreign currency impact of 2%.

Operating income decreased $1.8 billion or 8% driven by a decline in More Personal Computing, offset in part by the change in accounting estimate.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 5%, 7%, and 8%, respectively. Cost of revenue and operating expenses both included a favorable foreign currency impact of 2%.

Current year gross margin, operating income, net income, and diluted EPS were negatively impacted by the Q2 charge, which resulted in decreases of $152 million, $1.2 billion, $946 million, and $0.12, respectively.

Six Months Ended December 31, 2022 Compared with Six Months Ended December 31, 2021

Revenue increased $5.8 billion or 6% driven by growth in Intelligent Cloud and Productivity and Business Processes, offset in part by a decline in More Personal Computing. Intelligent Cloud revenue increased driven by Azure and other cloud services. Productivity and Business Processes revenue increased driven by Office 365 Commercial and LinkedIn. More Personal Computing revenue decreased driven by declines in Windows, Devices, and Gaming, offset in part by growth in Search and news advertising.

Cost of revenue increased $2.3 billion or 8% driven by growth in Microsoft Cloud, offset in part by the change in accounting estimate.

Gross margin increased $3.5 billion or 5% driven by growth in Intelligent Cloud and Productivity and Business Processes and the change in accounting estimate, offset in part by a decline in More Personal Computing.

- Gross margin percentage decreased slightly. Excluding the impact of the change in accounting estimate, gross margin percentage decreased 2 points driven by reductions in More Personal Computing and Intelligent Cloud, offset in part by sales mix shift.
- Microsoft Cloud gross margin percentage increased 2 points to 72%. Excluding the impact of the change in accounting estimate, Microsoft Cloud gross margin percentage decreased 1 point driven by sales mix shift to Azure and other cloud services and higher energy costs.

Operating expenses increased $4.1 billion or 17% driven by investment in cloud engineering, employee severance expenses, LinkedIn, the Nuance acquisition, and commercial sales.

Key changes in operating expenses were:

- Research and development expenses increased $2.1 billion or 19% driven by investments in cloud engineering and LinkedIn.
- Sales and marketing expenses increased $879 million or 9% driven by investments in commercial sales and the Nuance acquisition. Sales and marketing included a favorable foreign currency impact of 4%.
- General and administrative expenses increased $1.1 billion or 40% driven by employee severance expenses. General and administrative included a favorable foreign currency impact of 3%.

Operating income decreased $568 million or 1% driven by a decline in More Personal Computing, offset in part by the change in accounting estimate and growth in Productivity and Business Processes and Intelligent Cloud.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 5%, 7%, and 8%, respectively. Cost of revenue and operating expenses included a favorable foreign currency impact of 2% and 3%, respectively.

Current year gross margin, operating income, net income, and diluted EPS were negatively impacted by the Q2 charge, which resulted in decreases of $152 million, $1.2 billion, $946 million, and $0.13, respectively. Prior year net income and diluted EPS were positively impacted by the net tax benefit related to the transfer of intangible properties, which resulted in an increase to net income and diluted EPS of $3.3 billion and $0.43, respectively.

SEGMENT RESULTS OF OPERATIONS

(In millions, except percentages)	Three Months Ended December 31, 2022	2021	Percentage Change	Six Months Ended December 31, 2022	2021	Percentage Change
Revenue						
Productivity and Business Processes	**$ 17,002**	$ 15,936	7%	**$ 33,467**	$ 30,975	8%
Intelligent Cloud	**21,508**	18,262	18%	**41,833**	35,174	19%
More Personal Computing	**14,237**	17,530	(19)%	**27,569**	30,896	(11)%
Total	**$ 52,747**	$ 51,728	2%	**$ 102,869**	$ 97,045	6%
Operating Income						
Productivity and Business Processes	**$ 8,175**	$ 7,688	6%	**$ 16,498**	$ 15,269	8%
Intelligent Cloud	**8,904**	8,323	7%	**17,882**	16,004	12%
More Personal Computing	**3,320**	6,236	(47)%	**7,537**	11,212	(33)%
Total	**$ 20,399**	$ 22,247	(8)%	**$ 41,917**	$ 42,485	(1)%

Reportable Segments

Three Months Ended December 31, 2022 Compared with Three Months Ended December 31, 2021

Productivity and Business Processes

Revenue increased $1.1 billion or 7%.

- Office Commercial products and cloud services revenue increased $627 million or 7%. Office 365 Commercial revenue grew 11% with seat growth of 12%, driven by small and medium business and frontline worker offerings, as well as growth in revenue per user. Office Commercial products revenue declined 30% driven by continued customer shift to cloud offerings.
- Office Consumer products and cloud services revenue decreased $39 million or 2%. Microsoft 365 Consumer subscribers grew 12% to 63.2 million.
- LinkedIn revenue increased $345 million or 10% driven by Talent Solutions.
- Dynamics products and cloud services revenue increased 13% driven by Dynamics 365 growth of 21%.

Operating income increased $487 million or 6%.

- Gross margin increased $1.0 billion or 8% driven by growth in Office 365 Commercial. Gross margin percentage increased. Excluding the impact of the change in accounting estimate, gross margin percentage decreased slightly driven by sales mix shift to cloud offerings.
- Operating expenses increased $554 million or 12% driven by investment in LinkedIn and employee severance expenses.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 6%, 8%, and 11%, respectively. Operating expenses included a favorable foreign currency impact of 2%.

Intelligent Cloud

Revenue increased $3.2 billion or 18%.

- Server products and cloud services revenue increased $3.2 billion or 20% driven by Azure and other cloud services. Azure and other cloud services revenue grew 31% driven by growth in our consumption-based services. Server products revenue decreased 2%.
- Enterprise Services revenue increased $39 million or 2% driven by growth in Enterprise Support Services, offset by a decline in Microsoft Consulting Services.

Operating income increased $581 million or 7%.

- Gross margin increased $2.2 billion or 17% driven by growth in Azure and other cloud services and the change in accounting estimate. Gross margin percentage decreased slightly. Excluding the impact of the change in accounting estimate, gross margin percentage decreased 3 points driven by sales mix shift to Azure and other cloud services and higher energy costs.
- Operating expenses increased $1.6 billion or 34% driven by employee severance expenses, investments in Azure, and the Nuance acquisition.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 6%, 6%, and 8%, respectively. Operating expenses included a favorable foreign currency impact of 3%.

More Personal Computing

Revenue decreased $3.3 billion or 19%.

- Windows revenue decreased $1.8 billion or 27% driven by a decrease in Windows OEM. Windows OEM revenue decreased 39% on a strong prior year comparable, driven by continued PC market weakness and 3 points of negative impact from the prior year Windows 11 revenue deferral. Windows Commercial products and cloud services revenue decreased 3% driven by a decline in standalone product sales.
- Devices revenue decreased $927 million or 39% driven by continued PC market weakness and execution challenges on new product launches.
- Gaming revenue decreased $684 million or 13% driven by declines in Xbox content and services and Xbox hardware. Xbox content and services revenue decreased 12% on a strong prior year comparable impacted by first-party game launches, driven by declines in first-party content and a lower rate of monetization in third-party content, offset in part by growth in Xbox Game Pass subscriptions. Xbox hardware revenue decreased 13% driven by lower price and volume of consoles sold.
- Search and news advertising revenue increased $159 million or 5%. Search and news advertising revenue excluding traffic acquisition costs increased 10% driven by higher search volume and the Xandr acquisition, offset in part by lower revenue per search.

Operating income decreased $2.9 billion or 47%.

- Gross margin decreased $2.7 billion or 29% driven by declines in Windows and Devices. Gross margin percentage decreased driven by reductions in Devices, including the impact of impairment charges resulting from changes to our hardware portfolio, and sales mix shift to lower margin businesses.
- Operating expenses increased $198 million or 6% driven by employee severance expenses and investments in Search and news advertising, offset in part by a decline in Devices.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 3%, 5%, and 7%, respectively. Operating expenses included a favorable foreign currency impact of 3%.

Six Months Ended December 31, 2022 Compared with Six Months Ended December 31, 2021

Productivity and Business Processes

Revenue increased $2.5 billion or 8%.

- Office Commercial products and cloud services revenue increased $1.3 billion or 7%. Office 365 Commercial revenue grew 11% with seat growth of 12%, driven by small and medium business and frontline worker offerings, as well as growth in revenue per user. Office Commercial products revenue declined 29% driven by continued customer shift to cloud offerings.
- Office Consumer products and cloud services revenue increased $66 million or 2% with continued growth in Microsoft 365 Consumer subscription revenue.
- LinkedIn revenue increased $872 million or 13% driven by Talent Solutions.
- Dynamics products and cloud services revenue increased 14% driven by Dynamics 365 growth of 23%.

Operating income increased $1.2 billion or 8%.

- Gross margin increased $2.4 billion or 10% driven by growth in Office 365 Commercial and LinkedIn. Gross margin percentage increased. Excluding the impact of the change in accounting estimate, gross margin percentage decreased slightly driven by sales mix shift to cloud offerings.
- Operating expenses increased $1.1 billion or 12% driven by investments in LinkedIn and cloud engineering, as well as employee severance expenses.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 6%, 7%, and 10%, respectively. Operating expenses included a favorable foreign currency impact of 3%.

Intelligent Cloud

Revenue increased $6.7 billion or 19%.

- Server products and cloud services revenue increased $6.5 billion or 21% driven by Azure and other cloud services. Azure and other cloud services revenue grew 33% driven by growth in our consumption-based services. Server products revenue decreased 1%.
- Enterprise Services revenue increased $124 million or 3% driven by growth in Enterprise Support Services, offset in part by a decline in Microsoft Consulting Services.

Operating income increased $1.9 billion or 12%.

- Gross margin increased $4.5 billion or 18% driven by growth in Azure and other cloud services and the change in accounting estimate. Gross margin percentage decreased slightly. Excluding the impact of the change in accounting estimate, gross margin percentage decreased 3 points driven by sales mix shift to Azure and other cloud services and higher energy costs.
- Operating expenses increased $2.7 billion or 30% driven by investments in Azure, the Nuance acquisition, and employee severance expenses.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 6%, 7%, and 8%, respectively. Operating expenses included a favorable foreign currency impact of 3%.

More Personal Computing

Revenue decreased $3.3 billion 11%.

- Windows revenue decreased $2.1 billion or 18% driven by a decrease in Windows OEM. Windows OEM revenue decreased 28% driven by continued PC market weakness. Windows Commercial products and cloud services revenue increased 2% driven by demand for Microsoft 365, offset in part by a decline in standalone product sales.
- Devices revenue decreased $893 million or 24% driven by continued PC market weakness and execution challenges on new product launches.
- Gaming revenue decreased $667 million or 7% driven by declines in Xbox content and services and Xbox hardware. Xbox content and services revenue decreased 8% driven by declines in first-party content and in third-party content, with lower rate of monetization and engagement hours, offset in part by growth in Xbox Game Pass subscriptions. Xbox hardware revenue decreased 5% driven by lower price of consoles sold.
- Search and news advertising revenue increased $431 million or 8%. Search and news advertising revenue excluding traffic acquisition costs increased 13% driven by higher search volume and the Xandr acquisition, offset in part by lower revenue per search.

Operating income decreased $3.7 billion or 33%.

- Gross margin decreased $3.4 billion or 20% driven by declines in Windows, Devices, and Gaming. Gross margin percentage decreased driven by reductions in Devices, including the impact of impairment charges resulting from changes to our hardware portfolio, and sales mix shift to lower margin businesses.
- Operating expenses increased $269 million or 4% driven by investment in Search and news advertising and employee severance expenses, offset in part by a decline in Devices.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 3%, 5%, and 7%, respectively. Operating expenses included a favorable foreign currency impact of 3%.

OPERATING EXPENSES

Research and Development

(In millions, except percentages)		Three Months Ended December 31,		Percentage Change		Six Months Ended December 31,		Percentage Change
		2022		2021		2022		2021	
Research and development	$	**6,844**	$	5,758	19%	$	**13,472**	$	11,357	19%
As a percent of revenue		**13%**		11%	2ppt		**13%**		12%	1ppt

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

Three Months Ended December 31, 2022 Compared with Three Months Ended December 31, 2021

Research and development expenses increased $1.1 billion or 19% driven by investments in cloud engineering, impairment charges resulting from changes to our hardware portfolio, and LinkedIn. Research and development included a favorable foreign currency impact of 2%.

Six Months Ended December 31, 2022 Compared with Six Months Ended December 31, 2021

Research and development expenses increased $2.1 billion or 19% driven by investments in cloud engineering and LinkedIn.

Sales and Marketing

(In millions, except percentages)		Three Months Ended December 31,			Percentage Change		Six Months Ended December 31,			Percentage Change
		2022		2021			2022		2021	
Sales and marketing	$	**5,679**	$	5,379	6%	$	**10,805**	$	9,926	9%
As a percent of revenue		**11%**		10%	1ppt		**11%**		10%	1ppt

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, 2022 Compared with Three Months Ended December 31, 2021

Sales and marketing expenses increased $300 million or 6% driven by the Nuance acquisition and investments in commercial sales. Sales and marketing included a favorable foreign currency impact of 3%.

Six Months Ended December 31, 2022 Compared with Six Months Ended December 31, 2021

Sales and marketing expenses increased $879 million or 9% driven by investments in commercial sales and the Nuance acquisition. Sales and marketing included a favorable foreign currency impact of 4%.

General and Administrative

(In millions, except percentages)	Three Months Ended December 31,		Percentage Change	Six Months Ended December 31,		Percentage Change
	2022	**2021**		**2022**	**2021**	
General and administrative	**$ 2,337**	$ 1,384	69%	**$ 3,735**	$ 2,671	40%
As a percent of revenue	**4%**	3%	1ppt	**4%**	3%	1ppt

General and administrative expenses include payroll, employee benefits, stock-based compensation expense, employee severance expense, 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, 2022 Compared with Three Months Ended December 31, 2021

General and administrative expenses increased $953 million or 69% driven by employee severance expenses. General and administrative included a favorable foreign currency impact of 2%.

Six Months Ended December 31, 2022 Compared with Six Months Ended December 31, 2021

General and administrative expenses increased $1.1 billion or 40% driven by employee severance expenses. General and administrative included a favorable foreign currency impact of 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,	
	2022	**2021**	**2022**	**2021**
Interest and dividends income	**$ 700**	$ 503	**$ 1,341**	$ 1,023
Interest expense	**(490)**	(525)	**(990)**	(1,064)
Net recognized gains (losses) on investments	**(15)**	300	**(2)**	671
Net gains (losses) on derivatives	**(199)**	7	**(190)**	0
Net losses on foreign currency remeasurements	**(18)**	(13)	**(96)**	(78)
Other, net	**(38)**	(4)	**(69)**	2
Total	**$ (60)**	$ 268	**$ (6)**	$ 554

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

Three Months Ended December 31, 2022 Compared with Three Months Ended December 31, 2021

Interest and dividends income increased due to higher yields, offset in part by lower portfolio balances. Interest expense decreased due to a decrease in outstanding long-term debt due to debt maturities. Net recognized losses on investments increased due to losses on equity securities in the current period compared to gains in the prior period. Net losses on derivatives increased due to losses on a forward purchase agreement for shares of the London Stock Exchange Group.

Six Months Ended December 31, 2022 Compared with Six Months Ended December 31, 2021

Interest and dividends income increased due to higher yields, offset in part by lower portfolio balances. Interest expense decreased due to a decrease in outstanding long-term debt due to debt maturities. Net recognized losses on investments increased due to losses on fixed income securities in the current period compared to gains in the prior period, and lower gains on equity securities in the current period. Net losses on derivatives increased due to losses on a forward purchase agreement for shares of the London Stock Exchange Group.

INCOME TAXES

Effective Tax Rate

Our effective tax rate was 19% and 17% for the three months ended December 31, 2022 and 2021, respectively, and 19% and 9% for the six months ended December 31, 2022 and 2021, respectively. The increase in our effective tax rate for the three months ended December 31, 2022 compared to the prior year was primarily due to a decrease in tax benefits relating to stock-based compensation. The increase in our effective tax rate for the six months ended December 31, 2022 compared to the prior year was primarily due to a $3.3 billion net income tax benefit in the first quarter of fiscal year 2022 related to the transfer of intangible properties and a decrease in tax benefits relating to stock-based compensation.

In the first quarter of fiscal year 2022, we transferred certain intangible properties from our Puerto Rico subsidiary to the U.S. The transfer of intangible properties resulted in a $3.3 billion net income tax benefit in the first quarter of fiscal year 2022, as the value of future U.S. tax deductions exceeded the current tax liability from the U.S. global intangible low-taxed income tax.

Our effective tax rate was lower than the U.S. federal statutory rate for the three and six months ended December 31, 2022, 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 settled a portion of the Internal Revenue Service (“IRS”) audit for tax years 2004 to 2006 in fiscal year 2011. In February 2012, the IRS withdrew its 2011 Revenue Agents Report related to unresolved issues for tax years 2004 to 2006 and reopened the audit phase of the examination. We also settled a portion of the IRS audit for tax years 2007 to 2009 in fiscal year 2016, and a portion of the IRS audit for tax years 2010 to 2013 in fiscal year 2018. In the second quarter of fiscal year 2021, we settled an additional portion of the IRS audits for tax years 2004 to 2013 and made a payment of $1.7 billion, including tax and interest. We remain under audit for tax years 2004 to 2017.

As of December 31, 2022, the primary unresolved issues for the IRS audits relate to transfer pricing, which could have a material impact in our consolidated financial statements when the matters are resolved. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved key transfer pricing issues and 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 tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2022, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NON-GAAP FINANCIAL MEASURES

Adjusted gross margin, operating income, net income, and diluted EPS are non-GAAP financial measures. Current year non-GAAP financial measures exclude the impact of the Q2 charge, which includes employee severance expenses, impairment charges resulting from changes to our hardware portfolio, and costs related to lease consolidation activities. Prior year non-GAAP financial measures exclude the net income tax benefit related to transfer of intangible properties in the first quarter of fiscal year 2022. We believe these non-GAAP measures aid investors by providing additional insight into our operational 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
	2022	**2021**		**2022**	**2021**	
Gross margin	**$ 35,259**	$ 34,768	1%	**$ 69,929**	$ 66,439	5%
Severance, hardware-related impairment, and lease consolidation costs	**152**	0	*	**152**	0	*
Adjusted gross margin (non-GAAP)	**$ 35,411**	$ 34,768	2%	**$ 70,081**	$ 66,439	5%
Operating income	**$ 20,399**	$ 22,247	(8)%	**$ 41,917**	$ 42,485	(1)%
Severance, hardware-related impairment, and lease consolidation costs	**1,171**	0	*	**1,171**	0	*
Adjusted operating income (non-GAAP)	**$ 21,570**	$ 22,247	(3)%	**$ 43,088**	$ 42,485	1%
Net income	**$ 16,425**	$ 18,765	(12)%	**$ 33,981**	$ 39,270	(13)%
Severance, hardware-related impairment, and lease consolidation costs	**946**	0	*	**946**	0	*
Net income tax benefit related to transfer of intangible properties	**0**	0	*	**0**	(3,291)	*
Adjusted net income (non-GAAP)	**$ 17,371**	$ 18,765	(7)%	**$ 34,927**	$ 35,979	(3)%
Diluted earnings per share	**$ 2.20**	$ 2.48	(11)%	**$ 4.54**	$ 5.19	(13)%
Severance, hardware-related impairment, and lease consolidation costs	**0.12**	0	*	**0.13**	0	*
Net income tax benefit related to transfer of intangible properties	**0**	0	*	**0**	(0.43)	*
Adjusted diluted earnings per share (non-GAAP)	**$ 2.32**	$ 2.48	(6)%	**$ 4.67**	$ 4.76	(2)%

* *Not meaningful.*

LIQUIDITY AND CAPITAL RESOURCES

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

Cash, Cash Equivalents, and Investments

Cash, cash equivalents, and short-term investments totaled $99.5 billion and $104.8 billion as of December 31, 2022 and June 30, 2022, respectively. Equity investments were $7.1 billion and $6.9 billion as of December 31, 2022 and June 30, 2022, respectively. Our short-term investments are primarily intended to facilitate liquidity and capital preservation. They consist predominantly of highly liquid investment-grade fixed-income securities, diversified among industries and individual issuers. The investments are predominantly U.S. dollar-denominated securities, but also include foreign currency-denominated securities to diversify risk. Our fixed-income investments are exposed to interest rate risk and credit risk. The credit risk and average maturity of our fixed-income portfolio are managed to achieve economic returns that correlate to certain fixed-income indices. The settlement risk related to these investments is insignificant given that the short-term investments held are primarily highly liquid investment-grade fixed-income securities.

Valuation

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

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

Cash Flows

Cash from operations decreased $4.7 billion to $34.4 billion for the six months ended December 31, 2022, mainly due to an increase in cash paid to employees and suppliers and cash used to pay income taxes, offset in part by an increase in cash received from customers. Cash used in financing decreased $6.0 billion to $22.2 billion for the six months ended December 31, 2022, mainly due to a $4.1 billion decrease in common stock repurchases and a $3.1 billion decrease in repayments of debt. Cash used in investing increased $5.9 billion to $10.3 billion for the six months ended December 31, 2022, due to a $5.4 billion decrease in cash from net investment purchases, sales, and maturities, an $882 million increase in additions to property and equipment, and a $655 million increase in other investing to facilitate the purchase of components, offset in part by a $1.0 billion decrease in cash used for acquisitions of companies, net of cash acquired, and purchases of intangible and other assets.

Debt Proceeds

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

Unearned Revenue

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

The following table outlines the expected future recognition of unearned revenue as of December 31, 2022:

(In millions)		
Three Months Ending		
March 31, 2023	$	**18,324**
June 30, 2023		**11,215**
September 30, 2023		**4,888**
December 31, 2023		**2,555**
Thereafter		**2,644**
Total	$	**39,626**

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

Material Cash Requirements and Other Obligations

Income Taxes

As a result of the TCJA, we are required to pay a one-time transition tax on deferred foreign income not previously subject to U.S. income tax. Under the TCJA, the transition tax is payable in interest-free installments over eight years, with 8% due in each of the first five years, 15% in year six, 20% in year seven, and 25% in year eight. We have paid transition tax of $7.7 billion, which included $1.5 billion during the six months ended December 31, 2022. The remaining transition tax of $10.5 billion is payable over the next three years, with $2.5 billion payable within 12 months.

Provisions enacted in the TCJA related to the capitalization for tax purposes of research and experimental expenditures became effective on July 1, 2022. These provisions require us to capitalize research and experimental expenditures and amortize them on the U.S. tax return over five or fifteen years, depending on where research is conducted. The final foreign tax credit regulations, also effective on July 1, 2022, introduced significant changes to foreign tax credit calculations in the U.S. tax return. While these provisions are not expected to have a material impact on our fiscal year 2023 effective tax rate on a net basis, our cash paid for taxes would increase unless these provisions are postponed or modified through legislative processes.

Share Repurchases

For the six months ended December 31, 2022 and 2021, we repurchased 37 million shares and 41 million shares of our common stock for $9.2 billion and $12.4 billion, respectively, through our share repurchase programs. All repurchases were made using cash resources. As of December 31, 2022, $31.5 billion remained of our $60 billion share repurchase program. Refer to Note 15 – Stockholders’ Equity of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

Dividends

For the six months ended December 31, 2022 and 2021, our Board of Directors declared quarterly dividends of $0.68 per share and $0.62 per share, respectively. We intend to continue returning capital to shareholders in the form of dividends, subject to declaration by our Board of Directors. Refer to Note 15 – Stockholders’ Equity of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

Other Planned Uses of Capital

On January 18, 2022, we entered into a definitive agreement to acquire Activision Blizzard, Inc. (“Activision Blizzard”) for $95.00 per share in an all-cash transaction valued at $68.7 billion, inclusive of Activision Blizzard’s net cash. The acquisition has been approved by Activision Blizzard’s shareholders. We are continuing to engage with regulators reviewing the transaction and are working toward closing it in fiscal year 2023, subject to obtaining required regulatory approvals and satisfaction of other customary closing conditions.

We will continue to invest in sales, marketing, product support infrastructure, and existing and advanced areas of technology, as well as continue making acquisitions that align with our business strategy. Additions to property and equipment will continue, including new facilities, datacenters, and computer systems for research and development, sales and marketing, support, and administrative staff. We expect capital expenditures to increase in coming years to support growth in our cloud offerings. 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.

CRITICAL ACCOUNTING ESTIMATES

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

Revenue Recognition

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

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

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

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

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

Impairment of Investment Securities

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

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

Goodwill

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

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

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

Research and Development Costs

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

Legal and Other Contingencies

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

Income Taxes

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

Inventories

Inventories are stated at average cost, subject to the lower of cost or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. Net realizable value is the estimated selling price less estimated costs of completion, disposal, and transportation. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. These reviews include analysis of demand forecasts, product life cycle status, product development plans, current sales levels, pricing strategy, and component cost trends. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue.

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 2023:

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, 2022 – October 31, 2022	6,496,123	$ 236.37	6,496,123	$ 34,574
November 1, 2022 – November 30, 2022	6,637,411	236.49	6,637,411	33,004
December 1, 2022 – December 31, 2022	6,080,667	245.83	6,080,667	31,509
	19,214,201		19,214,201	

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 2023:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
				(In millions)
November 29, 2022	February 16, 2023	March 9, 2023	$ 0.68	$ 5,064

We returned $9.7 billion to shareholders in the form of share repurchases and dividends in the second quarter of fiscal year 2023. Refer to Note 15 – Stockholders' Equity of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion regarding share repurchases and dividends.

ITEM 6. EXHIBITS

15.1	Letter regarding unaudited interim financial information
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
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
101.SCH	Inline XBRL Taxonomy Extension Schema
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase
104	Cover page formatted as Inline XBRL and contained in Exhibit 101

* *Furnished, not filed.*

Items 3, 4, and 5 are not applicable and have been omitted.

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 September 30, 2022

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 October 20, 2022**
Common Stock, $0.00000625 par value per share	7,454,473,144 shares

MICROSOFT CORPORATION

FORM 10-Q

For the Quarter Ended September 30, 2022

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INCOME STATEMENTS

(In millions, except per share amounts) (Unaudited)

Three Months Ended September 30,	**2022**	**2021**
Revenue:		
Product	**$ 15,741**	$ 16,631
Service and other	**34,381**	28,686
Total revenue	**50,122**	45,317
Cost of revenue:		
Product	**4,302**	3,792
Service and other	**11,150**	9,854
Total cost of revenue	**15,452**	13,646
Gross margin	**34,670**	31,671
Research and development	**6,628**	5,599
Sales and marketing	**5,126**	4,547
General and administrative	**1,398**	1,287
Operating income	**21,518**	20,238
Other income, net	**54**	286
Income before income taxes	**21,572**	20,524
Provision for income taxes	**4,016**	19
Net income	**$ 17,556**	$ 20,505
Earnings per share:		
Basic	**$ 2.35**	$ 2.73
Diluted	**$ 2.35**	$ 2.71
Weighted average shares outstanding:		
Basic	**7,457**	7,513
Diluted	**7,485**	7,567

Refer to accompanying notes.

COMPREHENSIVE INCOME STATEMENTS

(In millions) (Unaudited)

Three Months Ended September 30,	**2022**	**2021**
Net income	**$ 17,556**	$ 20,505
Other comprehensive income (loss), net of tax:		
Net change related to derivatives	**7**	2
Net change related to investments	**(1,897)**	(422)
Translation adjustments and other	**(775)**	(119)
Other comprehensive loss	**(2,665)**	(539)
Comprehensive income	**$ 14,891**	$ 19,966

Refer to accompanying notes.

BALANCE SHEETS

(In millions) (Unaudited)

		September 30, 2022		June 30, 2022
Assets				
Current assets:				
Cash and cash equivalents	**$**	**22,884**	$	13,931
Short-term investments		**84,378**		90,826
Total cash, cash equivalents, and short-term investments		**107,262**		104,757
Accounts receivable, net of allowance for doubtful accounts of **$438** and $633		**31,279**		44,261
Inventories		**4,268**		3,742
Other current assets		**18,003**		16,924
Total current assets		**160,812**		169,684
Property and equipment, net of accumulated depreciation of **$60,638** and $59,660		**77,037**		74,398
Operating lease right-of-use assets		**13,347**		13,148
Equity investments		**6,839**		6,891
Goodwill		**67,459**		67,524
Intangible assets, net		**10,808**		11,298
Other long-term assets		**23,482**		21,897
Total assets	**$**	**359,784**	$	364,840
Liabilities and stockholders' equity				
Current liabilities:				
Accounts payable	**$**	**16,609**	$	19,000
Current portion of long-term debt		**3,248**		2,749
Accrued compensation		**7,405**		10,661
Short-term income taxes		**6,729**		4,067
Short-term unearned revenue		**41,340**		45,538
Other current liabilities		**12,058**		13,067
Total current liabilities		**87,389**		95,082
Long-term debt		**45,374**		47,032
Long-term income taxes		**23,712**		26,069
Long-term unearned revenue		**2,549**		2,870
Deferred income taxes		**223**		230
Operating lease liabilities		**11,660**		11,489
Other long-term liabilities		**15,311**		15,526
Total liabilities		**186,218**		198,298
Commitments and contingencies				
Stockholders' equity:				
Common stock and paid-in capital – shares authorized 24,000; outstanding **7,457** and 7,464		**88,535**		86,939
Retained earnings		**92,374**		84,281
Accumulated other comprehensive loss		**(7,343)**		(4,678)
Total stockholders' equity		**173,566**		166,542
Total liabilities and stockholders' equity	**$**	**359,784**	$	364,840

Refer to accompanying notes.

CASH FLOWS STATEMENTS

(In millions) (Unaudited)

Three Months Ended September 30,	2022	2021
Operations		
Net income	**$ 17,556**	$ 20,505
Adjustments to reconcile net income to net cash from operations:		
Depreciation, amortization, and other	**2,790**	3,212
Stock-based compensation expense	**2,192**	1,702
Net recognized gains on investments and derivatives	**(22)**	(364)
Deferred income taxes	**(1,191)**	(5,970)
Changes in operating assets and liabilities:		
Accounts receivable	**11,729**	10,486
Inventories	**(543)**	(777)
Other current assets	**(332)**	940
Other long-term assets	**(666)**	(598)
Accounts payable	**(1,567)**	(471)
Unearned revenue	**(3,322)**	(2,885)
Income taxes	**410**	2,653
Other current liabilities	**(4,024)**	(4,143)
Other long-term liabilities	**188**	250
Net cash from operations	**23,198**	24,540
Financing		
Repayments of debt	**(1,000)**	(4,826)
Common stock issued	**575**	612
Common stock repurchased	**(5,573)**	(7,684)
Common stock cash dividends paid	**(4,621)**	(4,206)
Other, net	**(264)**	(172)
Net cash used in financing	**(10,883)**	(16,276)
Investing		
Additions to property and equipment	**(6,283)**	(5,810)
Acquisition of companies, net of cash acquired, and purchases of intangible and other assets	**(349)**	(1,206)
Purchases of investments	**(5,013)**	(10,309)
Maturities of investments	**6,662**	8,862
Sales of investments	**2,711**	5,630
Other, net	**(860)**	(417)
Net cash used in investing	**(3,132)**	(3,250)
Effect of foreign exchange rates on cash and cash equivalents	**(230)**	(73)
Net change in cash and cash equivalents	**8,953**	4,941
Cash and cash equivalents, beginning of period	**13,931**	14,224
Cash and cash equivalents, end of period	**$ 22,884**	$ 19,165

Refer to accompanying notes.

STOCKHOLDERS' EQUITY STATEMENTS

(In millions, except per share amounts) (Unaudited)

Three Months Ended September 30,	2022	2021
Common stock and paid-in capital		
Balance, beginning of period	**$ 86,939**	$ 83,111
Common stock issued	**575**	612
Common stock repurchased	**(1,171)**	(1,677)
Stock-based compensation expense	**2,192**	1,702
Other, net	**0**	3
Balance, end of period	**88,535**	83,751
Retained earnings		
Balance, beginning of period	**84,281**	57,055
Net income	**17,556**	20,505
Common stock cash dividends	**(5,064)**	(4,651)
Common stock repurchased	**(4,399)**	(5,965)
Balance, end of period	**92,374**	66,944
Accumulated other comprehensive income (loss)		
Balance, beginning of period	**(4,678)**	1,822
Other comprehensive loss	**(2,665)**	(539)
Balance, end of period	**(7,343)**	1,283
Total stockholders' equity	**$ 173,566**	$ 151,978
Cash dividends declared per common share	**$ 0.68**	$ 0.62

Refer to accompanying notes.

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 — ACCOUNTING POLICIES

Accounting Principles

Our unaudited interim consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). In the opinion of management, the unaudited interim consolidated financial statements reflect all adjustments of a normal recurring nature that are necessary for a fair presentation of the results for the interim periods presented. Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with information included in the Microsoft Corporation fiscal year 2022 Form 10-K filed with the U.S. Securities and Exchange Commission on July 28, 2022.

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 ("SSP") of performance obligations, variable consideration, and other obligations such as product returns and refunds; loss contingencies; product warranties; the fair value of and/or potential impairment of goodwill and intangible assets for our reporting units; product life cycles; useful lives of our tangible and intangible assets; allowances for doubtful accounts; the market value of, and demand for, our inventory; stock-based compensation forfeiture rates; when technological feasibility is achieved for our products; the potential outcome of uncertain tax positions that have been recognized in our consolidated financial statements or tax returns; and determining the timing and amount of impairments for investments. Actual results and outcomes may differ from management's estimates and assumptions due to risks and uncertainties.

In July 2022, we completed an assessment of the useful lives of our server and network equipment. Due to investments in software that increased efficiencies in how we operate our server and network equipment, as well as advances in technology, we determined we should increase the estimated useful lives of both server and network equipment from four years to six years. This change in accounting estimate was effective beginning fiscal year 2023. Based on the carrying amount of server and network equipment included in property and equipment, net as of June 30, 2022, the effect of this change in estimate for the three months ended September 30, 2022, was an increase in operating income of $1.1 billion and net income of $859 million, or $0.12 and $0.11 per basic and diluted share, respectively.

Financial Instruments

Investments

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

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

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

Derivatives

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

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

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

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

Fair Value Measurements

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

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

- *Level 2* – inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques (e.g. the Black-Scholes model) for which all significant inputs are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, credit spreads, foreign exchange rates, and forward and spot prices for currencies. Our Level 2 investments include commercial paper, certificates of deposit, U.S. agency securities, foreign government bonds, mortgage- and asset-backed securities, corporate notes and bonds, and municipal securities. Our Level 2 derivative assets and liabilities include certain 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 September 30, 2022 and June 30, 2022, other receivables due from suppliers were $736 million and $1.0 billion, respectively, and are included in accounts receivable, net in our consolidated balance sheets.

As of both September 30, 2022 and June 30, 2022, long-term accounts receivable, net of allowance for doubtful accounts, was $3.8 billion and is included in other long-term assets in our consolidated balance sheets.

We record financing receivables when we offer certain of our customers the option to acquire our software products and services offerings through a financing program in a limited number of countries. As of September 30, 2022 and June 30, 2022, our financing receivables, net were $3.9 billion and $4.1 billion, respectively, for short-term and long-term financing receivables, which are included in other current assets and other long-term assets in our consolidated balance sheets. We record an allowance to cover expected losses based on troubled accounts, historical experience, and other currently available evidence.

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 earnings per share)

Three Months Ended September 30,	2022	2021
Net income available for common shareholders (A)	**$ 17,556**	$ 20,505
Weighted average outstanding shares of common stock (B)	**7,457**	7,513
Dilutive effect of stock-based awards	**28**	54
Common stock and common stock equivalents (C)	**7,485**	7,567
Earnings Per Share		
Basic (A/B)	**$ 2.35**	$ 2.73
Diluted (A/C)	**$ 2.35**	$ 2.71

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

NOTE 3 — OTHER INCOME (EXPENSE), NET

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

(In millions)

Three Months Ended September 30,	2022	2021
Interest and dividends income	**$ 641**	$ 520
Interest expense	**(500)**	(539)
Net recognized gains on investments	**13**	371
Net gains (losses) on derivatives	**9**	(7)
Net losses on foreign currency remeasurements	**(78)**	(65)
Other, net	**(31)**	6
Total	**$ 54**	$ 286

Net Recognized Gains (Losses) on Investments

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

(In millions)

Three Months Ended September 30,	2022	2021
Realized gains from sales of available-for-sale securities	**$ 3**	$ 19
Realized losses from sales of available-for-sale securities	**(20)**	(7)
Impairments and allowance for credit losses	**(18)**	(3)
Total	**$ (35)**	$ 9

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

(In millions)

Three Months Ended September 30,	2022	2021
Net realized gains on investments sold	**$ 83**	$ 37
Net unrealized gains (losses) on investments still held	**(28)**	325
Impairments of investments	**(7)**	0
Total	**$ 48**	$ 362

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 Investments
September 30, 2022								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 6,286	$ 2	$ 0	$ 6,288	$ 5,662	$ 626	$ 0
Certificates of deposit	Level 2	2,570	0	0	2,570	2,531	39	0
U.S. government securities	Level 1	76,079	7	(4,232)	71,854	1,955	69,899	0
U.S. agency securities	Level 2	5,815	5	(9)	5,811	4,352	1,459	0
Foreign government bonds	Level 2	493	0	(36)	457	0	457	0
Mortgage- and asset-backed securities	Level 2	845	0	(45)	800	0	800	0
Corporate notes and bonds	Level 2	11,373	1	(825)	10,549	0	10,549	0
Corporate notes and bonds	Level 3	76	0	0	76	0	76	0
Municipal securities	Level 2	372	8	(22)	358	0	358	0
Municipal securities	Level 3	104	0	(7)	97	0	97	0
Total debt investments		$ 104,013	$ 23	$ (5,176)	$ 98,860	$ 14,500	$ 84,360	$ 0
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				$ 1,616	$ 1,147	$ 0	$ 469
Equity investments	Other				6,370	0	0	6,370
Total equity investments					$ 7,986	$ 1,147	$ 0	$ 6,839
Cash					$ 7,237	$ 7,237	$ 0	$ 0
Derivatives, net (a)					18	0	18	0
Total					$ 114,101	$ 22,884	$ 84,378	$ 6,839

(In millions)	Fair Value Level	Adjusted Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity Investments
June 30, 2022								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 2,500	$ 0	$ 0	$ 2,500	$ 2,498	$ 2	$ 0
Certificates of deposit	Level 2	2,071	0	0	2,071	2,032	39	0
U.S. government securities	Level 1	79,696	29	(2,178)	77,547	9	77,538	0
U.S. agency securities	Level 2	419	0	(9)	410	0	410	0
Foreign government bonds	Level 2	506	0	(24)	482	0	482	0
Mortgage- and asset-backed securities	Level 2	727	1	(30)	698	0	698	0
Corporate notes and bonds	Level 2	11,661	4	(554)	11,111	0	11,111	0
Corporate notes and bonds	Level 3	67	0	0	67	0	67	0
Municipal securities	Level 2	368	19	(13)	374	0	374	0
Municipal securities	Level 3	103	0	(6)	97	0	97	0
Total debt investments		$ 98,118	$ 53	$ (2,814)	$ 95,357	$ 4,539	$ 90,818	$ 0
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				$ 1,590	$ 1,134	$ 0	$ 456
Equity investments	Other				6,435	0	0	6,435
Total equity investments					$ 8,025	$ 1,134	$ 0	$ 6,891
Cash					$ 8,258	$ 8,258	$ 0	$ 0
Derivatives, net (a)					8	0	8	0
Total					$ 111,648	$ 13,931	$ 90,826	$ 6,891

(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 using the equity method or measured at cost with adjustments for observable changes in price or impairments, and investments measured at fair value using net asset value as a practical expedient which are not categorized in the fair value hierarchy. As of both September 30, 2022 and June 30, 2022, equity investments without readily determinable fair values measured at cost with adjustments for observable changes in price or impairments were $3.8 billion.

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:

	Less than 12 Months		12 Months or Greater			
(In millions)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Total Fair Value	Total Unrealized Losses
September 30, 2022						
U.S. government and agency securities	**$ 61,761**	**$ (3,411)**	**$ 4,233**	**$ (830)**	**$ 65,994**	**$ (4,241)**
Foreign government bonds	**392**	**(22)**	**64**	**(14)**	**456**	**(36)**
Mortgage- and asset-backed securities	**434**	**(27)**	**130**	**(18)**	**564**	**(45)**
Corporate notes and bonds	**8,258**	**(554)**	**2,178**	**(271)**	**10,436**	**(825)**
Municipal securities	**190**	**(22)**	**74**	**(7)**	**264**	**(29)**
Total	**$ 71,035**	**$ (4,036)**	**$ 6,679**	**$ (1,140)**	**$ 77,714**	**$ (5,176)**

(In millions)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses	Total Fair Value	Total Unrealized Losses
June 30, 2022						
U.S. government and agency securities	$ 59,092	$ (1,835)	$ 2,210	$ (352)	$ 61,302	$ (2,187)
Foreign government bonds	418	(18)	27	(6)	445	(24)
Mortgage- and asset-backed securities	510	(26)	41	(4)	551	(30)
Corporate notes and bonds	9,443	(477)	786	(77)	10,229	(554)
Municipal securities	178	(12)	74	(7)	252	(19)
Total	$ 69,641	$ (2,368)	$ 3,138	$ (446)	$ 72,779	$ (2,814)

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

(In millions)	Adjusted Cost Basis	Estimated Fair Value
September 30, 2022		
Due in one year or less	**$ 35,526**	**$ 35,416**
Due after one year through five years	**50,062**	**47,328**
Due after five years through 10 years	**17,070**	**14,925**
Due after 10 years	**1,355**	**1,191**
Total	**$ 104,013**	**$ 98,860**

NOTE 5 — DERIVATIVES

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

Foreign Currencies

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

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

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 exchange-traded option and futures contracts and over-the-counter swap and option 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 and are included in “Other contracts” in the tables below.

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 of our counterparty agreements for derivative instruments contain provisions that require our issued and outstanding long-term unsecured debt to maintain an investment grade credit rating and require us to maintain minimum liquidity of $1.0 billion. To the extent we fail to meet these requirements, we will be required to post collateral, similar to the standard convention related to over-the-counter derivatives. As of September 30, 2022, 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)	September 30, 2022	June 30, 2022
Designated as Hedging Instruments		
Foreign exchange contracts purchased	**$ 1,492**	$ 635
Interest rate contracts purchased	**1,088**	1,139
Not Designated as Hedging Instruments		
Foreign exchange contracts purchased	**6,933**	10,322
Foreign exchange contracts sold	**11,580**	21,606
Other contracts purchased	**2,568**	2,773
Other contracts sold	**848**	544

Fair Values of Derivative Instruments

The following table presents our derivative instruments:

(In millions)	Derivative Assets	Derivative Liabilities	Derivative Assets	Derivative Liabilities
		September 30, 2022		June 30, 2022
Designated as Hedging Instruments				
Foreign exchange contracts	**$ 0**	**$ (127)**	$ 0	$ (77)
Interest rate contracts	**2**	**0**	3	0
Not Designated as Hedging Instruments				
Foreign exchange contracts	**406**	**(482)**	333	(362)
Other contracts	**36**	**(153)**	20	(112)
Gross amounts of derivatives	**444**	**(762)**	356	(551)
Gross amounts of derivatives offset in the balance sheet	**(158)**	**163**	(130)	133
Cash collateral received	**0**	**(67)**	0	(75)
Net amounts of derivatives	**$ 286**	**$ (666)**	$ 226	$ (493)
Reported as				
Short-term investments	**$ 18**	**$ 0**	$ 8	$ 0
Other current assets	**271**	**0**	218	0
Other long-term assets	**(3)**	**0**	0	0
Other current liabilities	**0**	**(396)**	0	(298)
Other long-term liabilities	**0**	**(270)**	0	(195)
Total	**$ 286**	**$ (666)**	$ 226	$ (493)

Gross derivative assets and liabilities subject to legally enforceable master netting agreements for which we have elected to offset were $409 million and $759 million, respectively, as of September 30, 2022, and $343 million and $550 million, respectively, as of June 30, 2022.

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

(In millions)	Level 1	Level 2	Level 3	Total
September 30, 2022				
Derivative assets	**$ 0**	**$ 427**	**$ 17**	**$ 444**
Derivative liabilities	**0**	**(762)**	**0**	**(762)**
June 30, 2022				
Derivative assets	1	349	6	356
Derivative liabilities	0	(551)	0	(551)

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

(In millions)

Three Months Ended September 30,		**2022**		**2021**
Designated as Fair Value Hedging Instruments				
Foreign exchange contracts				
Derivatives	**$**	**0**	$	3
Hedged items		**0**		(5)
Excluded from effectiveness assessment		**0**		4
Interest rate contracts				
Derivatives		**(43)**		(3)
Hedged items		**43**		7
Designated as Cash Flow Hedging Instruments				
Foreign exchange contracts				
Amount reclassified from accumulated other comprehensive income (loss)		**(59)**		(15)
Not Designated as Hedging Instruments				
Foreign exchange contracts		**240**		177
Other contracts		**2**		(18)

Losses, net of tax, on derivative instruments recognized in our consolidated comprehensive income statements were as follows:

(In millions)

Three Months Ended September 30,		**2022**		**2021**
Designated as Cash Flow Hedging Instruments				
Foreign exchange contracts				
Included in effectiveness assessment	**$**	**(40)**	$	(10)

NOTE 6 — INVENTORIES

The components of inventories were as follows:

(In millions)

		September 30, 2022		**June 30, 2022**
Raw materials	**$**	**1,143**	$	1,144
Work in process		**51**		82
Finished goods		**3,074**		2,516
Total	**$**	**4,268**	$	3,742

NOTE 7 — BUSINESS COMBINATIONS

Nuance Communications, Inc.

On March 4, 2022, we completed our acquisition of Nuance Communications, Inc. (“Nuance”) for a total purchase price of $18.8 billion, consisting primarily of cash. Nuance is a cloud and artificial intelligence (“AI”) software provider with healthcare and enterprise AI experience, and the acquisition will build on our industry-specific cloud offerings. The financial results of Nuance have been included in our consolidated financial statements since the date of the acquisition. Nuance is reported as part of our Intelligent Cloud segment.

The purchase price allocation as of the date of acquisition was based on a preliminary valuation and is subject to revision as more detailed analyses are completed and additional information about the fair value of assets acquired and liabilities assumed becomes available.

The major classes of assets and liabilities to which we have preliminarily allocated the purchase price were as follows:

(In millions)		
Goodwill (a)	$	16,329
Intangible assets		4,365
Other assets		42
Other liabilities (b)		(1,973)
Total	$	18,763

(a) *Goodwill was assigned to our Intelligent Cloud segment and was primarily attributed to increased synergies that are expected to be achieved from the integration of Nuance. None of the goodwill is expected to be deductible for income tax purposes.*
(b) *Includes $986 million of convertible senior notes issued by Nuance in 2015 and 2017, of which $985 million was redeemed as of September 30, 2022.*

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

(In millions, except average life)		Amount	Weighted Average Life
Customer-related	$	2,610	9 years
Technology-based		1,540	5 years
Marketing-related		215	4 years
Total	$	4,365	7 years

Activision Blizzard, Inc.

On January 18, 2022, we entered into a definitive agreement to acquire Activision Blizzard, Inc. (“Activision Blizzard”) for $95.00 per share in an all-cash transaction valued at $68.7 billion, inclusive of Activision Blizzard’s net cash. Activision Blizzard is a leader in game development and an interactive entertainment content publisher. The acquisition will accelerate the growth in our gaming business across mobile, PC, console, and cloud and will provide building blocks for the metaverse. The acquisition has been approved by Activision Blizzard’s shareholders, and we expect it to close in fiscal year 2023, subject to the satisfaction of certain regulatory approvals and other customary closing conditions.

NOTE 8 — GOODWILL

Changes in the carrying amount of goodwill were as follows:

(In millions)		June 30, 2022		Acquisitions		Other		September 30, 2022
Productivity and Business Processes	$	**24,811**	$	**11**	$	**(106)**	$	**24,716**
Intelligent Cloud		**30,182**		**8**		**76**		**30,266**
More Personal Computing		**12,531**		**0**		**(54)**		**12,477**
Total	$	**67,524**	$	**19**	$	**(84)**	$	**67,459**

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 9 — INTANGIBLE ASSETS

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

(In millions)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
			September 30, 2022			June 30, 2022
Technology-based	**$ 11,409**	**$ (7,253)**	**$ 4,156**	$ 11,277	$ (6,958)	$ 4,319
Customer-related	**7,343**	**(3,407)**	**3,936**	7,342	(3,171)	4,171
Marketing-related	**4,941**	**(2,237)**	**2,704**	4,942	(2,143)	2,799
Contract-based	**21**	**(9)**	**12**	16	(7)	9
Total	**$ 23,714**	**$ (12,906)**	**$ 10,808**	$ 23,577	$ (12,279)	$ 11,298

Intangible assets amortization expense was $633 million and $439 million for the three months ended September 30, 2022 and 2021, respectively.

The following table outlines the estimated future amortization expense related to intangible assets held as of September 30, 2022:

(In millions)	
Year Ending June 30,	
2023 (excluding the three months ended September 30, 2022)	**$ 2,033**
2024	**2,408**
2025	**1,666**
2026	**1,244**
2027	**826**
Thereafter	**2,631**
Total	**$ 10,808**

NOTE 10 — DEBT

The components of debt were as follows:

(In millions, issuance by calendar year)	Maturities (calendar year)	Stated Interest Rate	Effective Interest Rate	September 30, 2022	June 30, 2022
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	**2022 – 2042**	**2.13% – 3.50%**	**2.24%–3.57%**	**1,204**	1,204
2013 issuance of $5.2 billion	**2023 – 2043**	**2.38% – 4.88%**	**2.47%–4.92%**	**2,814**	2,814
2013 issuance of €4.1 billion	**2028 – 2033**	**2.63% – 3.13%**	**2.69%–3.22%**	**2,251**	2,404
2015 issuance of $23.8 billion	**2025 – 2055**	**2.70% – 4.75%**	**2.77%–4.78%**	**9,805**	10,805
2016 issuance of $19.8 billion	**2026 – 2056**	**2.40% – 3.95%**	**2.46%–4.03%**	**9,430**	9,430
2017 issuance of $17.0 billion	**2027 – 2057**	**3.30% – 4.50%**	**3.38%–4.53%**	**8,945**	8,945
2020 issuance of $10.0 billion	**2060**	**2.68%**	**2.68%**	**10,000**	10,000
2021 issuance of $8.2 billion	**2062**	**3.04%**	**3.04%**	**8,185**	8,185
Total face value				**54,358**	55,511
Unamortized discount and issuance costs				**(461)**	(471)
Hedge fair value adjustments (a)				**(111)**	(68)
Premium on debt exchange				**(5,164)**	(5,191)
Total debt				**48,622**	49,781
Current portion of long-term debt				**(3,248)**	(2,749)
Long-term debt				**$ 45,374**	$ 47,032

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

As of September 30, 2022 and June 30, 2022, the estimated fair value of long-term debt, including the current portion, was $46.1 billion and $50.9 billion, respectively. The estimated fair values are based on Level 2 inputs.

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

The following table outlines maturities of our long-term debt, including the current portion, as of September 30, 2022:

(In millions)	
Year Ending June 30,	
2023 (excluding the three months ended September 30, 2022)	**$ 1,750**
2024	**5,250**
2025	**2,250**
2026	**3,000**
2027	**8,000**
Thereafter	**34,108**
Total	**$ 54,358**

NOTE 11 — INCOME TAXES

Effective Tax Rate

Our effective tax rate was 19% and 0% for the three months ended September 30, 2022 and 2021, respectively. The increase in our effective tax rate for the current quarter compared to the prior year was primarily due to a $3.3 billion net income tax benefit in the first quarter of fiscal year 2022 related to the transfer of intangible properties and a decrease in tax benefits relating to stock-based compensation.

In the first quarter of fiscal year 2022, we transferred certain intangible properties from our Puerto Rico subsidiary to the U.S. The transfer of intangible properties resulted in a $3.3 billion net income tax benefit in the first quarter of fiscal year 2022, as the value of future U.S. tax deductions exceeded the current tax liability from the U.S. global intangible low-taxed income tax.

Our effective tax rate was lower than the U.S. federal statutory rate for the three months ended September 30, 2022, 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 September 30, 2022 and June 30, 2022, unrecognized tax benefits and other income tax liabilities were $16.7 billion and $16.3 billion, respectively, and are included in long-term income taxes in our consolidated balance sheets.

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

As of September 30, 2022, the primary unresolved issues for the IRS audits relate to transfer pricing, which could have a material impact in our consolidated financial statements when the matters are resolved. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved key transfer pricing issues and 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 tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2022, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NOTE 12 — UNEARNED REVENUE

Unearned revenue by segment was as follows:

(In millions)

	September 30, 2022	June 30, 2022
Productivity and Business Processes	**$ 22,405**	$ 24,558
Intelligent Cloud	**17,294**	19,371
More Personal Computing	**4,190**	4,479
Total	**$ 43,889**	$ 48,408

Changes in unearned revenue were as follows:

(In millions)

Three Months Ended September 30, 2022	
Balance, beginning of period	**$ 48,408**
Deferral of revenue	**23,577**
Recognition of unearned revenue	**(28,096)**
Balance, end of period	**$ 43,889**

Revenue allocated to remaining performance obligations, which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods, was $183 billion as of September 30, 2022, of which $180 billion is related to the commercial portion of revenue. We expect to recognize approximately 45% of this revenue over the next 12 months and the remainder thereafter.

NOTE 13 — LEASES

We have operating and finance leases for datacenters, corporate offices, research and development facilities, Microsoft Experience Centers, and certain equipment. Our leases have remaining lease terms of less than 1 year to 19 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 September 30,	2022	2021
Operating lease cost	**$ 662**	$ 588
Finance lease cost:		
Amortization of right-of-use assets	**$ 189**	$ 226
Interest on lease liabilities	**113**	104
Total finance lease cost	**$ 302**	$ 330

Supplemental cash flow information related to leases was as follows:

(In millions)

Three Months Ended September 30,	2022	2021
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	**$ 654**	$ 566
Operating cash flows from finance leases	**113**	104
Financing cash flows from finance leases	**256**	200
Right-of-use assets obtained in exchange for lease obligations:		
Operating leases	**1,189**	1,171
Finance leases	**611**	1,389

Supplemental balance sheet information related to leases was as follows:

(In millions, except lease term and discount rate)

	September 30, 2022	June 30, 2022
Operating Leases		
Operating lease right-of-use assets	**$ 13,347**	$ 13,148
Other current liabilities	**$ 2,224**	$ 2,228
Operating lease liabilities	**11,660**	11,489
Total operating lease liabilities	**$ 13,884**	$ 13,717
Finance Leases		
Property and equipment, at cost	**$ 17,322**	$ 17,388
Accumulated depreciation	**(3,475)**	(3,285)
Property and equipment, net	**$ 13,847**	$ 14,103
Other current liabilities	**$ 1,055**	$ 1,060
Other long-term liabilities	**13,575**	13,842
Total finance lease liabilities	**$ 14,630**	$ 14,902
Weighted Average Remaining Lease Term		
Operating leases	**8 years**	8 years
Finance leases	**11 years**	12 years
Weighted Average Discount Rate		
Operating leases	**2.4%**	2.1%
Finance leases	**3.2%**	3.1%

The following table outlines maturities of our lease liabilities as of September 30, 2022:

(In millions)

Year Ending June 30,	**Operating Leases**	**Finance Leases**
2023 (excluding the three months ended September 30, 2022)	**$ 1,913**	**$ 1,107**
2024	**2,327**	**1,480**
2025	**2,060**	**1,796**
2026	**1,706**	**1,477**
2027	**1,409**	**1,482**
Thereafter	**5,960**	**10,028**
Total lease payments	**15,375**	**17,370**
Less imputed interest	**(1,491)**	**(2,740)**
Total	**$ 13,884**	**$ 14,630**

As of September 30, 2022, we have additional operating and finance leases, primarily for datacenters, that have not yet commenced of $6.5 billion and $10.5 billion, respectively. These operating and finance leases will commence between fiscal year 2023 and fiscal year 2028 with lease terms of less than 1 year to 18 years.

NOTE 14 — CONTINGENCIES

U.S. Cell Phone Litigation

Microsoft Mobile Oy, a subsidiary of Microsoft, along with other handset manufacturers and network operators, is a defendant in 46 lawsuits, including 45 lawsuits filed in the Superior Court for the District of Columbia by individual plaintiffs who allege that radio emissions from cellular handsets caused their brain tumors and other adverse health effects. We assumed responsibility for these claims in our agreement to acquire Nokia's Devices and Services business and have been substituted for the Nokia defendants. Nine of these cases were filed in 2002 and are consolidated for certain pre-trial proceedings; the remaining cases are stayed. In a separate 2009 decision, the Court of Appeals for the District of Columbia held that adverse health effect claims arising from the use of cellular handsets that operate within the U.S. Federal Communications Commission radio frequency emission guidelines ("FCC Guidelines") are pre-empted by federal law. The plaintiffs allege that their handsets either operated outside the FCC Guidelines or were manufactured before the FCC Guidelines went into effect. The lawsuits also allege an industry-wide conspiracy to manipulate the science and testing around emission guidelines.

In 2013, the defendants in the consolidated cases moved to exclude the plaintiffs' expert evidence of general causation on the basis of flawed scientific methodologies. In 2014, the trial court granted in part and denied in part the defendants' motion to exclude the plaintiffs' general causation experts. The defendants filed an interlocutory appeal to the District of Columbia Court of Appeals challenging the standard for evaluating expert scientific evidence. In October 2016, the Court of Appeals issued its decision adopting the standard advocated by the defendants and remanding the cases to the trial court for further proceedings under that standard. The plaintiffs have filed supplemental expert evidence, portions of which were stricken by the court. A hearing on general causation took place in September of 2022.

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 September 30, 2022, we accrued aggregate legal liabilities of $264 million. While we intend to defend these matters vigorously, adverse outcomes that we estimate could reach approximately $500 million in aggregate beyond recorded amounts are reasonably possible. Were unfavorable final outcomes to occur, there exists the possibility of a material adverse impact in our consolidated financial statements for the period in which the effects become reasonably estimable.

NOTE 15 — STOCKHOLDERS' EQUITY

Share Repurchases

On September 18, 2019, our Board of Directors approved a share repurchase program authorizing up to $40.0 billion in share repurchases. This share repurchase program commenced in February 2020 and was completed in November 2021.

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, following completion of the program approved on September 18, 2019, has no expiration date, and may be terminated at any time. As of September 30, 2022, $36.1 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		2023		2022
First Quarter	**17**	**$ 4,600**	21	$ 6,200

All repurchases were made using cash resources. Shares repurchased during the first quarter of fiscal year 2023 were under the share repurchase program approved on September 14, 2021. Shares repurchased during the first quarter of fiscal year 2022 were under the share repurchase program approved on September 18, 2019. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards of $973 million and $1.5 billion for the first quarter of fiscal years 2023 and 2022, respectively.

Dividends

Our Board of Directors declared the following dividends:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
Fiscal Year 2023				**(In millions)**
September 20, 2022	**November 17, 2022**	**December 8, 2022**	**$ 0.68**	**$ 5,071**
Fiscal Year 2022				
September 14, 2021	November 18, 2021	December 9, 2021	$ 0.62	$ 4,652

The dividend declared on September 20, 2022 was included in other current liabilities as of September 30, 2022.

NOTE 16 — ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

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

(In millions)

Three Months Ended September 30,	2022	2021
Derivatives		
Balance, beginning of period	**$ (13)**	$ (19)
Unrealized losses, net of tax of **$(11)** and $(3)	**(40)**	(10)
Reclassification adjustments for losses included in other income (expense), net	**59**	15
Tax benefit included in provision for income taxes	**(12)**	(3)
Amounts reclassified from accumulated other comprehensive income (loss)	**47**	12
Net change related to derivatives, net of tax of **$1** and $0	**7**	2
Balance, end of period	**$ (6)**	$ (17)
Investments		
Balance, beginning of period	**$ (2,138)**	$ 3,222
Unrealized losses, net of tax of **$(510)** and $(110)	**(1,925)**	(415)
Reclassification adjustments for (gains) losses included in other income (expense), net	**35**	(9)
Tax expense (benefit) included in provision for income taxes	**(7)**	2
Amounts reclassified from accumulated other comprehensive income (loss)	**28**	(7)
Net change related to investments, net of tax of **$(503)** and $(112)	**(1,897)**	(422)
Balance, end of period	**$ (4,035)**	$ 2,800
Translation Adjustments and Other		
Balance, beginning of period	**$ (2,527)**	$ (1,381)
Translation adjustments and other, net of tax of **$0** and $0	**(775)**	(119)
Balance, end of period	**$ (3,302)**	$ (1,500)
Accumulated other comprehensive income (loss), end of period	**$ (7,343)**	$ 1,283

NOTE 17 — SEGMENT INFORMATION AND GEOGRAPHIC DATA

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

We have recast certain prior period amounts to conform to the way we internally manage and monitor our business.

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:

- Office Commercial (Office 365 subscriptions, the Office 365 portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises), comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, and Microsoft Viva.
- Office Consumer, including Microsoft 365 Consumer subscriptions, Office licensed on-premises, and other Office services.
- LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions.
- Dynamics business solutions, including Dynamics 365, comprising a set of intelligent, cloud-based applications across ERP, CRM, Customer Insights, Power Apps, and Power Automate; and on-premises ERP and CRM applications.

Intelligent Cloud

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

- Server products and cloud services, including Azure and other cloud services; SQL Server, Windows Server, Visual Studio, System Center, and related Client Access Licenses (“CALs”); and Nuance and GitHub.
- Enterprise Services, including Enterprise Support Services, Microsoft Consulting Services, and Nuance professional services.

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, including Windows original equipment manufacturer (“OEM”) licensing and other non-volume licensing of the Windows operating system; Windows Commercial, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings; patent licensing; and Windows Internet of Things.
- Devices, including Surface, HoloLens, and PC accessories.
- Gaming, including Xbox hardware and Xbox content and services, comprising first- and third-party content (including games and in-game content), Xbox Game Pass and other subscriptions, Xbox Cloud Gaming, third-party disc royalties, advertising, and other cloud services.
- Search and news advertising.

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

In addition, certain costs incurred at a corporate level that are identifiable and that benefit our segments are allocated to them. These allocated costs include legal, including settlements and fines, information technology, human resources, finance, excise taxes, field selling, shared facilities services, and customer service and support. Each allocation is measured differently based on the specific facts and circumstances of the costs being allocated.

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

(In millions)

Three Months Ended September 30,	**2022**	**2021**
Revenue		
Productivity and Business Processes	**$ 16,465**	$ 15,039
Intelligent Cloud	**20,325**	16,912
More Personal Computing	**13,332**	13,366
Total	**$ 50,122**	$ 45,317
Operating Income		
Productivity and Business Processes	**$ 8,323**	$ 7,581
Intelligent Cloud	**8,978**	7,681
More Personal Computing	**4,217**	4,976
Total	**$ 21,518**	$ 20,238

No sales to an individual customer or country other than the United States accounted for more than 10% of revenue for the three months ended September 30, 2022 or 2021. Revenue, classified by the major geographic areas in which our customers were located, was as follows:

(In millions)

Three Months Ended September 30,	**2022**	**2021**
United States (a)	**$ 25,867**	$ 22,830
Other countries	**24,255**	22,487
Total	**$ 50,122**	$ 45,317

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

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

(In millions)

Three Months Ended September 30,	**2022**	**2021**
Server products and cloud services	**$ 18,388**	$ 15,070
Office products and cloud services	**11,548**	10,808
Windows	**5,313**	5,674
LinkedIn	**3,663**	3,136
Gaming	**3,610**	3,593
Search and news advertising	**2,928**	2,656
Enterprise Services	**1,876**	1,791
Devices	**1,448**	1,414
Other	**1,348**	1,175
Total	**$ 50,122**	$ 45,317

Our Microsoft Cloud revenue, which includes Azure and other cloud services, Office 365 Commercial, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties, was $25.7 billion and $20.7 billion for the three months ended September 30, 2022 and 2021, respectively. These amounts are primarily included in Server products and cloud services, Office products and cloud services, and LinkedIn in the table above.

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

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Microsoft Corporation

Results of Review of Interim Financial Information

We have reviewed the accompanying consolidated balance sheet of Microsoft Corporation and subsidiaries (the "Company") as of September 30, 2022, the related consolidated statements of income, comprehensive income, cash flows, and stockholders' equity for the three-month periods ended September 30, 2022 and 2021, 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, 2022, 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 28, 2022, 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, 2022, 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
October 25, 2022

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, 2022, and our financial statements and the accompanying Notes to Financial Statements (Part I, Item 1 of this Form 10-Q).

OVERVIEW

Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. Our platforms and tools help drive small business productivity, large business competitiveness, and public-sector efficiency. We are creating the platforms and tools that deliver better, faster, and more effective solutions to support new startups, improve educational and health outcomes, and empower human ingenuity.

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

Highlights from the first quarter of fiscal year 2023 compared with the first quarter of fiscal year 2022 included:

- Microsoft Cloud revenue increased 24% to $25.7 billion.
- Office Commercial products and cloud services revenue increased 7% driven by Office 365 Commercial growth of 11%.
- Office Consumer products and cloud services revenue increased 7% and Microsoft 365 Consumer subscribers increased to 61.3 million.
- LinkedIn revenue increased 17%.
- Dynamics products and cloud services revenue increased 15% driven by Dynamics 365 growth of 24%.
- Server products and cloud services revenue increased 22% driven by Azure and other cloud services growth of 35%.
- Windows original equipment manufacturer licensing ("Windows OEM") revenue decreased 15%.
- Windows Commercial products and cloud services revenue increased 8%.
- Xbox content and services revenue decreased 3%.
- Search and news advertising revenue excluding traffic acquisition costs increased 16%.
- Devices revenue increased 2%.

Industry Trends

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

Economic Conditions, Challenges, and Risks

The markets for software, devices, and cloud-based services are dynamic and highly competitive. Our competitors are developing new software and devices, while also deploying competing cloud-based services for consumers and businesses. The devices and form factors customers prefer evolve rapidly, and influence how users access services in the cloud, and in some cases, the user's choice of which suite of cloud-based services to use. We must continue to evolve and adapt over an extended time in pace with this changing environment. The investments we are making in infrastructure and devices will continue to increase our operating costs and may decrease our operating margins.

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. Aggregate demand for our software, services, and devices is correlated to global macroeconomic and geopolitical factors, which remain dynamic.

Our devices are primarily manufactured by third-party contract manufacturers, some of which contain certain components for which there are very few qualified suppliers. For these components, we have limited near-term flexibility to use other manufacturers if a current vendor becomes unavailable or is unable to meet our requirements. Extended disruptions at these suppliers and/or manufacturers could lead to a similar disruption in our ability to manufacture devices on time to meet consumer demand.

Our international operations provide a significant portion of our total revenue and expenses. Many of these revenue and expenses are denominated in currencies other than the U.S. dollar. As a result, changes in foreign exchange rates may significantly affect revenue and expenses. Fluctuations in the U.S. dollar relative to certain foreign currencies reduced reported revenue and expenses from our international operations in the first quarter of fiscal year 2023. 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 second and fourth quarters of our fiscal year. Second quarter revenue is driven by corporate year-end spending trends in our major markets and holiday season spending by consumers, and fourth quarter revenue is driven by the volume of multi-year on-premises contracts executed during the period.

Change in Accounting Estimate

In July 2022, we completed an assessment of the useful lives of our server and network equipment. Due to investments in software that increased efficiencies in how we operate our server and network equipment, as well as advances in technology, we determined we should increase the estimated useful lives of both server and network equipment from four years to six years. This change in accounting estimate was effective beginning fiscal year 2023. Based on the carrying amount of server and network equipment included in property and equipment, net as of June 30, 2022, the effect of this change in estimate for the three months ended September 30, 2022, was an increase in operating income of $1.1 billion and net income of $859 million, or $0.12 and $0.11 per basic and diluted share, respectively. It is estimated this change will increase our fiscal year 2023 annual operating income by $3.7 billion.

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. We have recast certain prior period amounts to conform to the way we internally manage and monitor our business.

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

Metrics

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

In the first quarter of fiscal year 2023, we made updates to the presentation and method of calculation for certain metrics, most notably expanding our Surface metric into a broader Devices metric to incorporate additional revenue streams, along with other minor changes to align with how we manage our businesses.

Commercial

Our commercial business primarily consists of Server products and cloud services, Office Commercial, Windows Commercial, the commercial portion of LinkedIn, Enterprise Services, and Dynamics. 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	Revenue from Azure and other cloud services, Office 365 Commercial, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties
Microsoft Cloud gross margin percentage	Gross margin percentage for our Microsoft Cloud business

Productivity and Business Processes and Intelligent Cloud

Metrics related to our Productivity and Business Processes and Intelligent Cloud segments assess the health of our core businesses within these segments. The metrics reflect our cloud and on-premises product strategies and trends.

Office Commercial products and cloud services revenue growth	Revenue from Office Commercial products and cloud services (Office 365 subscriptions, the Office 365 portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises), comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, and Microsoft Viva
Office Consumer products and cloud services revenue growth	Revenue from Office Consumer products and cloud services, including Microsoft 365 Consumer subscriptions, Office licensed on-premises, and other Office services
Office 365 Commercial seat growth	The number of Office 365 Commercial seats at end of period where seats are paid users covered by an Office 365 Commercial subscription
Microsoft 365 Consumer subscribers	The number of Microsoft 365 Consumer subscribers at end of period
Dynamics products and cloud services revenue growth	Revenue from Dynamics products and cloud services, including Dynamics 365, comprising a set of intelligent, cloud-based applications across ERP, CRM, Customer Insights, Power Apps, and Power Automate; and on-premises ERP and CRM applications
LinkedIn revenue growth	Revenue from LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions
Server products and cloud services revenue growth	Revenue from Server products and cloud services, including Azure and other cloud services; SQL Server, Windows Server, Visual Studio, System Center, and related Client Access Licenses (“CALs”); and Nuance and GitHub

More Personal Computing

Metrics related to our More Personal Computing segment assess the performance of key lines of business within this segment. These metrics provide strategic product insights which allow us to assess the performance across our commercial and consumer businesses. As we have diversity of target audiences and sales motions within the Windows business, we monitor metrics that are reflective of those varying motions.

Windows OEM revenue growth	Revenue from sales of Windows Pro and non-Pro licenses sold through the OEM channel
Windows Commercial products and cloud services revenue growth	Revenue from Windows Commercial products and cloud services, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings
Devices revenue growth	Revenue from Devices, including Surface, HoloLens, and PC accessories
Xbox content and services revenue growth	Revenue from Xbox content and services, comprising first- and third-party content (including games and in-game content), Xbox Game Pass and other subscriptions, Xbox Cloud Gaming, third-party disc royalties, 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 September 30,		Percentage Change
	2022	**2021**	
Revenue	**$ 50,122**	$ 45,317	11%
Gross margin	**34,670**	31,671	9%
Operating income	**21,518**	20,238	6%
Net income	**17,556**	20,505	(14)%
Diluted earnings per share	**2.35**	2.71	(13)%
Adjusted net income (non-GAAP)	**17,556**	17,214	2%
Adjusted diluted earnings per share (non-GAAP)	**2.35**	2.27	4%

Adjusted net income and adjusted diluted earnings per share ("EPS") are non-GAAP financial measures which exclude the net income tax benefit related to transfer of intangible properties in the first quarter of fiscal year 2022. 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. Refer to Note 11 – Income Taxes of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

Three Months Ended September 30, 2022 Compared with Three Months Ended September 30, 2021

Revenue increased $4.8 billion or 11% driven by growth in Intelligent Cloud and Productivity and Business Processes. Intelligent Cloud revenue increased driven by Azure and other cloud services. Productivity and Business Processes revenue increased driven by Office 365 Commercial and LinkedIn. More Personal Computing revenue decreased slightly primarily driven by a decline in Windows, offset in part by growth in Search and news advertising.

Cost of revenue increased $1.8 billion or 13% driven by growth in Microsoft Cloud and Gaming, offset in part by a reduction in depreciation expense due to the change in accounting estimate for the useful lives of our server and network equipment.

Gross margin increased $3.0 billion or 9% driven by growth in Intelligent Cloud and Productivity and Business Processes and the change in accounting estimate, offset in part by a decline in More Personal Computing.

- Gross margin percentage decreased slightly. Excluding the impact of the change in accounting estimate, gross margin percentage decreased 3 points driven by reductions in More Personal Computing and Intelligent Cloud.
- Microsoft Cloud gross margin percentage increased 2 points to 73%. Excluding the impact of the change in accounting estimate, Microsoft Cloud gross margin percentage decreased 1 point driven by sales mix shift to Azure and other cloud services and lower margins in Azure and other cloud services, primarily due to higher energy costs.

Operating expenses increased $1.7 billion or 15% driven by investments in cloud engineering, LinkedIn, Nuance, and commercial sales.

Key changes in operating expenses were:

- Research and development expenses increased $1.0 billion or 18% driven by investments in cloud engineering and LinkedIn. Research and development included a favorable foreign currency impact of 2%.
- Sales and marketing expenses increased $579 million or 13% driven by investments in commercial sales, Nuance, and LinkedIn. Sales and marketing included a favorable foreign currency impact of 4%.
- General and administrative expenses increased $111 million or 9% driven by investments in corporate functions. General and administrative included a favorable foreign currency impact of 3%.

Operating income increased $1.3 billion or 6% driven by growth in Intelligent Cloud and Productivity and Business Processes and the change in accounting estimate, offset in part by a decline in More Personal Computing.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 5%, 7%, and 9%, respectively. Cost of revenue and operating expenses both included a favorable foreign currency impact of 3%.

Prior year net income and diluted EPS were positively impacted by the net tax benefit related to the transfer of intangible properties, which resulted in an increase to net income and diluted EPS of $3.3 billion and $0.44, respectively.

SEGMENT RESULTS OF OPERATIONS

(In millions, except percentages)	Three Months Ended September 30, 2022	2021	Percentage Change
Revenue			
Productivity and Business Processes	**$ 16,465**	$ 15,039	9%
Intelligent Cloud	**20,325**	16,912	20%
More Personal Computing	**13,332**	13,366	0%
Total	**$ 50,122**	$ 45,317	11%
Operating Income			
Productivity and Business Processes	**$ 8,323**	$ 7,581	10%
Intelligent Cloud	**8,978**	7,681	17%
More Personal Computing	**4,217**	4,976	(15)%
Total	**$ 21,518**	$ 20,238	6%

Reportable Segments

Three Months Ended September 30, 2022 Compared with Three Months Ended September 30, 2021

Productivity and Business Processes

Revenue increased $1.4 billion or 9%.

- Office Commercial products and cloud services revenue increased $633 million or 7%. Office 365 Commercial revenue grew 11% with seat growth of 14%, driven by small and medium business and frontline worker offerings, as well as growth in revenue per user. Office Commercial products revenue declined 28% driven by continued customer shift to cloud offerings.
- Office Consumer products and cloud services revenue increased $105 million or 7% driven by Microsoft 365 Consumer subscription revenue. Microsoft 365 Consumer subscribers grew 13% to 61.3 million.
- LinkedIn revenue increased $527 million or 17% driven by Talent Solutions.
- Dynamics products and cloud services revenue increased 15% driven by Dynamics 365 growth of 24%.

Operating income increased $742 million or 10%.

- Gross margin increased $1.3 billion or 11% driven by growth in Office 365 Commercial and LinkedIn, as well as the change in accounting estimate. Gross margin percentage increased. Excluding the impact of the change in accounting estimate, gross margin percentage decreased slightly driven by sales mix shift to cloud offerings.
- Operating expenses increased $568 million or 13% driven by investments in LinkedIn and cloud engineering.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 6%, 7%, and 9%, respectively. Operating expenses included a favorable foreign currency impact of 3%.

Intelligent Cloud

Revenue increased $3.4 billion or 20%.

- Server products and cloud services revenue increased $3.3 billion or 22% driven by Azure and other cloud services. Azure and other cloud services revenue grew 35% driven by growth in our consumption-based services. Server products revenue was relatively unchanged.
- Enterprise Services revenue increased $85 million or 5% driven by growth in Enterprise Support Services.

Operating income increased $1.3 billion or 17%.

- Gross margin increased $2.4 billion or 20% driven by growth in Azure and other cloud services and the change in accounting estimate. Gross margin percentage decreased slightly. Excluding the impact of the change in accounting estimate, gross margin percentage decreased 3 points driven by sales mix shift to Azure and other cloud services and lower margins in Azure and other cloud services, primarily due to higher energy costs.
- Operating expenses increased $1.1 billion or 25% driven by investments in Azure and Nuance.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 6%, 6%, and 8%, respectively. Operating expenses included a favorable foreign currency impact of 3%.

More Personal Computing

Revenue decreased slightly.

- Windows revenue decreased $361 million or 6% driven by a decrease in Windows OEM, offset in part by growth in Windows Commercial. Windows OEM revenue decreased 15% driven by continued deterioration in the PC market, offset in part by 5 points of positive impact from the prior year Windows 11 revenue deferral. Windows Commercial products and cloud services revenue increased 8% driven by demand for Microsoft 365.
- Search and news advertising revenue increased $272 million or 10%. Search and news advertising revenue excluding traffic acquisition costs increased 16% driven by higher search volume and Xandr.
- Devices revenue increased $34 million or 2%.
- Gaming revenue increased slightly driven by growth in Xbox hardware, offset in part by a decline in Xbox content and services. Xbox hardware revenue increased 13% driven by higher volume and price of consoles sold. Xbox content and services revenue decreased 3% driven by declines in first-party content and in third-party content, with lower engagement hours and higher rate of monetization, offset in part by growth in Xbox Game Pass subscriptions.

Operating income decreased $759 million or 15%.

- Gross margin decreased $688 million or 9% driven by declines in Windows and Gaming. Gross margin percentage decreased driven by sales mix shift to lower margin businesses.
- Operating expenses increased $71 million or 2% primarily driven by investments in Search and news advertising.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 3%, 5%, and 6%, respectively. Operating expenses included a favorable foreign currency impact of 3%.

OPERATING EXPENSES

Research and Development

(In millions, except percentages)	Three Months Ended September 30, 2022	2021	Percentage Change
Research and development	**$ 6,628**	$ 5,599	18%
As a percent of revenue	**13%**	12%	1ppt

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

Three Months Ended September 30, 2022 Compared with Three Months Ended September 30, 2021

Research and development expenses increased $1.0 billion or 18% driven by investments in cloud engineering and LinkedIn. Research and development included a favorable foreign currency impact of 2%.

Sales and Marketing

(In millions, except percentages)	Three Months Ended September 30,		Percentage Change
	2022	**2021**	
Sales and marketing	**$ 5,126**	$ 4,547	13%
As a percent of revenue	**10%**	10%	0ppt

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 September 30, 2022 Compared with Three Months Ended September 30, 2021

Sales and marketing expenses increased $579 million or 13% driven by investments in commercial sales, Nuance, and LinkedIn. Sales and marketing included a favorable foreign currency impact of 4%.

General and Administrative

(In millions, except percentages)	Three Months Ended September 30,		Percentage Change
	2022	**2021**	
General and administrative	**$ 1,398**	$ 1,287	9%
As a percent of revenue	**3%**	3%	0ppt

General and administrative expenses include payroll, employee benefits, stock-based compensation expense, 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 September 30, 2022 Compared with Three Months Ended September 30, 2021

General and administrative expenses increased $111 million or 9% driven by investments in corporate functions. General and administrative included a favorable foreign currency impact of 3%.

OTHER INCOME (EXPENSE), NET

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

(In millions)

Three Months Ended September 30,	**2022**	**2021**
Interest and dividends income	**$ 641**	$ 520
Interest expense	**(500)**	(539)
Net recognized gains on investments	**13**	371
Net gains (losses) on derivatives	**9**	(7)
Net losses on foreign currency remeasurements	**(78)**	(65)
Other, net	**(31)**	6
Total	**$ 54**	$ 286

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

Three Months Ended September 30, 2022 Compared with Three Months Ended September 30, 2021

Interest and dividends income increased due to higher yields, offset in part by lower portfolio balances. Interest expense decreased due to a decrease in outstanding long-term debt due to debt maturities. Net recognized gains on investments decreased primarily due to lower gains on equity securities.

INCOME TAXES

Effective Tax Rate

Our effective tax rate was 19% and 0% for the three months ended September 30, 2022 and 2021, respectively. The increase in our effective tax rate for the current quarter compared to the prior year was primarily due to a $3.3 billion net income tax benefit in the first quarter of fiscal year 2022 related to the transfer of intangible properties and a decrease in tax benefits relating to stock-based compensation.

In the first quarter of fiscal year 2022, we transferred certain intangible properties from our Puerto Rico subsidiary to the U.S. The transfer of intangible properties resulted in a $3.3 billion net income tax benefit in the first quarter of fiscal year 2022, as the value of future U.S. tax deductions exceeded the current tax liability from the U.S. global intangible low-taxed income tax.

Our effective tax rate was lower than the U.S. federal statutory rate for the three months ended September 30, 2022, 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 settled a portion of the Internal Revenue Service (“IRS”) audit for tax years 2004 to 2006 in fiscal year 2011. In February 2012, the IRS withdrew its 2011 Revenue Agents Report related to unresolved issues for tax years 2004 to 2006 and reopened the audit phase of the examination. We also settled a portion of the IRS audit for tax years 2007 to 2009 in fiscal year 2016, and a portion of the IRS audit for tax years 2010 to 2013 in fiscal year 2018. In the second quarter of fiscal year 2021, we settled an additional portion of the IRS audits for tax years 2004 to 2013 and made a payment of $1.7 billion, including tax and interest. We remain under audit for tax years 2004 to 2017.

As of September 30, 2022, the primary unresolved issues for the IRS audits relate to transfer pricing, which could have a material impact in our consolidated financial statements when the matters are resolved. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved key transfer pricing issues and 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 tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2022, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NON-GAAP FINANCIAL MEASURES

Adjusted net income and adjusted diluted EPS are non-GAAP financial measures which exclude the net tax benefit related to the transfer of intangible properties in the first quarter of fiscal year 2022. We believe these non-GAAP measures aid investors by providing additional insight into our operational 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)		**Three Months Ended September 30,**	**Percentage Change**
	2022	**2021**	
Net income	**$ 17,556**	$ 20,505	(14)%
Net income tax benefit related to transfer of intangible properties	**0**	(3,291)	*
Adjusted net income (non-GAAP)	**$ 17,556**	$ 17,214	2%
Diluted earnings per share	**$ 2.35**	$ 2.71	(13)%
Net income tax benefit related to transfer of intangible properties	**0**	(0.44)	*
Adjusted diluted earnings per share (non-GAAP)	**$ 2.35**	$ 2.27	4%

* *Not meaningful.*

LIQUIDITY AND CAPITAL RESOURCES

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

Cash, Cash Equivalents, and Investments

Cash, cash equivalents, and short-term investments totaled $107.3 billion and $104.8 billion as of September 30, 2022 and June 30, 2022, respectively. Equity investments were $6.8 billion and $6.9 billion as of September 30, 2022 and June 30, 2022, respectively. Our short-term investments are primarily intended to facilitate liquidity and capital preservation. They consist predominantly of highly liquid investment-grade fixed-income securities, diversified among industries and individual issuers. The investments are predominantly U.S. dollar-denominated securities, but also include foreign currency-denominated securities to diversify risk. Our fixed-income investments are exposed to interest rate risk and credit risk. The credit risk and average maturity of our fixed-income portfolio are managed to achieve economic returns that correlate to certain fixed-income indices. The settlement risk related to these investments is insignificant given that the short-term investments held are primarily highly liquid investment-grade fixed-income securities.

Valuation

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

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

Cash Flows

Cash from operations decreased $1.3 billion to $23.2 billion for the three months ended September 30, 2022, mainly due to an increase in cash paid to suppliers and employees and cash used to pay income taxes, offset in part by an increase in cash received from customers. Cash used in financing decreased $5.4 billion to $10.9 billion for the three months ended September 30, 2022, mainly due to a $3.8 billion decrease in repayments of debt and a $2.1 billion decrease in common stock repurchases. Cash used in investing decreased $118 million to $3.1 billion for the three months ended September 30, 2022, due to an $857 million decrease in cash used for acquisitions of companies, net of cash acquired, and purchases of intangible and other assets, and a $177 million increase in cash from net investment purchases, sales, and maturities, offset in part by a $473 million increase in additions to property and equipment and a $443 million increase in other investing to facilitate the purchase of components.

Debt Proceeds

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

Unearned Revenue

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

The following table outlines the expected future recognition of unearned revenue as of September 30, 2022:

(In millions)		
Three Months Ending		
December 31, 2022	$	**18,766**
March 31, 2023		**13,080**
June 30, 2023		**7,631**
September 30, 2023		**1,863**
Thereafter		**2,549**
Total	$	**43,889**

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

Material Cash Requirements and Other Obligations

Income Taxes

As a result of the TCJA, we are required to pay a one-time transition tax on deferred foreign income not previously subject to U.S. income tax. Under the TCJA, the transition tax is payable in interest-free installments over eight years, with 8% due in each of the first five years, 15% in year six, 20% in year seven, and 25% in year eight. We have paid transition tax of $7.7 billion, which included $1.5 billion during the three months ended September 30, 2022. The remaining transition tax of $10.5 billion is payable over the next three years, with $2.5 billion payable within 12 months.

Provisions enacted in the TCJA related to the capitalization for tax purposes of research and experimental expenditures became effective on July 1, 2022. These provisions require us to capitalize research and experimental expenditures and amortize them on the U.S. tax return over five or fifteen years, depending on where research is conducted. The final foreign tax credit regulations, also effective on July 1, 2022, introduced significant changes to foreign tax credit calculations in the U.S. tax return. While these provisions are not expected to have a material impact on our fiscal year 2023 effective tax rate on a net basis, our cash paid for taxes would increase unless these provisions are postponed or modified through legislative processes.

Share Repurchases

For the three months ended September 30, 2022 and 2021, we repurchased 17 million shares and 21 million shares of our common stock for $4.6 billion and $6.2 billion, respectively, through our share repurchase programs. All repurchases were made using cash resources. As of September 30, 2022, $36.1 billion remained of our $60 billion share repurchase program. Refer to Note 15 – Stockholders' Equity of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

Dividends

For the three months ended September 30, 2022 and 2021, our Board of Directors declared quarterly dividends of $0.68 per share and $0.62 per share, respectively. We intend to continue returning capital to shareholders in the form of dividends, subject to declaration by our Board of Directors. Refer to Note 15 – Stockholders' Equity of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

Other Planned Uses of Capital

On January 18, 2022, we entered into a definitive agreement to acquire Activision Blizzard, Inc. ("Activision Blizzard") for $95.00 per share in an all-cash transaction valued at $68.7 billion, inclusive of Activision Blizzard's net cash. The acquisition has been approved by Activision Blizzard's shareholders, and we expect it to close in fiscal year 2023, subject to the satisfaction of certain regulatory approvals and other customary closing conditions.

We will continue to invest in sales, marketing, product support infrastructure, and existing and advanced areas of technology, as well as continue making acquisitions that align with our business strategy. Additions to property and equipment will continue, including new facilities, datacenters, and computer systems for research and development, sales and marketing, support, and administrative staff. We expect capital expenditures to increase in coming years to support growth in our cloud offerings. 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.

CRITICAL ACCOUNTING ESTIMATES

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

Revenue Recognition

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

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

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

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

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

Impairment of Investment Securities

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

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

Goodwill

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

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

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

Research and Development Costs

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

Legal and Other Contingencies

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

Income Taxes

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

Inventories

Inventories are stated at average cost, subject to the lower of cost or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. Net realizable value is the estimated selling price less estimated costs of completion, disposal, and transportation. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. These reviews include analysis of demand forecasts, product life cycle status, product development plans, current sales levels, pricing strategy, and component cost trends. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue.

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 September 30, 2023

OR

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

For the Transition Period From to

Commission File Number 001-37845

MICROSOFT CORPORATION

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

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 October 19, 2023**
Common Stock, $0.00000625 par value per share	7,432,262,329 shares

MICROSOFT CORPORATION

FORM 10-Q

For the Quarter Ended September 30, 2023

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INCOME STATEMENTS

(In millions, except per share amounts) (Unaudited)

Three Months Ended September 30,	**2023**	**2022**
Revenue:		
Product	**$ 15,535**	$ 15,741
Service and other	**40,982**	34,381
Total revenue	**56,517**	50,122
Cost of revenue:		
Product	**3,531**	4,302
Service and other	**12,771**	11,150
Total cost of revenue	**16,302**	15,452
Gross margin	**40,215**	34,670
Research and development	**6,659**	6,628
Sales and marketing	**5,187**	5,126
General and administrative	**1,474**	1,398
Operating income	**26,895**	21,518
Other income, net	**389**	54
Income before income taxes	**27,284**	21,572
Provision for income taxes	**4,993**	4,016
Net income	**$ 22,291**	$ 17,556
Earnings per share:		
Basic	**$ 3.00**	$ 2.35
Diluted	**$ 2.99**	$ 2.35
Weighted average shares outstanding:		
Basic	**7,429**	7,457
Diluted	**7,462**	7,485

Refer to accompanying notes.

COMPREHENSIVE INCOME STATEMENTS

(In millions) (Unaudited)

Three Months Ended September 30,	**2023**	**2022**
Net income	**$ 22,291**	$ 17,556
Other comprehensive income (loss), net of tax:		
Net change related to derivatives	**21**	7
Net change related to investments	**(260)**	(1,897)
Translation adjustments and other	**(355)**	(775)
Other comprehensive loss	**(594)**	(2,665)
Comprehensive income	**$ 21,697**	$ 14,891

Refer to accompanying notes.

BALANCE SHEETS

(In millions) (Unaudited)

	September 30, 2023	June 30, 2023
Assets		
Current assets:		
Cash and cash equivalents	**$ 80,452**	$ 34,704
Short-term investments	**63,499**	76,558
Total cash, cash equivalents, and short-term investments	**143,951**	111,262
Accounts receivable, net of allowance for doubtful accounts of **$512** and $650	**36,953**	48,688
Inventories	**3,000**	2,500
Other current assets	**23,682**	21,807
Total current assets	**207,586**	184,257
Property and equipment, net of accumulated depreciation of **$69,486** and $68,251	**102,502**	95,641
Operating lease right-of-use assets	**15,435**	14,346
Equity investments	**11,423**	9,879
Goodwill	**67,790**	67,886
Intangible assets, net	**8,895**	9,366
Other long-term assets	**32,154**	30,601
Total assets	**$ 445,785**	$ 411,976
Liabilities and stockholders’ equity		
Current liabilities:		
Accounts payable	**$ 19,307**	$ 18,095
Short-term debt	**25,808**	0
Current portion of long-term debt	**3,748**	5,247
Accrued compensation	**6,990**	11,009
Short-term income taxes	**8,035**	4,152
Short-term unearned revenue	**46,429**	50,901
Other current liabilities	**14,475**	14,745
Total current liabilities	**124,792**	104,149
Long-term debt	**41,946**	41,990
Long-term income taxes	**22,983**	25,560
Long-term unearned revenue	**2,759**	2,912
Deferred income taxes	**470**	433
Operating lease liabilities	**13,487**	12,728
Other long-term liabilities	**18,634**	17,981
Total liabilities	**225,071**	205,753
Commitments and contingencies		
Stockholders’ equity:		
Common stock and paid-in capital – shares authorized 24,000; outstanding **7,431** and 7,432	**95,508**	93,718
Retained earnings	**132,143**	118,848
Accumulated other comprehensive loss	**(6,937)**	(6,343)
Total stockholders’ equity	**220,714**	206,223
Total liabilities and stockholders’ equity	**$ 445,785**	$ 411,976

Refer to accompanying notes.

CASH FLOWS STATEMENTS

(In millions) (Unaudited)

Three Months Ended September 30,	2023	2022
Operations		
Net income	$ 22,291	$ 17,556
Adjustments to reconcile net income to net cash from operations:		
Depreciation, amortization, and other	3,921	2,790
Stock-based compensation expense	2,507	2,192
Net recognized losses (gains) on investments and derivatives	14	(22)
Deferred income taxes	(568)	(1,191)
Changes in operating assets and liabilities:		
Accounts receivable	11,034	11,729
Inventories	(505)	(543)
Other current assets	(796)	(332)
Other long-term assets	(2,013)	(666)
Accounts payable	1,214	(1,567)
Unearned revenue	(4,126)	(3,322)
Income taxes	1,425	410
Other current liabilities	(4,106)	(4,024)
Other long-term liabilities	291	188
Net cash from operations	30,583	23,198
Financing		
Proceeds from issuance of debt, maturities of 90 days or less, net	18,692	0
Proceeds from issuance of debt	7,073	0
Repayments of debt	(1,500)	(1,000)
Common stock issued	685	575
Common stock repurchased	(4,831)	(5,573)
Common stock cash dividends paid	(5,051)	(4,621)
Other, net	(307)	(264)
Net cash from (used in) financing	14,761	(10,883)
Investing		
Additions to property and equipment	(9,917)	(6,283)
Acquisition of companies, net of cash acquired, and purchases of intangible and other assets	(1,186)	(349)
Purchases of investments	(8,460)	(5,013)
Maturities of investments	15,718	6,662
Sales of investments	5,330	2,711
Other, net	(982)	(860)
Net cash from (used in) investing	503	(3,132)
Effect of foreign exchange rates on cash and cash equivalents	(99)	(230)
Net change in cash and cash equivalents	45,748	8,953
Cash and cash equivalents, beginning of period	34,704	13,931
Cash and cash equivalents, end of period	$ 80,452	$ 22,884

Refer to accompanying notes.

STOCKHOLDERS' EQUITY STATEMENTS

(In millions, except per share amounts) (Unaudited)

Three Months Ended September 30,	2023	2022
Common stock and paid-in capital		
Balance, beginning of period	$ 93,718	$ 86,939
Common stock issued	685	575
Common stock repurchased	(1,401)	(1,171)
Stock-based compensation expense	2,507	2,192
Other, net	(1)	0
Balance, end of period	95,508	88,535
Retained earnings		
Balance, beginning of period	118,848	84,281
Net income	22,291	17,556
Common stock cash dividends	(5,571)	(5,064)
Common stock repurchased	(3,425)	(4,399)
Balance, end of period	132,143	92,374
Accumulated other comprehensive loss		
Balance, beginning of period	(6,343)	(4,678)
Other comprehensive loss	(594)	(2,665)
Balance, end of period	(6,937)	(7,343)
Total stockholders' equity	$ 220,714	$ 173,566
Cash dividends declared per common share	$ 0.75	$ 0.68

Refer to accompanying notes.

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 — ACCOUNTING POLICIES

Accounting Principles

Our unaudited interim consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). In the opinion of management, the unaudited interim consolidated financial statements reflect all adjustments of a normal recurring nature that are necessary for a fair presentation of the results for the interim periods presented. Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with information included in the Microsoft Corporation fiscal year 2023 Form 10-K filed with the U.S. Securities and Exchange Commission on July 27, 2023.

We have recast certain prior period amounts 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 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; product warranties; the fair value of and/or potential impairment of goodwill and intangible assets for our reporting units; product life cycles; useful lives of our tangible and intangible assets; allowances for doubtful accounts; the market value of, and demand for, our inventory; stock-based compensation forfeiture rates; when technological feasibility is achieved for our products; the potential outcome of uncertain tax positions that have been recognized in our consolidated financial statements or tax returns; and determining the timing and amount of impairments for investments. Actual results and outcomes may differ from management’s estimates and assumptions due to risks and uncertainties.

Financial Instruments

Investments

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

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

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

Derivatives

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

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

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

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

Fair Value Measurements

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

- *Level 1* – inputs are based upon unadjusted quoted prices for identical instruments in active markets. Our Level 1 investments include U.S. government securities, common and preferred stock, and mutual funds. Our Level 1 derivative assets and liabilities include those actively traded on exchanges.
- *Level 2* – inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques (e.g. the Black-Scholes model) for which all significant inputs are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, credit spreads, foreign exchange rates, and forward and spot prices for currencies. Our Level 2 investments include commercial paper, certificates of deposit, U.S. agency securities, foreign government bonds, mortgage- and asset-backed securities, corporate notes and bonds, and municipal securities. Our Level 2 derivative assets and liabilities include certain cleared swap contracts and over-the-counter forward, option, and swap contracts.
- *Level 3* – inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques, including option pricing models and discounted cash flow models. Our Level 3 assets and liabilities include investments in corporate notes and bonds, municipal securities, and goodwill and intangible assets, when they are recorded at fair value due to an impairment charge. Unobservable inputs used in the models are significant to the fair values of the assets and liabilities.

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

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

Contract Balances and Other Receivables

As of both September 30, 2023 and June 30, 2023, long-term accounts receivable, net of allowance for doubtful accounts, was $4.5 billion and is included in other long-term assets in our consolidated balance sheets.

As of September 30, 2023 and June 30, 2023, other receivables related to activities to facilitate the purchase of server components were $10.2 billion and $9.2 billion, respectively, and are included in other current assets in our consolidated balance sheets.

We record financing receivables when we offer certain of our customers the option to acquire our software products and services offerings through a financing program in a limited number of countries. As of September 30, 2023 and June 30, 2023, our financing receivables, net were $4.8 billion and $5.3 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 to cover expected losses based on troubled accounts, historical experience, and other currently available evidence.

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 earnings per share)

Three Months Ended September 30,	**2023**	**2022**
Net income available for common shareholders (A)	**$ 22,291**	$ 17,556
Weighted average outstanding shares of common stock (B)	**7,429**	7,457
Dilutive effect of stock-based awards	**33**	28
Common stock and common stock equivalents (C)	**7,462**	7,485
Earnings Per Share		
Basic (A/B)	**$ 3.00**	$ 2.35
Diluted (A/C)	**$ 2.99**	$ 2.35

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

NOTE 3 — OTHER INCOME (EXPENSE), NET

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

(In millions)

Three Months Ended September 30,	2023	2022
Interest and dividends income	$ 1,166	$ 641
Interest expense	(525)	(500)
Net recognized gains (losses) on investments	(107)	13
Net gains on derivatives	93	9
Net losses on foreign currency remeasurements	(101)	(78)
Other, net	(137)	(31)
Total	$ 389	$ 54

Net Recognized Gains (Losses) on Investments

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

(In millions)

Three Months Ended September 30,	2023	2022
Realized gains from sales of available-for-sale securities	$ 2	$ 3
Realized losses from sales of available-for-sale securities	(25)	(20)
Impairments and allowance for credit losses	(6)	(18)
Total	$ (29)	$ (35)

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

(In millions)

Three Months Ended September 30,	2023	2022
Net realized gains on investments sold	$ 45	$ 83
Net unrealized losses on investments still held	(123)	(28)
Impairments of investments	0	(7)
Total	$ (78)	$ 48

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 Investments
September 30, 2023								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 3,008	$ 0	$ 0	$ 3,008	$ 3,005	$ 3	$ 0
Certificates of deposit	Level 2	1,694	0	0	1,694	1,650	44	0
U.S. government securities	Level 1	56,210	2	(4,147)	52,065	255	51,810	0
U.S. agency securities	Level 2	29	0	0	29	0	29	0
Foreign government bonds	Level 2	516	1	(24)	493	5	488	0
Mortgage- and asset-backed securities	Level 2	863	1	(52)	812	0	812	0
Corporate notes and bonds	Level 2	10,443	3	(612)	9,834	0	9,834	0
Corporate notes and bonds	Level 3	122	0	0	122	0	122	0
Municipal securities	Level 2	283	1	(21)	263	0	263	0
Municipal securities	Level 3	104	0	(16)	88	0	88	0
Total debt investments		$ 73,272	$ 8	$ (4,872)	$ 68,408	$ 4,915	$ 63,493	$ 0
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				$ 70,729	$ 68,159	$ 0	$ 2,570
Equity investments	Other				8,853	0	0	8,853
Total equity investments					$ 79,582	$ 68,159	$ 0	$ 11,423
Cash					$ 7,378	$ 7,378	$ 0	$ 0
Derivatives, net [(a)]					6	0	6	0
Total					$ 155,374	$ 80,452	$ 63,499	$ 11,423

(In millions)	Fair Value Level	Adjusted Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity Investments
June 30, 2023								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 16,589	$ 0	$ 0	$ 16,589	$ 12,231	$ 4,358	$ 0
Certificates of deposit	Level 2	2,701	0	0	2,701	2,657	44	0
U.S. government securities	Level 1	65,237	2	(3,870)	61,369	2,991	58,378	0
U.S. agency securities	Level 2	2,703	0	0	2,703	894	1,809	0
Foreign government bonds	Level 2	498	1	(24)	475	0	475	0
Mortgage- and asset-backed securities	Level 2	824	1	(39)	786	0	786	0
Corporate notes and bonds	Level 2	10,809	8	(583)	10,234	0	10,234	0
Corporate notes and bonds	Level 3	120	0	0	120	0	120	0
Municipal securities	Level 2	285	1	(18)	268	7	261	0
Municipal securities	Level 3	103	0	(16)	87	0	87	0
Total debt investments		$ 99,869	$ 13	$ (4,550)	$ 95,332	$ 18,780	$ 76,552	$ 0
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				$ 10,138	$ 7,446	$ 0	$ 2,692
Equity investments	Other				7,187	0	0	7,187
Total equity investments					$ 17,325	$ 7,446	$ 0	$ 9,879
Cash					$ 8,478	$ 8,478	$ 0	$ 0
Derivatives, net [(a)]					6	0	6	0
Total					$ 121,141	$ 34,704	$ 76,558	$ 9,879

(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 using the equity method or measured at cost with adjustments for observable changes in price or impairments, and investments measured at fair value using net asset value as a practical expedient which are not categorized in the fair value hierarchy. As of both September 30, 2023 and June 30, 2023, equity investments without readily determinable fair values measured at cost with adjustments for observable changes in price or impairments were $4.2 billion.

Unrealized Losses on Debt Investments

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

(In millions)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses	Total Fair Value	Total Unrealized Losses
September 30, 2023						
U.S. government and agency securities	**$ 526**	**$ (23)**	**$ 51,241**	**$ (4,124)**	**$ 51,767**	**$ (4,147)**
Foreign government bonds	**72**	**(4)**	**411**	**(20)**	**483**	**(24)**
Mortgage- and asset-backed securities	**309**	**(12)**	**417**	**(40)**	**726**	**(52)**
Corporate notes and bonds	**2,044**	**(49)**	**7,568**	**(563)**	**9,612**	**(612)**
Municipal securities	**67**	**(1)**	**235**	**(36)**	**302**	**(37)**
Total	**$ 3,018**	**$ (89)**	**$ 59,872**	**$ (4,783)**	**$ 62,890**	**$ (4,872)**

(In millions)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses	Total Fair Value	Total Unrealized Losses
June 30, 2023						
U.S. government and agency securities	$ 7,950	$ (336)	$ 45,273	$ (3,534)	$ 53,223	$ (3,870)
Foreign government bonds	77	(5)	391	(19)	468	(24)
Mortgage- and asset-backed securities	257	(5)	412	(34)	669	(39)
Corporate notes and bonds	2,326	(49)	7,336	(534)	9,662	(583)
Municipal securities	111	(3)	186	(31)	297	(34)
Total	$ 10,721	$ (398)	$ 53,598	$ (4,152)	$ 64,319	$ (4,550)

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 September 30, 2023:

(In millions)	Adjusted Cost Basis	Estimated Fair Value
September 30, 2023		
Due in one year or less	**$ 13,575**	**$ 13,451**
Due after one year through five years	**46,882**	**44,003**
Due after five years through 10 years	**11,489**	**9,801**
Due after 10 years	**1,326**	**1,153**
Total	**$ 73,272**	**$ 68,408**

NOTE 5 — DERIVATIVES

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

Foreign Currencies

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

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

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 September 30, 2023, our long-term unsecured debt rating was AAA, and cash investments were in excess of $1.0 billion. As a result, no collateral was required to be posted.

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

(In millions)	September 30, 2023	June 30, 2023
Designated as Hedging Instruments		
Foreign exchange contracts purchased	**$ 1,492**	$ 1,492
Interest rate contracts purchased	**1,084**	1,078
Not Designated as Hedging Instruments		
Foreign exchange contracts purchased	**6,957**	7,874
Foreign exchange contracts sold	**17,026**	25,159
Equity contracts purchased	**3,548**	3,867
Equity contracts sold	**2,154**	2,154
Other contracts purchased	**1,698**	1,224
Other contracts sold	**678**	581

Fair Values of Derivative Instruments

The following table presents our derivative instruments:

(In millions)	Derivative Assets	Derivative Liabilities	Derivative Assets	Derivative Liabilities
		September 30, 2023		June 30, 2023
Designated as Hedging Instruments				
Foreign exchange contracts	$ **21**	$ **(75)**	$ 34	$ (67)
Interest rate contracts	**9**	**0**	16	0
Not Designated as Hedging Instruments				
Foreign exchange contracts	**503**	**(331)**	249	(332)
Equity contracts	**95**	**(342)**	165	(400)
Other contracts	**8**	**(24)**	5	(6)
Gross amounts of derivatives	**636**	**(772)**	469	(805)
Gross amounts of derivatives offset in the balance sheet	**(294)**	**296**	(202)	206
Cash collateral received	**0**	**(103)**	0	(125)
Net amounts of derivatives	$ **342**	$ **(579)**	$ 267	$ (724)
Reported as				
Short-term investments	$ **6**	$ **0**	$ 6	$ 0
Other current assets	**327**	**0**	245	0
Other long-term assets	**9**	**0**	16	0
Other current liabilities	**0**	**(259)**	0	(341)
Other long-term liabilities	**0**	**(320)**	0	(383)
Total	$ **342**	$ **(579)**	$ 267	$ (724)

Gross derivative assets and liabilities subject to legally enforceable master netting agreements for which we have elected to offset were $627 million and $772 million, respectively, as of September 30, 2023, and $442 million and $804 million, respectively, as of June 30, 2023.

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

(In millions)	Level 1	Level 2	Level 3	Total
September 30, 2023				
Derivative assets	$ **2**	$ **629**	$ **5**	$ **636**
Derivative liabilities	**0**	**(772)**	**0**	**(772)**
June 30, 2023				
Derivative assets	0	462	7	469
Derivative liabilities	0	(805)	0	(805)

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

(In millions)		
Three Months Ended September 30,	**2023**	**2022**
Designated as Fair Value Hedging Instruments		
Interest rate contracts		
Derivatives	**$ (16)**	$ (43)
Hedged items	**3**	43
Designated as Cash Flow Hedging Instruments		
Foreign exchange contracts		
Amount reclassified from accumulated other comprehensive loss	**(46)**	(59)
Not Designated as Hedging Instruments		
Foreign exchange contracts	**206**	240
Equity contracts	**113**	12
Other contracts	**(33)**	(10)

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

(In millions)		
Three Months Ended September 30,	**2023**	**2022**
Designated as Cash Flow Hedging Instruments		
Foreign exchange contracts		
Included in effectiveness assessment	**$ (15)**	$ (40)

NOTE 6 — INVENTORIES

The components of inventories were as follows:

(In millions)	**September 30, 2023**	**June 30, 2023**
Raw materials	**$ 520**	$ 709
Work in process	**15**	23
Finished goods	**2,465**	1,768
Total	**$ 3,000**	$ 2,500

NOTE 7 — GOODWILL

Changes in the carrying amount of goodwill were as follows:

(In millions)	**June 30, 2023**	**Acquisitions**	**Other**	**September 30, 2023**
Productivity and Business Processes	**$ 24,775**	**$ 0**	**$ (16)**	**$ 24,759**
Intelligent Cloud	**30,469**	**0**	**(49)**	**30,420**
More Personal Computing	**12,642**	**0**	**(31)**	**12,611**
Total	**$ 67,886**	**$ 0**	**$ (96)**	**$ 67,790**

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
			September 30, 2023			June 30, 2023
Technology-based	**$ 11,409**	**$ (7,904)**	**$ 3,505**	$ 11,245	$ (7,589)	$ 3,656
Customer-related	**7,281**	**(4,284)**	**2,997**	7,281	(4,047)	3,234
Marketing-related	**4,935**	**(2,555)**	**2,380**	4,935	(2,473)	2,462
Contract-based	**30**	**(17)**	**13**	29	(15)	14
Total	**$ 23,655**	**$ (14,760)**	**$ 8,895**	$ 23,490	$ (14,124)	$ 9,366

Intangible assets amortization expense was $636 million and $633 million for the three months ended September 30, 2023 and 2022, respectively.

The following table outlines the estimated future amortization expense related to intangible assets held as of September 30, 2023:

(In millions)	
Year Ending June 30,	
2024 (excluding the three months ended September 30, 2023)	**$ 1,748**
2025	**1,905**
2026	**1,407**
2027	**952**
2028	**675**
Thereafter	**2,208**
Total	**$ 8,895**

NOTE 9 — DEBT

Short-term Debt

As of September 30, 2023, we had $25.8 billion of commercial paper issued and outstanding, with a weighted average interest rate of 5.4% and maturities ranging from 7 days to 190 days. The estimated fair value of this commercial paper approximates its carrying value. As of June 30, 2023, we had no commercial paper issued or outstanding.

Long-term Debt

The components of long-term debt were as follows:

(In millions, issuance by calendar year)	Maturities (calendar year)	Stated Interest Rate	Effective Interest Rate	September 30, 2023	June 30, 2023
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	**2023 – 2043**	**3.63% – 4.88%**	**3.73% – 4.92%**	**1,814**	1,814
2013 issuance of €4.1 billion	**2028 – 2033**	**2.63% – 3.13%**	**2.69% – 3.22%**	**2,435**	2,509
2015 issuance of $23.8 billion	**2025 – 2055**	**2.70% – 4.75%**	**2.77% – 4.78%**	**9,805**	9,805
2016 issuance of $19.8 billion	**2026 – 2056**	**2.40% – 3.95%**	**2.46% – 4.03%**	**7,930**	9,430
2017 issuance of $17.0 billion	**2024 – 2057**	**2.88% – 4.50%**	**3.04% – 4.53%**	**8,945**	8,945
2020 issuance of $10.0 billion	**2050 – 2060**	**2.53% – 2.68%**	**2.53% – 2.68%**	**10,000**	10,000
2021 issuance of $8.2 billion	**2052 – 2062**	**2.92% – 3.04%**	**2.92% – 3.04%**	**8,185**	8,185
Total face value				**51,292**	52,866
Unamortized discount and issuance costs				**(431)**	(438)
Hedge fair value adjustments [(a)]				**(109)**	(106)
Premium on debt exchange				**(5,058)**	(5,085)
Total debt				**45,694**	47,237
Current portion of long-term debt				**(3,748)**	(5,247)
Long-term debt				**$ 41,946**	$ 41,990

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

As of September 30, 2023 and June 30, 2023, the estimated fair value of long-term debt, including the current portion, was $41.8 billion and $46.2 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 September 30, 2023:

(In millions)	
Year Ending June 30,	
2024 (excluding the three months ended September 30, 2023)	**$ 3,750**
2025	**2,250**
2026	**3,000**
2027	**8,000**
2028	**0**
Thereafter	**34,292**
Total	**$ 51,292**

NOTE 10 — INCOME TAXES

Effective Tax Rate

Our effective tax rate was 18% and 19% for the three months ended September 30, 2023 and 2022, respectively. The decrease in our effective tax rate for the current quarter compared to the prior year was primarily due to tax benefits from tax law changes in the first quarter of fiscal year 2024, including the impact from the issuance of Notice 2023-55 by the Internal Revenue Service (“IRS”) and U.S. Treasury Department, which delayed the effective date of final foreign tax credit regulations to fiscal year 2024 for Microsoft.

Our effective tax rate was lower than the U.S. federal statutory rate for the three months ended September 30, 2023, 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 September 30, 2023 and June 30, 2023, unrecognized tax benefits and other income tax liabilities were $19.8 billion and $18.7 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 September 30, 2023, we believe our allowances for income tax contingencies are adequate. We disagree with the proposed adjustments and will vigorously contest the NOPAs through the IRS’s administrative appeals office and, if necessary, judicial proceedings. We do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our income tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2023, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NOTE 11 — UNEARNED REVENUE

Unearned revenue by segment was as follows:

(In millions)

		September 30, 2023		June 30, 2023
Productivity and Business Processes	**$**	**25,316**	$	27,572
Intelligent Cloud		**19,471**		21,563
More Personal Computing		**4,401**		4,678
Total	**$**	**49,188**	$	53,813

Changes in unearned revenue were as follows:

(In millions)

Three Months Ended September 30, 2023		
Balance, beginning of period	**$**	**53,813**
Deferral of revenue		**27,646**
Recognition of unearned revenue		**(32,271)**
Balance, end of period	**$**	**49,188**

Revenue allocated to remaining performance obligations, which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods, was $216 billion as of September 30, 2023, of which $212 billion is related to the commercial portion of revenue. We expect to recognize approximately 45% of this revenue over the next 12 months and the remainder thereafter.

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 18 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 September 30,		**2023**		**2022**
Operating lease cost	**$**	**775**	$	662
Finance lease cost:				
Amortization of right-of-use assets	**$**	**380**	$	189
Interest on lease liabilities		**149**		113
Total finance lease cost	**$**	**529**	$	302

Supplemental cash flow information related to leases was as follows:

(In millions)

Three Months Ended September 30,		**2023**		**2022**
Cash paid for amounts included in the measurement of lease liabilities:				
Operating cash flows from operating leases	**$**	**795**	$	654
Operating cash flows from finance leases		**149**		113
Financing cash flows from finance leases		**285**		256
Right-of-use assets obtained in exchange for lease obligations:				
Operating leases		**1,804**		1,189
Finance leases		**1,704**		611

Supplemental balance sheet information related to leases was as follows:

(In millions, except lease term and discount rate)

	September 30, 2023	June 30, 2023
Operating Leases		
Operating lease right-of-use assets	**$ 15,435**	$ 14,346
Other current liabilities	**$ 2,538**	$ 2,409
Operating lease liabilities	**13,487**	12,728
Total operating lease liabilities	**$ 16,025**	$ 15,137
Finance Leases		
Property and equipment, at cost	**$ 21,892**	$ 20,538
Accumulated depreciation	**(4,949)**	(4,647)
Property and equipment, net	**$ 16,943**	$ 15,891
Other current liabilities	**$ 1,577**	$ 1,197
Other long-term liabilities	**16,577**	15,870
Total finance lease liabilities	**$ 18,154**	$ 17,067
Weighted Average Remaining Lease Term		
Operating leases	**8 years**	8 years
Finance leases	**11 years**	11 years
Weighted Average Discount Rate		
Operating leases	**3.1%**	2.9%
Finance leases	**3.6%**	3.4%

The following table outlines maturities of our lease liabilities as of September 30, 2023:

(In millions)

Year Ending June 30,	Operating Leases	Finance Leases
2024 (excluding the three months ended September 30, 2023)	**$ 2,287**	**$ 1,378**
2025	**2,834**	**2,196**
2026	**2,365**	**1,883**
2027	**1,961**	**1,890**
2028	**1,767**	**1,900**
Thereafter	**6,803**	**12,934**
Total lease payments	**18,017**	**22,181**
Less imputed interest	**(1,992)**	**(4,027)**
Total	**$ 16,025**	**$ 18,154**

As of September 30, 2023, we had additional operating and finance leases, primarily for datacenters, that had not yet commenced of $7.5 billion and $75.1 billion, respectively. These operating and finance leases will commence between fiscal year 2024 and fiscal year 2030 with lease terms of 1 year to 18 years.

NOTE 13 — CONTINGENCIES

U.S. Cell Phone Litigation

Microsoft Mobile Oy, a subsidiary of Microsoft, along with other handset manufacturers and network operators, is a defendant in 46 lawsuits, including 45 lawsuits filed in the Superior Court for the District of Columbia by individual plaintiffs who allege that radio emissions from cellular handsets caused their brain tumors and other adverse health effects. We assumed responsibility for these claims in our agreement to acquire Nokia's Devices and Services business and have been substituted for the Nokia defendants. Nine of these cases were filed in 2002 and are consolidated for certain pre-trial proceedings; the remaining cases are stayed. In a separate 2009 decision, the Court of Appeals for the District of Columbia held that adverse health effect claims arising from the use of cellular handsets that operate within the U.S. Federal Communications Commission radio frequency emission guidelines ("FCC Guidelines") are pre-empted by federal law. The plaintiffs allege that their handsets either operated outside the FCC Guidelines or were manufactured before the FCC Guidelines went into effect. The lawsuits also allege an industry-wide conspiracy to manipulate the science and testing around emission guidelines.

In 2013, the defendants in the consolidated cases moved to exclude the plaintiffs' expert evidence of general causation on the basis of flawed scientific methodologies. In 2014, the trial court granted in part and denied in part the defendants' motion to exclude the plaintiffs' general causation experts. The defendants filed an interlocutory appeal to the District of Columbia Court of Appeals challenging the standard for evaluating expert scientific evidence. In October 2016, the Court of Appeals issued its decision adopting the standard advocated by the defendants and remanding the cases to the trial court for further proceedings under that standard. The plaintiffs have filed supplemental expert evidence, portions of which were stricken by the court. A hearing on general causation took place in September of 2022. In April of 2023, the court granted defendants' motion to strike the testimony of plaintiffs' experts that cell phones cause brain cancer and entered an order excluding all of plaintiffs' experts from testifying. The plaintiffs appealed the court's order in August of 2023.

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 April 2023, the IDPC provided LinkedIn with a non-public preliminary draft decision alleging GDPR violations and proposing a fine. Microsoft intends to challenge the preliminary draft decision. There is no set timeline for the IDPC to issue a final decision.

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 September 30, 2023, we accrued aggregate legal liabilities of $597 million. While we intend to defend these matters vigorously, adverse outcomes that we estimate could reach approximately $600 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, has no expiration date, and may be terminated at any time. As of September 30, 2023, $18.7 billion remained of this $60.0 billion share repurchase program.

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

(In millions)	Shares	Amount	Shares	Amount
Fiscal Year		**2024**		**2023**
First Quarter	**11**	**$ 3,560**	17	$ 4,600

All repurchases were made using cash resources. All shares repurchased were under the share repurchase program approved on September 14, 2021. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards of $1.3 billion and $973 million for the first quarter of fiscal years 2024 and 2023, respectively.

Dividends

Our Board of Directors declared the following dividends:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
Fiscal Year 2024				**(In millions)**
September 19, 2023	**November 16, 2023**	**December 14, 2023**	**$ 0.75**	**$ 5,573**
Fiscal Year 2023				
September 20, 2022	November 17, 2022	December 8, 2022	$ 0.68	$ 5,066

The dividend declared on September 19, 2023 was included in other current liabilities as of September 30, 2023.

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 September 30,	**2023**	**2022**
Derivatives		
Balance, beginning of period	**$ (27)**	$ (13)
Unrealized losses, net of tax of **$(4)** and $(11)	**(15)**	(40)
Reclassification adjustments for losses included in other income (expense), net	**46**	59
Tax benefit included in provision for income taxes	**(10)**	(12)
Amounts reclassified from accumulated other comprehensive loss	**36**	47
Net change related to derivatives, net of tax of **$6** and $1	**21**	7
Balance, end of period	**$ (6)**	$ (6)
Investments		
Balance, beginning of period	**$ (3,582)**	$ (2,138)
Unrealized losses, net of tax of **$(75)** and $(510)	**(283)**	(1,925)
Reclassification adjustments for losses included in other income (expense), net	**29**	35
Tax benefit included in provision for income taxes	**(6)**	(7)
Amounts reclassified from accumulated other comprehensive loss	**23**	28
Net change related to investments, net of tax of **$(69)** and $(503)	**(260)**	(1,897)
Balance, end of period	**$ (3,842)**	$ (4,035)
Translation Adjustments and Other		
Balance, beginning of period	**$ (2,734)**	$ (2,527)
Translation adjustments and other, net of tax of **$0** and $0	**(355)**	(775)
Balance, end of period	**$ (3,089)**	$ (3,302)
Accumulated other comprehensive loss, end of period	**$ (6,937)**	$ (7,343)

NOTE 16 — SEGMENT INFORMATION AND GEOGRAPHIC DATA

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

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:

- Office Commercial (Office 365 subscriptions, the Office 365 portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises), comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, Microsoft Viva, and Microsoft 365 Copilot.
- Office Consumer, including Microsoft 365 Consumer subscriptions, Office licensed on-premises, and other Office services.

- LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions.
- Dynamics business solutions, including Dynamics 365, comprising a set of intelligent, cloud-based applications across ERP, CRM (including Customer Insights), Power Apps, and Power Automate; and on-premises ERP and CRM applications.

Intelligent Cloud

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

- Server products and cloud services, including Azure and other cloud services; SQL Server, Windows Server, Visual Studio, System Center, and related Client Access Licenses ("CALs"); and Nuance and GitHub.
- 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, including Windows original equipment manufacturer ("OEM") licensing and other non-volume licensing of the Windows operating system; Windows Commercial, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings; patent licensing; and Windows Internet of Things.
- Devices, including Surface, HoloLens, and PC accessories.
- Gaming, including Xbox hardware and Xbox content and services, comprising first- and third-party content (including games and in-game content), Xbox Game Pass and other subscriptions, Xbox Cloud Gaming, advertising, third-party disc royalties, and other cloud services.
- Search and news advertising, comprising Bing (including Bing Chat), Microsoft News, Microsoft Edge, and third-party affiliates.

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

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

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

(In millions)

Three Months Ended September 30,	**2023**	**2022**
Revenue		
Productivity and Business Processes	**$ 18,592**	$ 16,465
Intelligent Cloud	**24,259**	20,325
More Personal Computing	**13,666**	13,332
Total	**$ 56,517**	$ 50,122
Operating Income		
Productivity and Business Processes	**$ 9,970**	$ 8,323
Intelligent Cloud	**11,751**	8,978
More Personal Computing	**5,174**	4,217
Total	**$ 26,895**	$ 21,518

No sales to an individual customer or country other than the United States accounted for more than 10% of revenue for the three months ended September 30, 2023 or 2022. Revenue, classified by the major geographic areas in which our customers were located, was as follows:

(In millions)

Three Months Ended September 30,	**2023**	**2022**
United States [(a)]	**$ 28,812**	$ 25,867
Other countries	**27,705**	24,255
Total	**$ 56,517**	$ 50,122

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

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

(In millions)

Three Months Ended September 30,	**2023**	**2022**
Server products and cloud services	**$ 22,308**	$ 18,388
Office products and cloud services	**13,140**	11,577
Windows	**5,567**	5,313
Gaming	**3,919**	3,610
LinkedIn	**3,913**	3,628
Search and news advertising	**3,053**	2,913
Enterprise and partner services	**1,944**	1,929
Dynamics	**1,540**	1,260
Devices	**1,125**	1,448
Other	**8**	56
Total	**$ 56,517**	$ 50,122

We have recast certain prior period amounts to conform to the way we internally manage and monitor our business.

Our Microsoft Cloud revenue, which includes Azure and other cloud services, Office 365 Commercial, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties, was $31.8 billion and $25.7 billion for the three months ended September 30, 2023 and 2022, respectively. These amounts are primarily included in Server products and cloud services, Office products and cloud services, LinkedIn, and Dynamics 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.

NOTE 17 — SUBSEQUENT EVENT

On October 13, 2023, we completed our acquisition of Activision Blizzard, Inc. (“Activision Blizzard”) for a cash payment of $61.8 billion, net of cash acquired. Activision Blizzard is a leader in game development and an interactive entertainment content publisher. The acquisition will accelerate the growth in our gaming business across mobile, PC, console, and cloud gaming.

Due to the limited amount of time since closing the transaction, the preliminary allocation of the purchase price is not yet complete. The initial purchase price allocation will be provided within our Form 10-Q for the second quarter of fiscal year 2024, and we expect most of the purchase price will be allocated to goodwill and other identifiable intangible assets. Activision Blizzard will be included in our consolidated financial statements beginning on the date of acquisition and reported as part of our More Personal Computing segment.

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 September 30, 2023, the related consolidated statements of income, comprehensive income, cash flows, and stockholders' equity for the three-month periods ended September 30, 2023 and 2022, 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, 2023, 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 27, 2023, 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, 2023, 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
October 24, 2023

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, 2023, and our financial statements and the accompanying Notes to Financial Statements (Part I, Item 1 of this Form 10-Q).

OVERVIEW

Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. We are creating the platforms and tools, powered by artificial intelligence (“AI”), that deliver better, faster, and more effective solutions to support small and large business competitiveness, improve educational and health outcomes, grow public-sector efficiency, and empower human ingenuity.

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 first quarter of fiscal year 2024 compared with the first quarter of fiscal year 2023 included:

- Microsoft Cloud revenue increased 24% to $31.8 billion.
- Office Commercial products and cloud services revenue increased 15% driven by Office 365 Commercial growth of 18%.
- Office Consumer products and cloud services revenue increased 3% and Microsoft 365 Consumer subscribers grew to 76.7 million.
- LinkedIn revenue increased 8%.
- Dynamics products and cloud services revenue increased 22% driven by Dynamics 365 growth of 28%.
- Server products and cloud services revenue increased 21% driven by Azure and other cloud services growth of 29%.
- Windows revenue increased 5% with Windows original equipment manufacturer licensing (“Windows OEM”) revenue growth of 4% and Windows Commercial products and cloud services revenue growth of 8%.
- Devices revenue decreased 22%.
- Xbox content and services revenue increased 13%.
- Search and news advertising revenue excluding traffic acquisition costs increased 10%.

Industry Trends

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

Economic Conditions, Challenges, and Risks

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

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

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

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

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

Seasonality

Our revenue fluctuates quarterly and is generally higher in the second and fourth quarters of our fiscal year. Second quarter revenue is driven by corporate year-end spending trends in our major markets and holiday season spending by consumers, and fourth quarter revenue is driven by the volume of multi-year on-premises contracts executed during the period.

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 2024, we made updates to the presentation and method of calculation for certain metrics, revising our Microsoft Cloud revenue metric to include revenue growth and expanding our Microsoft 365 Consumer subscribers metric to include Microsoft 365 Basic subscribers, aligning with how we manage our business.

Commercial

Our commercial business primarily consists of Server products and cloud services, Office Commercial, Windows Commercial, the commercial portion of LinkedIn, Enterprise and partner services, and Dynamics. 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 Azure and other cloud services, Office 365 Commercial, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties
Microsoft Cloud gross margin percentage	Gross margin percentage for our Microsoft Cloud business

Productivity and Business Processes and Intelligent Cloud

Metrics related to our Productivity and Business Processes and Intelligent Cloud segments assess the health of our core businesses within these segments. The metrics reflect our cloud and on-premises product strategies and trends.

Office Commercial products and cloud services revenue growth	Revenue from Office Commercial products and cloud services (Office 365 subscriptions, the Office 365 portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises), comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, Microsoft Viva, and Microsoft 365 Copilot
Office Consumer products and cloud services revenue growth	Revenue from Office Consumer products and cloud services, including Microsoft 365 Consumer subscriptions, Office licensed on-premises, and other Office services
Office 365 Commercial seat growth	The number of Office 365 Commercial seats at end of period where seats are paid users covered by an Office 365 Commercial subscription
Microsoft 365 Consumer subscribers	The number of Microsoft 365 Consumer subscribers at end of period
Dynamics products and cloud services revenue growth	Revenue from Dynamics products and cloud services, including Dynamics 365, comprising a set of intelligent, cloud-based applications across ERP, CRM (including Customer Insights), Power Apps, and Power Automate; and on-premises ERP and CRM applications
LinkedIn revenue growth	Revenue from LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions
Server products and cloud services revenue growth	Revenue from Server products and cloud services, including Azure and other cloud services; SQL Server, Windows Server, Visual Studio, System Center, and related Client Access Licenses ("CALs"); and Nuance and GitHub

More Personal Computing

Metrics related to our More Personal Computing segment assess the performance of key lines of business within this segment. These metrics provide strategic product insights which allow us to assess the performance across our commercial and consumer businesses. As we have diversity of target audiences and sales motions within the Windows business, we monitor metrics that are reflective of those varying motions.

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

SUMMARY RESULTS OF OPERATIONS

(In millions, except percentages and per share amounts)	**Three Months Ended September 30,**		**Percentage Change**
	2023	**2022**	
Revenue	**$ 56,517**	$ 50,122	13%
Gross margin	**40,215**	34,670	16%
Operating income	**26,895**	21,518	25%
Net income	**22,291**	17,556	27%
Diluted earnings per share	**2.99**	2.35	27%

Three Months Ended September 30, 2023 Compared with Three Months Ended September 30, 2022

Revenue increased $6.4 billion or 13% driven by growth in Intelligent Cloud and Productivity and Business Processes. Intelligent Cloud revenue increased driven by Azure and other cloud services. Productivity and Business Processes revenue increased driven by Office 365 Commercial. More Personal Computing revenue increased driven by growth in Gaming and Windows, offset in part by a decline in Devices.

Cost of revenue increased $850 million or 6% driven by growth in Microsoft Cloud, offset in part by a decline in Devices.

Gross margin increased $5.5 billion or 16% driven by growth across each of our segments.

- Gross margin percentage increased. Excluding the impact of the prior year change in accounting estimate for the useful lives of our server and network equipment, gross margin percentage increased 3 points driven by improvements across each of our segments.
- Microsoft Cloud gross margin percentage increased slightly to 73%. Excluding the impact of the change in accounting estimate, Microsoft Cloud gross margin percentage increased 2 points driven by improvement in Azure and other cloud services and Office 365 Commercial.

Operating expenses increased $168 million or 1% driven by marketing, LinkedIn, and cloud engineering, offset in part by a decline in Devices.

Operating income increased $5.4 billion or 25% driven by growth across each of our segments.

SEGMENT RESULTS OF OPERATIONS

(In millions, except percentages)	Three Months Ended September 30, 2023	2022	Percentage Change
Revenue			
Productivity and Business Processes	**$ 18,592**	$ 16,465	13%
Intelligent Cloud	**24,259**	20,325	19%
More Personal Computing	**13,666**	13,332	3%
Total	**$ 56,517**	$ 50,122	13%
Operating Income			
Productivity and Business Processes	**$ 9,970**	$ 8,323	20%
Intelligent Cloud	**11,751**	8,978	31%
More Personal Computing	**5,174**	4,217	23%
Total	**$ 26,895**	$ 21,518	25%

Reportable Segments

Three Months Ended September 30, 2023 Compared with Three Months Ended September 30, 2022

Productivity and Business Processes

Revenue increased $2.1 billion or 13%.

- Office Commercial products and cloud services revenue increased $1.5 billion or 15%. Office 365 Commercial revenue grew 18% with seat growth of 10%, driven by small and medium business and frontline worker offerings, as well as growth in revenue per user. Office Commercial products revenue declined 17% driven by continued customer shift to cloud offerings.
- Office Consumer products and cloud services revenue increased $44 million or 3%. Microsoft 365 Consumer subscribers grew 18% to 76.7 million.
- LinkedIn revenue increased $285 million or 8% primarily driven by Talent Solutions.
- Dynamics products and cloud services revenue increased $280 million or 22% driven by Dynamics 365 growth of 28%.

Operating income increased $1.6 billion or 20%.

- Gross margin increased $1.8 billion or 13% driven by growth in Office 365 Commercial. Gross margin percentage increased slightly. Excluding the impact of the change in accounting estimate, gross margin percentage increased 1 point driven by improvement in Office 365 Commercial.
- Operating expenses increased $119 million or 2% primarily driven by LinkedIn.

Intelligent Cloud

Revenue increased $3.9 billion or 19%.

- Server products and cloud services revenue increased $3.9 billion or 21% driven by Azure and other cloud services. Azure and other cloud services revenue grew 29% driven by growth in our consumption-based services. Server products revenue increased 2% driven by demand for Windows Server and SQL Server running in multi-cloud environments, offset in part by continued customer shift to cloud offerings.
- Enterprise and partner services revenue increased $15 million or 1% driven by growth in Enterprise Support Services, offset in part by a decline in Industry Solutions.

Operating income increased $2.8 billion or 31%.

- Gross margin increased $2.9 billion or 20% driven by growth in Azure and other cloud services. Gross margin percentage increased slightly. Excluding the impact of the change in accounting estimate, gross margin percentage increased 2 points driven by improvement in Azure and other cloud services.
- Operating expenses increased $86 million or 2% driven by investments in Azure and other cloud services.

More Personal Computing

Revenue increased $334 million or 3%.

- Windows revenue increased $254 million or 5% driven by growth in Windows Commercial and Windows OEM. Windows Commercial products and cloud services revenue increased 8% driven by demand for Microsoft 365. Windows OEM revenue increased 4%.
- Gaming revenue increased $309 million or 9% driven by growth in Xbox content and services. Xbox content and services revenue increased 13% driven by growth in first-party content and Xbox Game Pass. Xbox hardware revenue decreased 7% driven by lower volume of consoles sold, offset in part by higher price of consoles sold.
- Search and news advertising revenue increased $140 million or 5%. Search and news advertising revenue excluding traffic acquisition costs increased 10% driven by higher search volume.
- Devices revenue decreased $323 million or 22%.

Operating income increased $957 million or 23%.

- Gross margin increased $920 million or 13% driven by growth in Gaming and Windows. Gross margin percentage increased primarily driven by sales mix shift.
- Operating expenses decreased $37 million or 1% driven by a decline in Devices, offset in part by investments in Gaming.

OPERATING EXPENSES

Research and Development

(In millions, except percentages)		Three Months Ended September 30,			Percentage Change
		2023		2022	
Research and development	**$**	**6,659**	$	6,628	0%
As a percent of revenue		**12%**		13%	(1)ppt

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

Three Months Ended September 30, 2023 Compared with Three Months Ended September 30, 2022

Research and development expenses increased slightly driven by cloud engineering, LinkedIn, and Windows, offset in part by a decline in Devices.

Sales and Marketing

(In millions, except percentages)		Three Months Ended September 30,			Percentage Change
		2023		2022	
Sales and marketing	**$**	**5,187**	$	5,126	1%
As a percent of revenue		**9%**		10%	(1)ppt

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

Three Months Ended September 30, 2023 Compared with Three Months Ended September 30, 2022

Sales and marketing expenses increased $61 million or 1% driven by investments in Gaming.

General and Administrative

(In millions, except percentages)	Three Months Ended September 30, 2023	2022	Percentage Change
General and administrative	**$ 1,474**	$ 1,398	5%
As a percent of revenue	**3%**	3%	0ppt

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

Three Months Ended September 30, 2023 Compared with Three Months Ended September 30, 2022

General and administrative expenses increased $76 million or 5% driven by legal expenses.

OTHER INCOME (EXPENSE), NET

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

(In millions) Three Months Ended September 30,	2023	2022
Interest and dividends income	**$ 1,166**	$ 641
Interest expense	**(525)**	(500)
Net recognized gains (losses) on investments	**(107)**	13
Net gains on derivatives	**93**	9
Net losses on foreign currency remeasurements	**(101)**	(78)
Other, net	**(137)**	(31)
Total	**$ 389**	$ 54

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

Three Months Ended September 30, 2023 Compared with Three Months Ended September 30, 2022

Interest and dividends income increased due to higher yields and higher portfolio balances. Interest expense increased due to the issuance of commercial paper. Net recognized losses on investments increased due to losses on equity securities in the current period as opposed to gains in the prior period. Net gains on derivatives increased due to higher gains on equity derivatives.

INCOME TAXES

Effective Tax Rate

Our effective tax rate was 18% and 19% for the three months ended September 30, 2023 and 2022, respectively. The decrease in our effective tax rate for the current quarter compared to the prior year was primarily due to tax benefits from tax law changes in the first quarter of fiscal year 2024, including the impact from the issuance of Notice 2023-55 by the Internal Revenue Service (“IRS”) and U.S. Treasury Department, which delayed the effective date of final foreign tax credit regulations to fiscal year 2024 for Microsoft.

Our effective tax rate was lower than the U.S. federal statutory rate for the three months ended September 30, 2023, 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 September 30, 2023, we believe our allowances for income tax contingencies are adequate. We disagree with the proposed adjustments and will vigorously contest the NOPAs through the IRS’s administrative appeals office and, if necessary, judicial proceedings. We do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our income tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2023, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

LIQUIDITY AND CAPITAL RESOURCES

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

Cash, Cash Equivalents, and Investments

Cash, cash equivalents, and short-term investments totaled $144.0 billion and $111.3 billion as of September 30, 2023 and June 30, 2023, respectively. Equity investments were $11.4 billion and $9.9 billion as of September 30, 2023 and June 30, 2023, respectively. Our short-term investments are primarily intended to facilitate liquidity and capital preservation. They consist predominantly of highly liquid investment-grade fixed-income securities, diversified among industries and individual issuers. The investments are predominantly U.S. dollar-denominated securities, but also include foreign currency-denominated securities to diversify risk. Our fixed-income investments are exposed to interest rate risk and credit risk. The credit risk and average maturity of our fixed-income portfolio are managed to achieve economic returns that correlate to certain fixed-income indices. The settlement risk related to these investments is insignificant given that the short-term investments held are primarily highly liquid investment-grade fixed-income securities.

Valuation

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

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

Cash Flows

Cash from operations increased $7.4 billion to $30.6 billion for the three months ended September 30, 2023, mainly due to an increase in cash received from customers and a decrease in cash paid to suppliers. Cash from financing increased $25.6 billion to $14.8 billion for the three months ended September 30, 2023, mainly due to a $25.3 billion increase in proceeds from issuance of debt, net of repayments. Cash from investing increased $3.6 billion to $503 million for the three months ended September 30, 2023, mainly due to an $8.2 billion increase in cash from net investment purchases, sales, and maturities, offset in part by a $3.6 billion increase in cash used for additions to property and equipment.

Debt Proceeds

We issue debt to take advantage of favorable pricing and liquidity in the debt markets, reflecting our credit rating. 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) for further discussion.

Unearned Revenue

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

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

(In millions)		
Three Months Ending		
December 31, 2023	$	**21,006**
March 31, 2024		**14,860**
June 30, 2024		**8,551**
September 30, 2024		**2,012**
Thereafter		**2,759**
Total	$	**49,188**

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) for further discussion.

Material Cash Requirements and Other Obligations

Income Taxes

As a result of the TCJA, we are required to pay a one-time transition tax on deferred foreign income not previously subject to U.S. income tax. Under the TCJA, the transition tax is payable in interest-free installments over eight years, with 8% due in each of the first five years, 15% in year six, 20% in year seven, and 25% in year eight. As of September 30, 2023, we had a remaining transition tax liability of $7.7 billion, of which $3.7 billion is short-term and payable in the first quarter of fiscal year 2025.

Share Repurchases

For the three months ended September 30, 2023 and 2022, we repurchased 11 million shares and 17 million shares of our common stock for $3.6 billion and $4.6 billion, respectively, through our share repurchase program. All repurchases were made using cash resources. As of September 30, 2023, $18.7 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) for further discussion.

Dividends

For the three months ended September 30, 2023 and 2022, our Board of Directors declared quarterly dividends of $0.75 per share and $0.68 per share, totaling $5.6 billion and $5.1 billion, respectively. We intend to continue returning capital to shareholders in the form of dividends, subject to declaration by our Board of Directors. Refer to Note 14 – Stockholders' Equity of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

Other Planned Uses of Capital

On October 13, 2023, we completed our acquisition of Activision Blizzard, Inc. for a cash payment of $61.8 billion, net of cash acquired.

We will continue to invest in sales, marketing, product support infrastructure, and existing and advanced areas of technology, as well as acquisitions that align with our business strategy. Additions to property and equipment will continue, including new facilities, datacenters, and computer systems for research and development, sales and marketing, support, and administrative staff. We expect capital expenditures to increase in coming years to support growth in our cloud offerings and our investments in AI infrastructure. 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.

CRITICAL ACCOUNTING ESTIMATES

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

Revenue Recognition

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

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

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

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

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

Impairment of Investment Securities

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

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

Goodwill

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

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

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

Research and Development Costs

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

Legal and Other Contingencies

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

Income Taxes

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

Inventories

Inventories are stated at average cost, subject to the lower of cost or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. Net realizable value is the estimated selling price less estimated costs of completion, disposal, and transportation. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. These reviews include analysis of demand forecasts, product life cycle status, product development plans, current sales levels, pricing strategy, and component cost trends. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue.

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 March 31, 2023

OR

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

For the Transition Period From to

Commission File Number 001-37845

MICROSOFT CORPORATION

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

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 April 20, 2023**
Common Stock, $0.00000625 par value per share	7,435,487,575 shares

MICROSOFT CORPORATION

FORM 10-Q

For the Quarter Ended March 31, 2023

INDEX

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INCOME STATEMENTS

(In millions, except per share amounts) (Unaudited)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2023	2022	2023	2022
Revenue:				
Product	$ **15,588**	$ 17,366	$ **47,846**	$ 54,776
Service and other	**37,269**	31,994	**107,880**	91,629
Total revenue	**52,857**	49,360	**155,726**	146,405
Cost of revenue:				
Product	**3,941**	4,584	**13,933**	14,707
Service and other	**12,187**	11,031	**35,135**	31,514
Total cost of revenue	**16,128**	15,615	**49,068**	46,221
Gross margin	**36,729**	33,745	**106,658**	100,184
Research and development	**6,984**	6,306	**20,456**	17,663
Sales and marketing	**5,750**	5,595	**16,555**	15,521
General and administrative	**1,643**	1,480	**5,378**	4,151
Operating income	**22,352**	20,364	**64,269**	62,849
Other income (expense), net	**321**	(174)	**315**	380
Income before income taxes	**22,673**	20,190	**64,584**	63,229
Provision for income taxes	**4,374**	3,462	**12,304**	7,231
Net income	$ **18,299**	$ 16,728	$ **52,280**	$ 55,998
Earnings per share:				
Basic	$ **2.46**	$ 2.23	$ **7.02**	$ 7.46
Diluted	$ **2.45**	$ 2.22	$ **6.99**	$ 7.41
Weighted average shares outstanding:				
Basic	**7,441**	7,493	**7,450**	7,504
Diluted	**7,464**	7,534	**7,474**	7,552

Refer to accompanying notes.

COMPREHENSIVE INCOME STATEMENTS

(In millions) (Unaudited)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2023	**2022**	**2023**	**2022**
Net income	**$ 18,299**	$ 16,728	**$ 52,280**	$ 55,998
Other comprehensive income (loss), net of tax:				
Net change related to derivatives	**(9)**	6	**(34)**	8
Net change related to investments	**753**	(2,882)	**(796)**	(4,047)
Translation adjustments and other	**69**	(37)	**(136)**	(259)
Other comprehensive income (loss)	**813**	(2,913)	**(966)**	(4,298)
Comprehensive income	**$ 19,112**	$ 13,815	**$ 51,314**	$ 51,700

Refer to accompanying notes.

BALANCE SHEETS

(In millions) (Unaudited)

	March 31, 2023	June 30, 2022
Assets		
Current assets:		
Cash and cash equivalents	**$ 26,562**	$ 13,931
Short-term investments	**77,865**	90,826
Total cash, cash equivalents, and short-term investments	**104,427**	104,757
Accounts receivable, net of allowance for doubtful accounts of **$495** and $633	**37,420**	44,261
Inventories	**2,877**	3,742
Other current assets	**19,165**	16,924
Total current assets	**163,889**	169,684
Property and equipment, net of accumulated depreciation of **$65,998** and $59,660	**88,132**	74,398
Operating lease right-of-use assets	**13,879**	13,148
Equity investments	**9,415**	6,891
Goodwill	**67,940**	67,524
Intangible assets, net	**9,879**	11,298
Other long-term assets	**26,954**	21,897
Total assets	**$ 380,088**	$ 364,840
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	**$ 15,305**	$ 19,000
Current portion of long-term debt	**6,245**	2,749
Accrued compensation	**10,411**	10,661
Short-term income taxes	**4,163**	4,067
Short-term unearned revenue	**36,903**	45,538
Other current liabilities	**12,664**	13,067
Total current liabilities	**85,691**	95,082
Long-term debt	**41,965**	47,032
Long-term income taxes	**25,000**	26,069
Long-term unearned revenue	**2,698**	2,870
Deferred income taxes	**302**	230
Operating lease liabilities	**12,312**	11,489
Other long-term liabilities	**17,437**	15,526
Total liabilities	**185,405**	198,298
Commitments and contingencies		
Stockholders' equity:		
Common stock and paid-in capital – shares authorized 24,000; outstanding **7,437** and 7,464	**92,093**	86,939
Retained earnings	**108,234**	84,281
Accumulated other comprehensive loss	**(5,644)**	(4,678)
Total stockholders' equity	**194,683**	166,542
Total liabilities and stockholders' equity	**$ 380,088**	$ 364,840

Refer to accompanying notes.

CASH FLOWS STATEMENTS

(In millions) (Unaudited)	Three Months Ended March 31, 2023	Three Months Ended March 31, 2022	Nine Months Ended March 31, 2023	Nine Months Ended March 31, 2022
Operations				
Net income	**$ 18,299**	$ 16,728	**$ 52,280**	$ 55,998
Adjustments to reconcile net income to net cash from operations:				
Depreciation, amortization, and other	**3,549**	3,773	**9,987**	10,481
Stock-based compensation expense	**2,465**	1,906	**7,195**	5,505
Net recognized losses (gains) on investments and derivatives	**(40)**	105	**152**	(566)
Deferred income taxes	**(1,675)**	(198)	**(4,171)**	(5,985)
Changes in operating assets and liabilities:				
Accounts receivable	**(1,408)**	857	**7,157**	5,800
Inventories	**106**	(279)	**868**	(662)
Other current assets	**1,152**	91	**428**	1,861
Other long-term assets	**(554)**	(724)	**(1,285)**	(2,230)
Accounts payable	**(407)**	520	**(4,032)**	284
Unearned revenue	**(181)**	(209)	**(8,689)**	(7,437)
Income taxes	**1,414**	1,091	**(1,039)**	1,687
Other current liabilities	**1,715**	1,287	**(490)**	(1,111)
Other long-term liabilities	**6**	438	**451**	781
Net cash from operations	**24,441**	25,386	**58,812**	64,406
Financing				
Repayments of debt	**0**	(4,197)	**(1,750)**	(9,023)
Common stock issued	**536**	477	**1,354**	1,380
Common stock repurchased	**(5,509)**	(8,822)	**(16,541)**	(23,939)
Common stock cash dividends paid	**(5,059)**	(4,645)	**(14,746)**	(13,503)
Other, net	**(258)**	(158)	**(839)**	(522)
Net cash used in financing	**(10,290)**	(17,345)	**(32,522)**	(45,607)
Investing				
Additions to property and equipment	**(6,607)**	(5,340)	**(19,164)**	(17,015)
Acquisition of companies, net of cash acquired, and purchases of intangible and other assets	**(301)**	(18,719)	**(1,329)**	(20,775)
Purchases of investments	**(9,063)**	(8,723)	**(25,675)**	(21,537)
Maturities of investments	**13,154**	1,099	**26,744**	15,214
Sales of investments	**1,239**	16,693	**8,725**	25,218
Other, net	**(1,686)**	(1,181)	**(2,847)**	(1,687)
Net cash used in investing	**(3,264)**	(16,171)	**(13,546)**	(20,582)
Effect of foreign exchange rates on cash and cash equivalents	**29**	24	**(113)**	57
Net change in cash and cash equivalents	**10,916**	(8,106)	**12,631**	(1,726)
Cash and cash equivalents, beginning of period	**15,646**	20,604	**13,931**	14,224
Cash and cash equivalents, end of period	**$ 26,562**	$ 12,498	**$ 26,562**	$ 12,498

Refer to accompanying notes.

STOCKHOLDERS' EQUITY STATEMENTS

(In millions, except per share amounts) (Unaudited)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2023	**2022**	**2023**	**2022**
Common stock and paid-in capital				
Balance, beginning of period	**$ 90,225**	$ 84,528	**$ 86,939**	$ 83,111
Common stock issued	**536**	477	**1,354**	1,380
Common stock repurchased	**(1,133)**	(1,313)	**(3,394)**	(4,401)
Stock-based compensation expense	**2,465**	1,906	**7,195**	5,505
Other, net	**0**	169	**(1)**	172
Balance, end of period	**92,093**	85,767	**92,093**	85,767
Retained earnings				
Balance, beginning of period	**99,368**	75,045	**84,281**	57,055
Net income	**18,299**	16,728	**52,280**	55,998
Common stock cash dividends	**(5,053)**	(4,634)	**(15,176)**	(13,931)
Common stock repurchased	**(4,380)**	(7,506)	**(13,151)**	(19,489)
Balance, end of period	**108,234**	79,633	**108,234**	79,633
Accumulated other comprehensive loss				
Balance, beginning of period	**(6,457)**	437	**(4,678)**	1,822
Other comprehensive income (loss)	**813**	(2,913)	**(966)**	(4,298)
Balance, end of period	**(5,644)**	(2,476)	**(5,644)**	(2,476)
Total stockholders' equity	**$ 194,683**	$ 162,924	**$ 194,683**	$ 162,924
Cash dividends declared per common share	**$ 0.68**	$ 0.62	**$ 2.04**	$ 1.86

Refer to accompanying notes.

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 — ACCOUNTING POLICIES

Accounting Principles

Our unaudited interim consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). In the opinion of management, the unaudited interim consolidated financial statements reflect all adjustments of a normal recurring nature that are necessary for a fair presentation of the results for the interim periods presented. Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with information included in the Microsoft Corporation fiscal year 2022 Form 10-K filed with the U.S. Securities and Exchange Commission on July 28, 2022.

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 (“SSP”) of performance obligations, variable consideration, and other obligations such as product returns and refunds; loss contingencies; product warranties; the fair value of and/or potential impairment of goodwill and intangible assets for our reporting units; product life cycles; useful lives of our tangible and intangible assets; allowances for doubtful accounts; the market value of, and demand for, our inventory; stock-based compensation forfeiture rates; when technological feasibility is achieved for our products; the potential outcome of uncertain tax positions that have been recognized in our consolidated financial statements or tax returns; and determining the timing and amount of impairments for investments. Actual results and outcomes may differ from management’s estimates and assumptions due to risks and uncertainties.

In July 2022, we completed an assessment of the useful lives of our server and network equipment. Due to investments in software that increased efficiencies in how we operate our server and network equipment, as well as advances in technology, we determined we should increase the estimated useful lives of both server and network equipment from four years to six years. This change in accounting estimate was effective beginning fiscal year 2023. Based on the carrying amount of server and network equipment included in property and equipment, net as of June 30, 2022, the effect of this change in estimate for the three months ended March 31, 2023 was an increase in operating income of $885 million and net income of $720 million, or $0.10 per both basic and diluted share. The effect of this change for the nine months ended March 31, 2023 was an increase in operating income of $2.9 billion and net income of $2.3 billion, or $0.32 and $0.31 per basic and diluted share, respectively.

Financial Instruments

Investments

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

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

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

Derivatives

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

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

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

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

Fair Value Measurements

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

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

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

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

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

Contract Balances and Other Receivables

As of March 31, 2023 and June 30, 2022, other receivables due from suppliers were $717 million and $1.0 billion, respectively, and are included in accounts receivable, net in our consolidated balance sheets.

As of March 31, 2023 and June 30, 2022, long-term accounts receivable, net of allowance for doubtful accounts, was $4.3 billion and $3.8 billion, respectively, and is included in other long-term assets in our consolidated balance sheets.

We record financing receivables when we offer certain of our customers the option to acquire our software products and services offerings through a financing program in a limited number of countries. As of March 31, 2023 and June 30, 2022, our financing receivables, net were $2.7 billion and $4.1 billion, respectively, for short-term and long-term financing receivables, which are included in other current assets and other long-term assets in our consolidated balance sheets. We record an allowance to cover expected losses based on troubled accounts, historical experience, and other currently available evidence.

Employee Severance

On January 18, 2023, we announced a decision to reduce our overall workforce by approximately 10,000 jobs through the third quarter of fiscal year 2023. During the three months ended December 31, 2022, we recorded $800 million of employee severance expenses related to these job eliminations as part of an ongoing employee benefit plan. These employee severance expenses were included in general and administrative expenses in our consolidated income statements and allocated to our segments based on relative gross margin. Refer to Note 17 – Segment Information and Geographic Data for further information.

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 earnings per share)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2023	2022	2023	2022
Net income available for common shareholders (A)	$ 18,299	$ 16,728	$ 52,280	$ 55,998
Weighted average outstanding shares of common stock (B)	7,441	7,493	7,450	7,504
Dilutive effect of stock-based awards	23	41	24	48
Common stock and common stock equivalents (C)	7,464	7,534	7,474	7,552
Earnings Per Share				
Basic (A/B)	$ 2.46	$ 2.23	$ 7.02	$ 7.46
Diluted (A/C)	$ 2.45	$ 2.22	$ 6.99	$ 7.41

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

NOTE 3 — OTHER INCOME (EXPENSE), NET

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

(In millions)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2023	2022	2023	2022
Interest and dividends income	$ 748	$ 519	$ 2,089	$ 1,542
Interest expense	(496)	(503)	(1,486)	(1,567)
Net recognized gains (losses) on investments	105	(76)	103	595
Net losses on derivatives	(65)	(29)	(255)	(29)
Net gains (losses) on foreign currency remeasurements	122	(74)	26	(152)
Other, net	(93)	(11)	(162)	(9)
Total	$ 321	$ (174)	$ 315	$ 380

Net Recognized Gains (Losses) on Investments

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

(In millions)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2023	2022	2023	2022
Realized gains from sales of available-for-sale securities	$ 4	$ 119	$ 19	$ 150
Realized losses from sales of available-for-sale securities	(30)	(89)	(73)	(102)
Impairments and allowance for credit losses	0	(45)	(13)	(53)
Total	$ (26)	$ (15)	$ (67)	$ (5)

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

(In millions)	Three Months Ended March 31, 2023	Three Months Ended March 31, 2022	Nine Months Ended March 31, 2023	Nine Months Ended March 31, 2022
Net realized gains (losses) on investments sold	**$ (13)**	$ (22)	**$ 77**	$ 46
Net unrealized gains (losses) on investments still held	**144**	(34)	**109**	559
Impairments of investments	**0**	(5)	**(16)**	(5)
Total	**$ 131**	$ (61)	**$ 170**	$ 600

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 Investments
March 31, 2023								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 9,853	$ 0	$ 0	$ 9,853	$ 9,207	$ 646	$ 0
Certificates of deposit	Level 2	2,229	0	0	2,229	2,185	44	0
U.S. government securities	Level 1	66,318	1	(3,169)	63,150	1,550	61,600	0
U.S. agency securities	Level 2	7,469	1	(2)	7,468	4,127	3,341	0
Foreign government bonds	Level 2	512	1	(23)	490	5	485	0
Mortgage- and asset-backed securities	Level 2	767	1	(36)	732	0	732	0
Corporate notes and bonds	Level 2	10,963	18	(552)	10,429	0	10,429	0
Corporate notes and bonds	Level 3	118	0	0	118	0	118	0
Municipal securities	Level 2	367	13	(15)	365	0	365	0
Municipal securities	Level 3	104	0	(7)	97	0	97	0
Total debt investments		$ 98,700	$ 35	$ (3,804)	$ 94,931	$ 17,074	$ 77,857	$ 0
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				$ 3,475	$ 979	$ 0	$ 2,496
Equity investments	Other				6,919	0	0	6,919
Total equity investments					$ 10,394	$ 979	$ 0	$ 9,415
Cash					$ 8,509	$ 8,509	$ 0	$ 0
Derivatives, net [(a)]					8	0	8	0
Total					$ 113,842	$ 26,562	$ 77,865	$ 9,415

(In millions)	Fair Value Level	Adjusted Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity Investments
June 30, 2022								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 2,500	$ 0	$ 0	$ 2,500	$ 2,498	$ 2	$ 0
Certificates of deposit	Level 2	2,071	0	0	2,071	2,032	39	0
U.S. government securities	Level 1	79,696	29	(2,178)	77,547	9	77,538	0
U.S. agency securities	Level 2	419	0	(9)	410	0	410	0
Foreign government bonds	Level 2	506	0	(24)	482	0	482	0
Mortgage- and asset-backed securities	Level 2	727	1	(30)	698	0	698	0
Corporate notes and bonds	Level 2	11,661	4	(554)	11,111	0	11,111	0
Corporate notes and bonds	Level 3	67	0	0	67	0	67	0
Municipal securities	Level 2	368	19	(13)	374	0	374	0
Municipal securities	Level 3	103	0	(6)	97	0	97	0
Total debt investments		$ 98,118	$ 53	$ (2,814)	$ 95,357	$ 4,539	$ 90,818	$ 0
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				$ 1,590	$ 1,134	$ 0	$ 456
Equity investments	Other				6,435	0	0	6,435
Total equity investments					$ 8,025	$ 1,134	$ 0	$ 6,891
Cash					$ 8,258	$ 8,258	$ 0	$ 0
Derivatives, net [(a)]					8	0	8	0
Total					$ 111,648	$ 13,931	$ 90,826	$ 6,891

(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 using the equity method or measured at cost with adjustments for observable changes in price or impairments, and investments measured at fair value using net asset value as a practical expedient which are not categorized in the fair value hierarchy. As of March 31, 2023 and June 30, 2022, equity investments without readily determinable fair values measured at cost with adjustments for observable changes in price or impairments were $4.1 billion and $3.8 billion, respectively.

Unrealized Losses on Debt Investments

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

	Less than 12 Months		12 Months or Greater			
(In millions)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Total Fair Value	Total Unrealized Losses
March 31, 2023						
U.S. government and agency securities	**$ 12,922**	**$ (354)**	**$ 41,520**	**$ (2,817)**	**$ 54,442**	**$ (3,171)**
Foreign government bonds	**74**	**(5)**	**390**	**(18)**	**464**	**(23)**
Mortgage- and asset-backed securities	**160**	**(5)**	**387**	**(31)**	**547**	**(36)**
Corporate notes and bonds	**2,015**	**(41)**	**7,486**	**(511)**	**9,501**	**(552)**
Municipal securities	**87**	**(2)**	**177**	**(20)**	**264**	**(22)**
Total	**$ 15,258**	**$ (407)**	**$ 49,960**	**$ (3,397)**	**$ 65,218**	**$ (3,804)**

	Less than 12 Months		12 Months or Greater			
(In millions)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Total Fair Value	Total Unrealized Losses
June 30, 2022						
U.S. government and agency securities	$ 59,092	$ (1,835)	$ 2,210	$ (352)	$ 61,302	$ (2,187)
Foreign government bonds	418	(18)	27	(6)	445	(24)
Mortgage- and asset-backed securities	510	(26)	41	(4)	551	(30)
Corporate notes and bonds	9,443	(477)	786	(77)	10,229	(554)
Municipal securities	178	(12)	74	(7)	252	(19)
Total	$ 69,641	$ (2,368)	$ 3,138	$ (446)	$ 72,779	$ (2,814)

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

(In millions)	Adjusted Cost Basis	Estimated Fair Value
March 31, 2023		
Due in one year or less	**$ 34,947**	**$ 34,805**
Due after one year through five years	**48,237**	**46,168**
Due after five years through 10 years	**14,143**	**12,698**
Due after 10 years	**1,373**	**1,260**
Total	**$ 98,700**	**$ 94,931**

NOTE 5 — DERIVATIVES

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

Foreign Currencies

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

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

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 and are included in “Other contracts” in the tables below.

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 of our counterparty agreements for derivative instruments contain provisions that require our issued and outstanding long-term unsecured debt to maintain an investment grade credit rating and require us to maintain minimum liquidity of $1.0 billion. To the extent we fail to meet these requirements, we will be required to post collateral, similar to the standard convention related to over-the-counter derivatives. As of March 31, 2023, our long-term unsecured debt rating was AAA, and cash investments were in excess of $1.0 billion. As a result, no collateral was required to be posted.

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

(In millions)	March 31, 2023	June 30, 2022
Designated as Hedging Instruments		
Foreign exchange contracts purchased	**$ 1,492**	$ 635
Interest rate contracts purchased	**1,108**	1,139
Not Designated as Hedging Instruments		
Foreign exchange contracts purchased	**10,232**	10,322
Foreign exchange contracts sold	**20,460**	21,606
Other contracts purchased	**4,787**	2,773
Other contracts sold	**2,952**	544

Fair Values of Derivative Instruments

The following table presents our derivative instruments:

(In millions)	Derivative Assets	Derivative Liabilities	Derivative Assets	Derivative Liabilities
		March 31, 2023		June 30, 2022
Designated as Hedging Instruments				
Foreign exchange contracts	**$ 19**	**$ (77)**	$ 0	$ (77)
Interest rate contracts	**6**	**0**	3	0
Not Designated as Hedging Instruments				
Foreign exchange contracts	**278**	**(333)**	333	(362)
Other contracts	**217**	**(311)**	20	(112)
Gross amounts of derivatives	**520**	**(721)**	356	(551)
Gross amounts of derivatives offset in the balance sheet	**(265)**	**263**	(130)	133
Cash collateral received	**0**	**(26)**	0	(75)
Net amounts of derivatives	**$ 255**	**$ (484)**	$ 226	$ (493)
Reported as				
Short-term investments	**$ 8**	**$ 0**	$ 8	$ 0
Other current assets	**243**	**0**	218	0
Other long-term assets	**4**	**0**	0	0
Other current liabilities	**0**	**(188)**	0	(298)
Other long-term liabilities	**0**	**(296)**	0	(195)
Total	**$ 255**	**$ (484)**	$ 226	$ (493)

Gross derivative assets and liabilities subject to legally enforceable master netting agreements for which we have elected to offset were $496 million and $720 million, respectively, as of March 31, 2023, and $343 million and $550 million, respectively, as of June 30, 2022.

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

(In millions)	Level 1	Level 2	Level 3	Total
March 31, 2023				
Derivative assets	**$ 4**	**$ 507**	**$ 9**	**$ 520**
Derivative liabilities	**0**	**(721)**	**0**	**(721)**
June 30, 2022				
Derivative assets	1	349	6	356
Derivative liabilities	0	(551)	0	(551)

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

(In millions)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2023	2022	2023	2022
Designated as Fair Value Hedging Instruments				
Foreign exchange contracts				
Derivatives	**$ 0**	$ 0	**$ 0**	$ 49
Hedged items	**0**	0	**0**	(50)
Excluded from effectiveness assessment	**0**	0	**0**	4
Interest rate contracts				
Derivatives	**1**	(57)	**(37)**	(71)
Hedged items	**(15)**	61	**20**	83
Designated as Cash Flow Hedging Instruments				
Foreign exchange contracts				
Amount reclassified from accumulated other comprehensive loss	**18**	(15)	**62**	(44)
Not Designated as Hedging Instruments				
Foreign exchange contracts	**(10)**	35	**(20)**	308
Other contracts	**(60)**	(29)	**(264)**	(41)

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

(In millions)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2023	2022	2023	2022
Designated as Cash Flow Hedging Instruments				
Foreign exchange contracts				
Included in effectiveness assessment	**$ 5**	$ (6)	**$ 14**	$ (27)

NOTE 6 — INVENTORIES

The components of inventories were as follows:

(In millions)	March 31, 2023	June 30, 2022
Raw materials	**$ 1,055**	$ 1,144
Work in process	**35**	82
Finished goods	**1,787**	2,516
Total	**$ 2,877**	$ 3,742

NOTE 7 — BUSINESS COMBINATIONS

Nuance Communications, Inc.

On March 4, 2022, we completed our acquisition of Nuance Communications, Inc. (“Nuance”) for a total purchase price of $18.8 billion, consisting primarily of cash. Nuance is a cloud and artificial intelligence (“AI”) software provider with healthcare and enterprise AI experience, and the acquisition will build on our industry-specific cloud offerings. The financial results of Nuance have been included in our consolidated financial statements since the date of the acquisition. Nuance is reported as part of our Intelligent Cloud segment.

The allocation of the purchase price to goodwill was completed as of December 31, 2022. The major classes of assets and liabilities to which we have allocated the purchase price were as follows:

(In millions)		
Goodwill (a)	$	16,326
Intangible assets		4,365
Other assets		42
Other liabilities (b)		(1,972)
Total	$	18,761

(a) *Goodwill was assigned to our Intelligent Cloud segment and was primarily attributed to increased synergies that are expected to be achieved from the integration of Nuance. None of the goodwill is expected to be deductible for income tax purposes.*
(b) *Includes $986 million of convertible senior notes issued by Nuance in 2015 and 2017, substantially all of which have been redeemed.*

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

(In millions, except average life)		Amount	Weighted Average Life
Customer-related	$	2,610	9 years
Technology-based		1,540	5 years
Marketing-related		215	4 years
Total	$	4,365	7 years

Activision Blizzard, Inc.

On January 18, 2022, we entered into a definitive agreement to acquire Activision Blizzard, Inc. (“Activision Blizzard”) for $95.00 per share in an all-cash transaction valued at $68.7 billion, inclusive of Activision Blizzard’s net cash. Activision Blizzard is a leader in game development and an interactive entertainment content publisher. The acquisition will accelerate the growth in our gaming business across mobile, PC, console, and cloud gaming. The acquisition has been approved by Activision Blizzard’s shareholders. We are continuing to engage with regulators reviewing the transaction and are working toward closing it in fiscal year 2023, subject to obtaining required regulatory approvals and satisfaction of other customary closing conditions.

NOTE 8 — GOODWILL

Changes in the carrying amount of goodwill were as follows:

(In millions)		June 30, 2022		Acquisitions		Other		March 31, 2023
Productivity and Business Processes	$	**24,811**	$	**11**	$	**(27)**	$	**24,795**
Intelligent Cloud		**30,182**		**223**		**87**		**30,492**
More Personal Computing		**12,531**		**0**		**122**		**12,653**
Total	$	**67,524**	$	**234**	$	**182**	$	**67,940**

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 9 — INTANGIBLE ASSETS

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

(In millions)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
			March 31, 2023			June 30, 2022
Technology-based	$ 11,228	$ (7,366)	$ 3,862	$ 11,277	$ (6,958)	$ 4,319
Customer-related	7,308	(3,837)	3,471	7,342	(3,171)	4,171
Marketing-related	4,929	(2,393)	2,536	4,942	(2,143)	2,799
Contract-based	23	(13)	10	16	(7)	9
Total	$ 23,488	$ (13,609)	$ 9,879	$ 23,577	$ (12,279)	$ 11,298

Intangible assets amortization expense was $612 million and $1.9 billion for the three and nine months ended March 31, 2023, respectively, and $502 million and $1.4 billion for the three and nine months ended March 31, 2022, respectively.

The following table outlines the estimated future amortization expense related to intangible assets held as of March 31, 2023:

(In millions)	
Year Ending June 30,	
2023 (excluding the nine months ended March 31, 2023)	$ 628
2024	2,403
2025	1,869
2026	1,341
2027	900
Thereafter	2,738
Total	$ 9,879

NOTE 10 — DEBT

The components of debt were as follows:

(In millions, issuance by calendar year)	Maturities (calendar year)	Stated Interest Rate	Effective Interest Rate	March 31, 2023	June 30, 2022
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	**2022 – 2042**	**2.13% – 3.50%**	**2.24% – 3.57%**	**454**	1,204
2013 issuance of $5.2 billion	**2023 – 2043**	**2.38% – 4.88%**	**2.47% – 4.92%**	**2,814**	2,814
2013 issuance of €4.1 billion	**2028 – 2033**	**2.63% – 3.13%**	**2.69% – 3.22%**	**2,499**	2,404
2015 issuance of $23.8 billion	**2025 – 2055**	**2.70% – 4.75%**	**2.77% – 4.78%**	**9,805**	10,805
2016 issuance of $19.8 billion	**2023 – 2056**	**2.00% – 3.95%**	**2.10% – 4.03%**	**9,430**	9,430
2017 issuance of $17.0 billion	**2024 – 2057**	**2.88% – 4.50%**	**3.04% – 4.53%**	**8,945**	8,945
2020 issuance of $10.0 billion	**2050 – 2060**	**2.53% – 2.68%**	**2.53% – 2.68%**	**10,000**	10,000
2021 issuance of $8.2 billion	**2052 – 2062**	**2.92% – 3.04%**	**2.92% – 3.04%**	**8,185**	8,185
Total face value				**53,856**	55,511
Unamortized discount and issuance costs				**(446)**	(471)
Hedge fair value adjustments [(a)]				**(88)**	(68)
Premium on debt exchange				**(5,112)**	(5,191)
Total debt				**48,210**	49,781
Current portion of long-term debt				**(6,245)**	(2,749)
Long-term debt				**$ 41,965**	$ 47,032

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

As of March 31, 2023 and June 30, 2022, the estimated fair value of long-term debt, including the current portion, was $47.8 billion and $50.9 billion, respectively. The estimated fair values are based on Level 2 inputs.

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

The following table outlines maturities of our long-term debt, including the current portion, as of March 31, 2023:

(In millions)

Year Ending June 30,		
2023 (excluding the nine months ended March 31, 2023)	$	1,000
2024		5,250
2025		2,250
2026		3,000
2027		8,000
Thereafter		34,356
Total	$	53,856

NOTE 11 — INCOME TAXES

Effective Tax Rate

Our effective tax rate was 19% and 17% for the three months ended March 31, 2023 and 2022, respectively, and 19% and 11% for the nine months ended March 31, 2023 and 2022, respectively. The increase in our effective tax rate for the three months ended March 31, 2023 compared to the prior year was primarily due to a decrease in tax benefits relating to stock-based compensation. The increase in our effective tax rate for the nine months ended March 31, 2023 compared to the prior year was primarily due to a $3.3 billion net income tax benefit in the first quarter of fiscal year 2022 related to the transfer of intangible properties and a decrease in tax benefits relating to stock-based compensation.

In the first quarter of fiscal year 2022, we transferred certain intangible properties from our Puerto Rico subsidiary to the U.S. The transfer of intangible properties resulted in a $3.3 billion net income tax benefit in the first quarter of fiscal year 2022, as the value of future U.S. tax deductions exceeded the current tax liability from the U.S. global intangible low-taxed income tax.

Our effective tax rate was lower than the U.S. federal statutory rate for the three and nine months ended March 31, 2023, 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 March 31, 2023 and June 30, 2022, unrecognized tax benefits and other income tax liabilities were $18.1 billion and $16.3 billion, respectively, and are included in long-term income taxes in our consolidated balance sheets.

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

As of March 31, 2023, the primary unresolved issues for the IRS audits relate to transfer pricing, which could have a material impact in our consolidated financial statements when the matters are resolved. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved key transfer pricing issues. 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 tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2022, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NOTE 12 — UNEARNED REVENUE

Unearned revenue by segment was as follows:

(In millions)	March 31, 2023	June 30, 2022
Productivity and Business Processes	**$ 20,504**	$ 24,558
Intelligent Cloud	**15,552**	19,371
More Personal Computing	**3,545**	4,479
Total	**$ 39,601**	$ 48,408

Changes in unearned revenue were as follows:

(In millions)	
Nine Months Ended March 31, 2023	
Balance, beginning of period	**$ 48,408**
Deferral of revenue	**78,046**
Recognition of unearned revenue	**(86,853)**
Balance, end of period	**$ 39,601**

Revenue allocated to remaining performance obligations, which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods, was $201 billion as of March 31, 2023, of which $196 billion is related to the commercial portion of revenue. We expect to recognize approximately 45% of this revenue over the next 12 months and the remainder thereafter.

NOTE 13 — LEASES

We have operating and finance leases for datacenters, corporate offices, research and development facilities, Microsoft Experience Centers, and certain equipment. Our leases have remaining lease terms of less than 1 year to 18 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 March 31,		Nine Months Ended March 31,	
	2023	2022	2023	2022
Operating lease cost	**$ 766**	$ 744	**$ 2,112**	$ 1,801
Finance lease cost:				
Amortization of right-of-use assets	**$ 348**	$ 289	**$ 994**	$ 779
Interest on lease liabilities	**132**	109	**364**	320
Total finance lease cost	**$ 480**	$ 398	**$ 1,358**	$ 1,099

Supplemental cash flow information related to leases was as follows:

(In millions)	Three Months Ended March 31, 2023	2022	Nine Months Ended March 31, 2023	2022
Cash paid for amounts included in the measurement of lease liabilities:				
Operating cash flows from operating leases	$ 690	$ 726	$ 1,989	$ 1,733
Operating cash flows from finance leases	132	109	364	320
Financing cash flows from finance leases	272	233	790	655
Right-of-use assets obtained in exchange for lease obligations:				
Operating leases	663	1,421	2,377	4,151
Finance leases	1,044	720	2,253	3,094

Supplemental balance sheet information related to leases was as follows:

(In millions, except lease term and discount rate)	March 31, 2023	June 30, 2022
Operating Leases		
Operating lease right-of-use assets	$ 13,879	$ 13,148
Other current liabilities	$ 2,327	$ 2,228
Operating lease liabilities	12,312	11,489
Total operating lease liabilities	$ 14,639	$ 13,717
Finance Leases		
Property and equipment, at cost	$ 19,652	$ 17,388
Accumulated depreciation	(4,287)	(3,285)
Property and equipment, net	$ 15,365	$ 14,103
Other current liabilities	$ 1,153	$ 1,060
Other long-term liabilities	15,310	13,842
Total finance lease liabilities	$ 16,463	$ 14,902
Weighted Average Remaining Lease Term		
Operating leases	8 years	8 years
Finance leases	11 years	12 years
Weighted Average Discount Rate		
Operating leases	2.7%	2.1%
Finance leases	3.4%	3.1%

The following table outlines maturities of our lease liabilities as of March 31, 2023:

(In millions)

Year Ending June 30,	Operating Leases	Finance Leases
2023 (excluding the nine months ended March 31, 2023)	$ 683	$ 413
2024	2,625	1,706
2025	2,334	2,025
2026	1,964	1,710
2027	1,646	1,720
Thereafter	7,175	12,395
Total lease payments	16,427	19,969
Less imputed interest	(1,788)	(3,506)
Total	$ 14,639	$ 16,463

As of March 31, 2023, we have additional operating and finance leases, primarily for datacenters, that have not yet commenced of $5.0 billion and $21.9 billion, respectively. These operating and finance leases will commence between fiscal year 2023 and fiscal year 2030 with lease terms of 1 year to 18 years.

NOTE 14 — CONTINGENCIES

U.S. Cell Phone Litigation

Microsoft Mobile Oy, a subsidiary of Microsoft, along with other handset manufacturers and network operators, is a defendant in 46 lawsuits, including 45 lawsuits filed in the Superior Court for the District of Columbia by individual plaintiffs who allege that radio emissions from cellular handsets caused their brain tumors and other adverse health effects. We assumed responsibility for these claims in our agreement to acquire Nokia's Devices and Services business and have been substituted for the Nokia defendants. Nine of these cases were filed in 2002 and are consolidated for certain pre-trial proceedings; the remaining cases are stayed. In a separate 2009 decision, the Court of Appeals for the District of Columbia held that adverse health effect claims arising from the use of cellular handsets that operate within the U.S. Federal Communications Commission radio frequency emission guidelines ("FCC Guidelines") are pre-empted by federal law. The plaintiffs allege that their handsets either operated outside the FCC Guidelines or were manufactured before the FCC Guidelines went into effect. The lawsuits also allege an industry-wide conspiracy to manipulate the science and testing around emission guidelines.

In 2013, the defendants in the consolidated cases moved to exclude the plaintiffs' expert evidence of general causation on the basis of flawed scientific methodologies. In 2014, the trial court granted in part and denied in part the defendants' motion to exclude the plaintiffs' general causation experts. The defendants filed an interlocutory appeal to the District of Columbia Court of Appeals challenging the standard for evaluating expert scientific evidence. In October 2016, the Court of Appeals issued its decision adopting the standard advocated by the defendants and remanding the cases to the trial court for further proceedings under that standard. The plaintiffs have filed supplemental expert evidence, portions of which were stricken by the court. A hearing on general causation took place in September of 2022.

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 March 31, 2023, we accrued aggregate legal liabilities of $177 million. While we intend to defend these matters vigorously, adverse outcomes that we estimate could reach approximately $600 million in aggregate beyond recorded amounts are reasonably possible. Were unfavorable final outcomes to occur, there exists the possibility of a material adverse impact in our consolidated financial statements for the period in which the effects become reasonably estimable.

NOTE 15 — STOCKHOLDERS' EQUITY

Share Repurchases

On September 18, 2019, our Board of Directors approved a share repurchase program authorizing up to $40.0 billion in share repurchases. This share repurchase program commenced in February 2020 and was completed in November 2021.

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, following completion of the program approved on September 18, 2019, has no expiration date, and may be terminated at any time. As of March 31, 2023, $26.9 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		**2023**		**2022**
First Quarter	**17**	**$ 4,600**	21	$ 6,200
Second Quarter	**20**	**4,600**	20	6,233
Third Quarter	**18**	**4,600**	26	7,800
Total	**55**	**$ 13,800**	67	$ 20,233

All repurchases were made using cash resources. Shares repurchased during fiscal year 2023 and the third quarter of fiscal year 2022 were under the share repurchase program approved on September 14, 2021. Shares repurchased during the second quarter of fiscal year 2022 were under the share repurchase programs approved on both September 14, 2021 and September 18, 2019. Shares repurchased during the first quarter of fiscal year 2022 were under the share repurchase program approved on September 18, 2019. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards of $909 million and $2.7 billion for the three and nine months ended March 31, 2023, respectively, and $1.0 billion and $3.7 billion for the three and nine months ended March 31, 2022, respectively.

Dividends

Our Board of Directors declared the following dividends:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
Fiscal Year 2023				**(In millions)**
September 20, 2022	**November 17, 2022**	**December 8, 2022**	**$ 0.68**	**$ 5,066**
November 29, 2022	**February 16, 2023**	**March 9, 2023**	**0.68**	**5,059**
March 14, 2023	**May 18, 2023**	**June 8, 2023**	**0.68**	**5,057**
Total			**$ 2.04**	**$ 15,182**
Fiscal Year 2022				
September 14, 2021	November 18, 2021	December 9, 2021	$ 0.62	$ 4,652
December 7, 2021	February 17, 2022	March 10, 2022	0.62	4,645
March 14, 2022	May 19, 2022	June 9, 2022	0.62	4,632
Total			$ 1.86	$ 13,929

The dividend declared on March 14, 2023 was included in other current liabilities as of March 31, 2023.

NOTE 16 — ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

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

(In millions)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2023	**2022**	**2023**	**2022**
Derivatives				
Balance, beginning of period	**$ (38)**	$ (17)	**$ (13)**	$ (19)
Unrealized gains (losses), net of tax of **$1**, $(1), **$3**, and $(7)	**5**	(6)	**14**	(27)
Reclassification adjustments for (gains) losses included in other income (expense), net	**(18)**	15	**(62)**	44
Tax expense (benefit) included in provision for income taxes	**4**	(3)	**14**	(9)
Amounts reclassified from accumulated other comprehensive loss	**(14)**	12	**(48)**	35
Net change related to derivatives, net of tax of **$(3)**, $2, **$(11)**, and $2	**(9)**	6	**(34)**	8
Balance, end of period	**$ (47)**	$ (11)	**$ (47)**	$ (11)
Investments				
Balance, beginning of period	**$ (3,687)**	$ 2,057	**$ (2,138)**	$ 3,222
Unrealized gains (losses), net of tax of **$194**, $(769), **$(225)**, and $(1,076)	**732**	(2,894)	**(851)**	(4,051)
Reclassification adjustments for losses included in other income (expense), net	**26**	15	**68**	5
Tax benefit included in provision for income taxes	**(5)**	(3)	**(13)**	(1)
Amounts reclassified from accumulated other comprehensive loss	**21**	12	**55**	4
Net change related to investments, net of tax of **$199**, $(766), **$(212)**, and $(1,075)	**753**	(2,882)	**(796)**	(4,047)
Balance, end of period	**$ (2,934)**	$ (825)	**$ (2,934)**	$ (825)
Translation Adjustments and Other				
Balance, beginning of period	**$ (2,732)**	$ (1,603)	**$ (2,527)**	$ (1,381)
Translation adjustments and other, net of tax of **$0**, $0, **$0**, and $0	**69**	(37)	**(136)**	(259)
Balance, end of period	**$ (2,663)**	$ (1,640)	**$ (2,663)**	$ (1,640)
Accumulated other comprehensive loss, end of period	**$ (5,644)**	$ (2,476)	**$ (5,644)**	$ (2,476)

NOTE 17 — SEGMENT INFORMATION AND GEOGRAPHIC DATA

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

We have recast certain prior period amounts to conform to the way we internally manage and monitor our business.

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:

- Office Commercial (Office 365 subscriptions, the Office 365 portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises), comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, and Microsoft Viva.
- Office Consumer, including Microsoft 365 Consumer subscriptions, Office licensed on-premises, and other Office services.
- LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions.
- Dynamics business solutions, including Dynamics 365, comprising a set of intelligent, cloud-based applications across ERP, CRM, Customer Insights, Power Apps, and Power Automate; and on-premises ERP and CRM applications.

Intelligent Cloud

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

- Server products and cloud services, including Azure and other cloud services; SQL Server, Windows Server, Visual Studio, System Center, and related Client Access Licenses (“CALs”); and Nuance and GitHub.
- Enterprise Services, including Enterprise Support Services, Microsoft Consulting Services, and Nuance professional services.

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, including Windows original equipment manufacturer (“OEM”) licensing and other non-volume licensing of the Windows operating system; Windows Commercial, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings; patent licensing; and Windows Internet of Things.
- Devices, including Surface, HoloLens, and PC accessories.
- Gaming, including Xbox hardware and Xbox content and services, comprising first- and third-party content (including games and in-game content), Xbox Game Pass and other subscriptions, Xbox Cloud Gaming, third-party disc royalties, advertising, and other cloud services.
- Search and news advertising, comprising Bing (including Chat), Microsoft News, Microsoft Edge, and third-party affiliates.

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

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

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

(In millions)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2023	2022	**2023**	2022
Revenue				
Productivity and Business Processes	**$ 17,516**	$ 15,789	**$ 50,983**	$ 46,764
Intelligent Cloud	**22,081**	18,987	**63,914**	54,161
More Personal Computing	**13,260**	14,584	**40,829**	45,480
Total	**$ 52,857**	$ 49,360	**$ 155,726**	$ 146,405
Operating Income				
Productivity and Business Processes	**$ 8,639**	$ 7,185	**$ 25,137**	$ 22,454
Intelligent Cloud	**9,476**	8,391	**27,358**	24,395
More Personal Computing	**4,237**	4,788	**11,774**	16,000
Total	**$ 22,352**	$ 20,364	**$ 64,269**	$ 62,849

No sales to an individual customer or country other than the United States accounted for more than 10% of revenue for the three or nine months ended March 31, 2023 or 2022. Revenue, classified by the major geographic areas in which our customers were located, was as follows:

(In millions)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2023	2022	**2023**	2022
United States [(a)]	**$ 26,007**	$ 24,771	**$ 78,850**	$ 74,064
Other countries	**26,850**	24,589	**76,876**	72,341
Total	**$ 52,857**	$ 49,360	**$ 155,726**	$ 146,405

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

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

(In millions)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2023	2022	**2023**	2022
Server products and cloud services	**$ 20,025**	$ 17,046	**$ 58,007**	$ 48,498
Office products and cloud services	**12,438**	11,164	**35,823**	33,223
Windows	**5,328**	6,069	**15,449**	18,337
Gaming	**3,607**	3,740	**11,975**	12,775
LinkedIn	**3,697**	3,437	**11,236**	10,104
Search and news advertising	**3,045**	2,945	**9,196**	8,665
Enterprise Services	**2,007**	1,891	**5,745**	5,505
Devices	**1,282**	1,835	**4,160**	5,606
Other	**1,428**	1,233	**4,135**	3,692
Total	**$ 52,857**	$ 49,360	**$ 155,726**	$ 146,405

Our Microsoft Cloud revenue, which includes Azure and other cloud services, Office 365 Commercial, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties, was $28.5 billion and $81.3 billion for the three and nine months ended March 31, 2023, respectively, and $23.4 billion and $66.3 billion for the three and nine months ended March 31, 2022, respectively. These amounts are primarily included in Server products and cloud services, Office products and cloud services, and LinkedIn in the table above.

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

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Microsoft Corporation

Results of Review of Interim Financial Information

We have reviewed the accompanying consolidated balance sheet of Microsoft Corporation and subsidiaries (the "Company") as of March 31, 2023, the related consolidated statements of income, comprehensive income, cash flows, and stockholders' equity for the three-month and nine-month periods ended March 31, 2023 and 2022, 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, 2022, 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 28, 2022, 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, 2022, 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
April 25, 2023

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, 2022, and our financial statements and the accompanying Notes to Financial Statements (Part I, Item 1 of this Form 10-Q).

OVERVIEW

Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. Our platforms and tools help drive small business productivity, large business competitiveness, and public-sector efficiency. We are creating the platforms and tools that deliver better, faster, and more effective solutions to support new startups, improve educational and health outcomes, and empower human ingenuity.

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

Highlights from the third quarter of fiscal year 2023 compared with the third quarter of fiscal year 2022 included:

- Microsoft Cloud revenue increased 22% to $28.5 billion.
- Office Commercial products and cloud services revenue increased 13% driven by Office 365 Commercial growth of 14%.
- Office Consumer products and cloud services revenue increased 1% and Microsoft 365 Consumer subscribers increased to 65.4 million.
- LinkedIn revenue increased 8%.
- Dynamics products and cloud services revenue increased 17% driven by Dynamics 365 growth of 25%.
- Server products and cloud services revenue increased 17% driven by Azure and other cloud services growth of 27%.
- Windows original equipment manufacturer licensing ("Windows OEM") revenue decreased 28%.
- Devices revenue decreased 30%.
- Windows Commercial products and cloud services revenue increased 14%.
- Xbox content and services revenue increased 3%.
- Search and news advertising revenue excluding traffic acquisition costs increased 10%.

Industry Trends

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

Economic Conditions, Challenges, and Risks

The markets for software, devices, and cloud-based services are dynamic and highly competitive. Our competitors are developing new software and devices, while also deploying competing cloud-based services for consumers and businesses. The devices and form factors customers prefer evolve rapidly, and influence how users access services in the cloud, and in some cases, the user's choice of which suite of cloud-based services to use. We must continue to evolve and adapt over an extended time in pace with this changing environment. The investments we are making in infrastructure and devices will continue to increase our operating costs and may decrease our operating margins.

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. Aggregate demand for our software, services, and devices is correlated to global macroeconomic and geopolitical factors, which remain dynamic.

Our devices are primarily manufactured by third-party contract manufacturers, some of which contain certain components for which there are very few qualified suppliers. For these components, we have limited near-term flexibility to use other manufacturers if a current vendor becomes unavailable or is unable to meet our requirements. Extended disruptions at these suppliers and/or manufacturers could lead to a similar disruption in our ability to manufacture devices on time to meet consumer demand.

Our international operations provide a significant portion of our total revenue and expenses. Many of these revenue and expenses are denominated in currencies other than the U.S. dollar. As a result, changes in foreign exchange rates may significantly affect revenue and expenses. Fluctuations in the U.S. dollar relative to certain foreign currencies reduced reported revenue and expenses from our international operations for the three and nine months ended March 31, 2023.

On January 18, 2023, we announced decisions we made to align our cost structure with our revenue and customer demand, prioritize our investments in strategic areas, and consolidate office space. As a result, we recorded a $1.2 billion charge in the second quarter of fiscal year 2023 ("Q2 charge"), which included employee severance expenses of $800 million, impairment charges resulting from changes to our hardware portfolio, and costs related to lease consolidation activities. First, we reduced our overall workforce by approximately 10,000 jobs through the third quarter of fiscal year 2023, which represents less than 5% of our total employee base. While we eliminated roles in some areas, we will continue to hire in key strategic areas. Second, we are allocating both our capital and talent to areas of secular growth and long-term competitiveness, while divesting in other areas. Third, we are consolidating our leases to create higher density across our workspaces, which will also impact our financial results through the remainder of fiscal year 2023, and we may make similar decisions in future periods as we continue to evaluate our real estate needs.

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 second and fourth quarters of our fiscal year. Second quarter revenue is driven by corporate year-end spending trends in our major markets and holiday season spending by consumers, and fourth quarter revenue is driven by the volume of multi-year on-premises contracts executed during the period.

Change in Accounting Estimate

In July 2022, we completed an assessment of the useful lives of our server and network equipment. Due to investments in software that increased efficiencies in how we operate our server and network equipment, as well as advances in technology, we determined we should increase the estimated useful lives of both server and network equipment from four years to six years. This change in accounting estimate was effective beginning fiscal year 2023. Based on the carrying amount of server and network equipment included in property and equipment, net as of June 30, 2022, the effect of this change in estimate for the three months ended March 31, 2023 was an increase in operating income of $885 million and net income of $720 million, or $0.10 per both basic and diluted share. The effect of this change for the nine months ended March 31, 2023 was an increase in operating income of $2.9 billion and net income of $2.3 billion, or $0.32 and $0.31 per basic and diluted share, respectively. It is estimated this change will increase our fiscal year 2023 annual operating income by $3.7 billion.

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. We have recast certain prior period amounts to conform to the way we internally manage and monitor our business.

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

Metrics

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

In the first quarter of fiscal year 2023, we made updates to the presentation and method of calculation for certain metrics, most notably expanding our Surface metric into a broader Devices metric to incorporate additional revenue streams, along with other minor changes to align with how we manage our businesses.

Commercial

Our commercial business primarily consists of Server products and cloud services, Office Commercial, Windows Commercial, the commercial portion of LinkedIn, Enterprise Services, and Dynamics. 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	Revenue from Azure and other cloud services, Office 365 Commercial, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties
Microsoft Cloud gross margin percentage	Gross margin percentage for our Microsoft Cloud business

Productivity and Business Processes and Intelligent Cloud

Metrics related to our Productivity and Business Processes and Intelligent Cloud segments assess the health of our core businesses within these segments. The metrics reflect our cloud and on-premises product strategies and trends.

Office Commercial products and cloud services revenue growth	Revenue from Office Commercial products and cloud services (Office 365 subscriptions, the Office 365 portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises), comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, and Microsoft Viva
Office Consumer products and cloud services revenue growth	Revenue from Office Consumer products and cloud services, including Microsoft 365 Consumer subscriptions, Office licensed on-premises, and other Office services
Office 365 Commercial seat growth	The number of Office 365 Commercial seats at end of period where seats are paid users covered by an Office 365 Commercial subscription
Microsoft 365 Consumer subscribers	The number of Microsoft 365 Consumer subscribers at end of period
Dynamics products and cloud services revenue growth	Revenue from Dynamics products and cloud services, including Dynamics 365, comprising a set of intelligent, cloud-based applications across ERP, CRM, Customer Insights, Power Apps, and Power Automate; and on-premises ERP and CRM applications
LinkedIn revenue growth	Revenue from LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions
Server products and cloud services revenue growth	Revenue from Server products and cloud services, including Azure and other cloud services; SQL Server, Windows Server, Visual Studio, System Center, and related Client Access Licenses (“CALs”); and Nuance and GitHub

More Personal Computing

Metrics related to our More Personal Computing segment assess the performance of key lines of business within this segment. These metrics provide strategic product insights which allow us to assess the performance across our commercial and consumer businesses. As we have diversity of target audiences and sales motions within the Windows business, we monitor metrics that are reflective of those varying motions.

Windows OEM revenue growth	Revenue from sales of Windows Pro and non-Pro licenses sold through the OEM channel
Windows Commercial products and cloud services revenue growth	Revenue from Windows Commercial products and cloud services, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings
Devices revenue growth	Revenue from Devices, including Surface, HoloLens, and PC accessories
Xbox content and services revenue growth	Revenue from Xbox content and services, comprising first- and third-party content (including games and in-game content), Xbox Game Pass and other subscriptions, Xbox Cloud Gaming, third-party disc royalties, 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 March 31,		Percentage Change	Nine Months Ended March 31,		Percentage Change
	2023	**2022**		**2023**	**2022**	
Revenue	**$ 52,857**	$ 49,360	7%	**$ 155,726**	$ 146,405	6%
Gross margin	**36,729**	33,745	9%	**106,658**	100,184	6%
Operating income	**22,352**	20,364	10%	**64,269**	62,849	2%
Net income	**18,299**	16,728	9%	**52,280**	55,998	(7)%
Diluted earnings per share	**2.45**	2.22	10%	**6.99**	7.41	(6)%
Adjusted gross margin (non-GAAP)	**36,729**	33,745	9%	**106,810**	100,184	7%
Adjusted operating income (non-GAAP)	**22,352**	20,364	10%	**65,440**	62,849	4%
Adjusted net income (non-GAAP)	**18,299**	16,728	9%	**53,226**	52,707	1%
Adjusted diluted earnings per share (non-GAAP)	**2.45**	2.22	10%	**7.12**	6.98	2%

Adjusted gross margin, operating income, net income, and diluted earnings per share ("EPS") are non-GAAP financial measures. Current year non-GAAP financial measures exclude the impact of the Q2 charge, which includes employee severance expenses, impairment charges resulting from changes to our hardware portfolio, and costs related to lease consolidation activities. Prior year non-GAAP financial measures exclude the net income tax benefit related to transfer of intangible properties in the first quarter of fiscal year 2022. Refer to Note 11 – Income Taxes of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion. 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 March 31, 2023 Compared with Three Months Ended March 31, 2022

Revenue increased $3.5 billion or 7% driven by growth in Intelligent Cloud and Productivity and Business Processes, offset in part by a decline in More Personal Computing. Intelligent Cloud revenue increased driven by Azure and other cloud services. Productivity and Business Processes revenue increased driven by Office 365 Commercial. More Personal Computing revenue decreased driven by Windows and Devices.

Cost of revenue increased $513 million or 3% driven by growth in Microsoft Cloud, offset in part by a reduction in depreciation expense due to the change in accounting estimate for the useful lives of our server and network equipment.

Gross margin increased $3.0 billion or 9% driven by growth in Intelligent Cloud and Productivity and Business Processes and the change in accounting estimate, offset in part by a decline in More Personal Computing.

- Gross margin percentage increased. Excluding the impact of the change in accounting estimate, gross margin percentage decreased slightly driven by reductions in Intelligent Cloud, offset in part by sales mix shift.
- Microsoft Cloud gross margin percentage increased 2 points to 72%. Excluding the impact of the change in accounting estimate, Microsoft Cloud gross margin percentage decreased slightly driven by reductions in Azure and other cloud services.

Operating expenses increased $996 million or 7% driven by 2 points of growth from the Nuance and Xandr acquisitions and investments in cloud engineering and LinkedIn.

Key changes in operating expenses were:

- Research and development expenses increased $678 million or 11% driven by investments in cloud engineering and LinkedIn.
- Sales and marketing expenses increased $155 million or 3% driven by 3 points of growth from the Nuance and Xandr acquisitions and investments in commercial sales, offset in part by declines in Windows and Devices advertising.

- General and administrative expenses increased $163 million or 11% driven by acquisition-related expenses and investments in corporate functions. General and administrative included a favorable foreign currency impact of 2%.

Operating income increased $2.0 billion or 10% driven by growth in Productivity and Business Processes and Intelligent Cloud and the change in accounting estimate, offset in part by a decline in More Personal Computing.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 3%, 4%, and 5%, respectively. Cost of revenue and operating expenses both included a favorable foreign currency impact of 2%.

Nine Months Ended March 31, 2023 Compared with Nine Months Ended March 31, 2022

Revenue increased $9.3 billion or 6% driven by growth in Intelligent Cloud and Productivity and Business Processes, offset in part by a decline in More Personal Computing. Intelligent Cloud revenue increased driven by Azure and other cloud services. Productivity and Business Processes revenue increased driven by Office 365 Commercial and LinkedIn. More Personal Computing revenue decreased driven by Windows and Devices.

Cost of revenue increased $2.8 billion or 6% driven by growth in Microsoft Cloud, offset in part by the change in accounting estimate.

Gross margin increased $6.5 billion or 6% driven by growth in Intelligent Cloud and Productivity and Business Processes and the change in accounting estimate, offset in part by a decline in More Personal Computing.

- Gross margin percentage was relatively unchanged. Excluding the impact of the change in accounting estimate, gross margin percentage decreased 2 points driven by reductions in More Personal Computing and Intelligent Cloud, offset in part by sales mix shift.
- Microsoft Cloud gross margin percentage increased 2 points to 72%. Excluding the impact of the change in accounting estimate, Microsoft Cloud gross margin percentage decreased 1 point driven by sales mix shift to Azure and other cloud services and higher energy costs.

Operating expenses increased $5.1 billion or 14% driven by investments in cloud engineering, 3 points of growth from the Nuance and Xandr acquisitions, employee severance expenses, LinkedIn, and commercial sales.

Key changes in operating expenses were:

- Research and development expenses increased $2.8 billion or 16% driven by investments in cloud engineering and LinkedIn.
- Sales and marketing expenses increased $1.0 billion or 7% driven by 4 points of growth from the Nuance and Xandr acquisitions and investments in commercial sales. Sales and marketing included a favorable foreign currency impact of 3%.
- General and administrative expenses increased $1.2 billion or 30% driven by employee severance expenses. General and administrative included a favorable foreign currency impact of 2%.

Operating income increased $1.4 billion or 2% driven by growth in Productivity and Business Processes and Intelligent Cloud and the change in accounting estimate, offset in part by a decline in More Personal Computing.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 5%, 6%, and 8%, respectively. Cost of revenue and operating expenses both included a favorable foreign currency impact of 2%.

Current year gross margin, operating income, net income, and diluted EPS were negatively impacted by the Q2 charge, which resulted in decreases of $152 million, $1.2 billion, $946 million, and $0.13, respectively. Prior year net income and diluted EPS were positively impacted by the net tax benefit related to the transfer of intangible properties, which resulted in an increase to net income and diluted EPS of $3.3 billion and $0.43, respectively.

SEGMENT RESULTS OF OPERATIONS

(In millions, except percentages)	Three Months Ended March 31,		Percentage Change	Nine Months Ended March 31,		Percentage Change
	2023	2022		2023	2022	
Revenue						
Productivity and Business Processes	**$ 17,516**	$ 15,789	11%	**$ 50,983**	$ 46,764	9%
Intelligent Cloud	**22,081**	18,987	16%	**63,914**	54,161	18%
More Personal Computing	**13,260**	14,584	(9)%	**40,829**	45,480	(10)%
Total	**$ 52,857**	$ 49,360	7%	**$ 155,726**	$ 146,405	6%
Operating Income						
Productivity and Business Processes	**$ 8,639**	$ 7,185	20%	**$ 25,137**	$ 22,454	12%
Intelligent Cloud	**9,476**	8,391	13%	**27,358**	24,395	12%
More Personal Computing	**4,237**	4,788	(12)%	**11,774**	16,000	(26)%
Total	**$ 22,352**	$ 20,364	10%	**$ 64,269**	$ 62,849	2%

Reportable Segments

Three Months Ended March 31, 2023 Compared with Three Months Ended March 31, 2022

Productivity and Business Processes

Revenue increased $1.7 billion or 11%.

- Office Commercial products and cloud services revenue increased $1.3 billion or 13%. Office 365 Commercial revenue grew 14% with seat growth of 11%, driven by small and medium business and frontline worker offerings, as well as growth in revenue per user. Office Commercial products revenue declined 1% driven by continued customer shift to cloud offerings, offset in part by transactional strength in Japan.
- Office Consumer products and cloud services revenue increased $20 million or 1%. Microsoft 365 Consumer subscribers grew 12% to 65.4 million.
- LinkedIn revenue increased $260 million or 8% driven by Talent Solutions.
- Dynamics products and cloud services revenue increased 17% driven by Dynamics 365 growth of 25%.

Operating income increased $1.5 billion or 20%.

- Gross margin increased $1.7 billion or 14% driven by growth in Office 365 Commercial. Gross margin percentage increased. Excluding the impact of the change in accounting estimate, gross margin percentage increased slightly driven by improvements in Office 365 Commercial, offset in part by sales mix shift to cloud offerings.
- Operating expenses increased $213 million or 4% driven by investments in LinkedIn.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 4%, 4%, and 7%, respectively.

Intelligent Cloud

Revenue increased $3.1 billion or 16%.

- Server products and cloud services revenue increased $3.0 billion or 17% driven by Azure and other cloud services. Azure and other cloud services revenue grew 27% driven by growth in our consumption-based services. Server products revenue decreased 2%.
- Enterprise Services revenue increased $116 million or 6% driven by growth in Enterprise Support Services, offset in part by a decline in Microsoft Consulting Services.

Operating income increased $1.1 billion or 13%.

- Gross margin increased $2.0 billion or 15% driven by growth in Azure and other cloud services and the change in accounting estimate. Gross margin percentage decreased slightly. Excluding the impact of the change in accounting estimate, gross margin percentage decreased 3 points driven by sales mix shift to Azure and other cloud services and reductions in Azure and other cloud services.
- Operating expenses increased $937 million or 19% driven by investments in Azure and 3 points of growth from the Nuance acquisition.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 3%, 3%, and 4%, respectively.

More Personal Computing

Revenue decreased $1.3 billion or 9%.

- Windows revenue decreased $741 million or 12% driven by a decrease in Windows OEM, offset in part by growth in Windows Commercial. Windows OEM revenue decreased 28% as elevated channel inventory levels continued to drive additional weakness beyond declining PC demand. Windows Commercial products and cloud services revenue increased 14% driven by strong renewal execution and an increase in agreements that carry higher in-period revenue recognition.
- Devices revenue decreased $553 million or 30% as elevated channel inventory levels continued to drive additional weakness beyond declining PC demand.
- Gaming revenue decreased $133 million or 4% driven by a decline in Xbox hardware. Xbox hardware revenue decreased 30% on a strong prior year comparable, driven by lower volume of consoles sold. Xbox content and services revenue increased 3% driven by growth in Xbox Game Pass.
- Search and news advertising revenue increased $100 million or 3%. Search and news advertising revenue excluding traffic acquisition costs increased 10% driven by higher search volume and the Xandr acquisition.

Operating income decreased $551 million or 12%.

- Gross margin decreased $705 million or 9% driven by a decline in Windows. Gross margin percentage increased slightly.
- Operating expenses decreased $154 million or 5% driven by a decline in Devices, offset in part by 3 points of growth from the Xandr acquisition.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 2%, 4%, and 5%, respectively. Operating expenses included a favorable foreign currency impact of 2%.

Nine Months Ended March 31, 2023 Compared with Nine Months Ended March 31, 2022

Productivity and Business Processes

Revenue increased $4.2 billion or 9%.

- Office Commercial products and cloud services revenue increased $2.5 billion or 9%. Office 365 Commercial revenue grew 12% with seat growth of 11%, driven by small and medium business and frontline worker offerings, as well as growth in revenue per user. Office Commercial products revenue declined 22% driven by continued customer shift to cloud offerings.
- Office Consumer products and cloud services revenue increased $86 million or 2% with continued growth in Microsoft 365 Consumer subscription revenue.
- LinkedIn revenue increased $1.1 billion or 11% driven by Talent Solutions.
- Dynamics products and cloud services revenue increased 15% driven by Dynamics 365 growth of 23%.

Operating income increased $2.7 billion or 12%.

- Gross margin increased $4.0 billion or 11% driven by growth in Office 365 Commercial and LinkedIn, as well as the change in accounting estimate. Gross margin percentage increased. Excluding the impact of the change in accounting estimate, gross margin percentage was relatively unchanged driven by sales mix shift to cloud offerings, offset in part by improvements in Office 365 Commercial.
- Operating expenses increased $1.3 billion or 9% driven by investments in LinkedIn and cloud engineering, as well as employee severance expenses.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 5%, 6%, and 9%, respectively. Operating expenses included a favorable foreign currency impact of 3%.

Intelligent Cloud

Revenue increased $9.8 billion or 18%.

- Server products and cloud services revenue increased $9.5 billion or 20% driven by Azure and other cloud services. Azure and other cloud services revenue grew 31% driven by growth in our consumption-based services. Server products revenue decreased 1%.
- Enterprise Services revenue increased $240 million or 4% driven by growth in Enterprise Support Services, offset in part by a decline in Microsoft Consulting Services.

Operating income increased $3.0 billion or 12%.

- Gross margin increased $6.6 billion or 17% driven by growth in Azure and other cloud services and the change in accounting estimate. Gross margin percentage decreased slightly. Excluding the impact of the change in accounting estimate, gross margin percentage decreased 3 points driven by sales mix shift to Azure and other cloud services and higher energy costs.
- Operating expenses increased $3.6 billion or 26% driven by investments in Azure, 6 points of growth from the Nuance acquisition, and employee severance expenses.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 5%, 5%, and 7%, respectively. Operating expenses included a favorable foreign currency impact of 2%.

More Personal Computing

Revenue decreased $4.7 billion 10%.

- Windows revenue decreased $2.9 billion or 16% driven by a decrease in Windows OEM. Windows OEM revenue decreased 28% as elevated channel inventory levels continued to drive additional weakness beyond declining PC demand. Windows Commercial products and cloud services revenue increased 6% driven by demand for Microsoft 365 with an increase in agreements that carry higher in-period revenue recognition.
- Devices revenue decreased $1.4 billion or 26% as elevated channel inventory levels continued to drive additional weakness beyond declining PC demand.
- Gaming revenue decreased $800 million or 6% driven by declines in Xbox content and services and Xbox hardware. Xbox content and services revenue decreased 5% driven by a decline in first-party content, offset in part by growth in Xbox Game Pass. Xbox hardware revenue decreased 11% driven by lower volume and price of consoles sold.
- Search and news advertising revenue increased $531 million or 6%. Search and news advertising revenue excluding traffic acquisition costs increased 12% driven by higher search volume and the Xandr acquisition.

Operating income decreased $4.2 billion or 26%.

- Gross margin decreased $4.1 billion or 16% driven by declines in Windows, Devices, and Gaming. Gross margin percentage decreased primarily driven by reductions in Devices.
- Operating expenses increased $115 million or 1% driven by 3 points of growth from the Xandr acquisition and employee severance expenses, offset in part by a decline in Devices.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 3%, 4%, and 6%, respectively. Operating expenses included a favorable foreign currency impact of 2%.

OPERATING EXPENSES

Research and Development

(In millions, except percentages)	Three Months Ended March 31,		Percentage Change	Nine Months Ended March 31,		Percentage Change
	2023	**2022**		**2023**	**2022**	
Research and development	**$ 6,984**	$ 6,306	11%	**$ 20,456**	$ 17,663	16%
As a percent of revenue	**13%**	13%	0ppt	**13%**	12%	1ppt

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

Three Months Ended March 31, 2023 Compared with Three Months Ended March 31, 2022

Research and development expenses increased $678 million or 11% driven by investments in cloud engineering and LinkedIn.

Nine Months Ended March 31, 2023 Compared with Nine Months Ended March 31, 2022

Research and development expenses increased $2.8 billion or 16% driven by investments in cloud engineering and LinkedIn.

Sales and Marketing

(In millions, except percentages)	Three Months Ended March 31,		Percentage Change	Nine Months Ended March 31,		Percentage Change
	2023	**2022**		**2023**	**2022**	
Sales and marketing	**$ 5,750**	$ 5,595	3%	**$ 16,555**	$ 15,521	7%
As a percent of revenue	**11%**	11%	0ppt	**11%**	11%	0ppt

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 March 31, 2023 Compared with Three Months Ended March 31, 2022

Sales and marketing expenses increased $155 million or 3% driven by 3 points of growth from the Nuance and Xandr acquisitions and investments in commercial sales, offset in part by declines in Windows and Devices advertising.

Nine Months Ended March 31, 2023 Compared with Nine Months Ended March 31, 2022

Sales and marketing expenses increased $1.0 billion or 7% driven by 4 points of growth from the Nuance and Xandr acquisitions and investments in commercial sales. Sales and marketing included a favorable foreign currency impact of 3%.

General and Administrative

(In millions, except percentages)	Three Months Ended March 31,		Percentage Change	Nine Months Ended March 31,		Percentage Change
	2023	**2022**		**2023**	**2022**	
General and administrative	**$ 1,643**	$ 1,480	11%	**$ 5,378**	$ 4,151	30%
As a percent of revenue	**3%**	3%	0ppt	**3%**	3%	0ppt

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

Three Months Ended March 31, 2023 Compared with Three Months Ended March 31, 2022

General and administrative expenses increased $163 million or 11% driven by acquisition-related expenses and investments in corporate functions. General and administrative included a favorable foreign currency impact of 2%.

Nine Months Ended March 31, 2023 Compared with Nine Months Ended March 31, 2022

General and administrative expenses increased $1.2 billion or 30% driven by employee severance expenses. General and administrative included a favorable foreign currency impact of 2%.

OTHER INCOME (EXPENSE), NET

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

(In millions)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2023	**2022**	**2023**	**2022**
Interest and dividends income	**$ 748**	$ 519	**$ 2,089**	$ 1,542
Interest expense	**(496)**	(503)	**(1,486)**	(1,567)
Net recognized gains (losses) on investments	**105**	(76)	**103**	595
Net losses on derivatives	**(65)**	(29)	**(255)**	(29)
Net gains (losses) on foreign currency remeasurements	**122**	(74)	**26**	(152)
Other, net	**(93)**	(11)	**(162)**	(9)
Total	**$ 321**	$ (174)	**$ 315**	$ 380

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

Three Months Ended March 31, 2023 Compared with Three Months Ended March 31, 2022

Interest and dividends income increased due to higher yields, offset in part by lower portfolio balances. Interest expense decreased due to a decrease in outstanding long-term debt due to debt maturities. Net recognized gains on investments increased due to gains on equity securities in the current period compared to losses in the prior period.

Nine Months Ended March 31, 2023 Compared with Nine Months Ended March 31, 2022

Interest and dividends income increased due to higher yields, offset in part by lower portfolio balances. Interest expense decreased due to a decrease in outstanding long-term debt due to debt maturities. Net recognized gains on investments decreased due to lower gains on equity securities and higher losses on fixed income securities in the current period. Net losses on derivatives increased due to losses related to managing strategic investments.

INCOME TAXES

Effective Tax Rate

Our effective tax rate was 19% and 17% for the three months ended March 31, 2023 and 2022, respectively, and 19% and 11% for the nine months ended March 31, 2023 and 2022, respectively. The increase in our effective tax rate for the three months ended March 31, 2023 compared to the prior year was primarily due to a decrease in tax benefits relating to stock-based compensation. The increase in our effective tax rate for the nine months ended March 31, 2023 compared to the prior year was primarily due to a $3.3 billion net income tax benefit in the first quarter of fiscal year 2022 related to the transfer of intangible properties and a decrease in tax benefits relating to stock-based compensation.

In the first quarter of fiscal year 2022, we transferred certain intangible properties from our Puerto Rico subsidiary to the U.S. The transfer of intangible properties resulted in a $3.3 billion net income tax benefit in the first quarter of fiscal year 2022, as the value of future U.S. tax deductions exceeded the current tax liability from the U.S. global intangible low-taxed income tax.

Our effective tax rate was lower than the U.S. federal statutory rate for the three and nine months ended March 31, 2023, 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 settled a portion of the Internal Revenue Service ("IRS") audit for tax years 2004 to 2006 in fiscal year 2011. In February 2012, the IRS withdrew its 2011 Revenue Agents Report related to unresolved issues for tax years 2004 to 2006 and reopened the audit phase of the examination. We also settled a portion of the IRS audit for tax years 2007 to 2009 in fiscal year 2016, and a portion of the IRS audit for tax years 2010 to 2013 in fiscal year 2018. In the second quarter of fiscal year 2021, we settled an additional portion of the IRS audits for tax years 2004 to 2013 and made a payment of $1.7 billion, including tax and interest. We remain under audit for tax years 2004 to 2017.

As of March 31, 2023, the primary unresolved issues for the IRS audits relate to transfer pricing, which could have a material impact in our consolidated financial statements when the matters are resolved. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved key transfer pricing issues. 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 tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2022, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NON-GAAP FINANCIAL MEASURES

Adjusted gross margin, operating income, net income, and diluted EPS are non-GAAP financial measures. Current year non-GAAP financial measures exclude the impact of the Q2 charge, which includes employee severance expenses, impairment charges resulting from changes to our hardware portfolio, and costs related to lease consolidation activities. Prior year non-GAAP financial measures exclude the net income tax benefit related to transfer of intangible properties in the first quarter of fiscal year 2022. We believe these non-GAAP measures aid investors by providing additional insight into our operational 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 March 31, 2023	Three Months Ended March 31, 2022	Percentage Change	Nine Months Ended March 31, 2023	Nine Months Ended March 31, 2022	Percentage Change
Gross margin	**$ 36,729**	$ 33,745	9%	**$ 106,658**	$ 100,184	6%
Severance, hardware-related impairment, and lease consolidation costs	**0**	0	*	**152**	0	*
Adjusted gross margin (non-GAAP)	**$ 36,729**	$ 33,745	9%	**$ 106,810**	$ 100,184	7%
Operating income	**$ 22,352**	$ 20,364	10%	**$ 64,269**	$ 62,849	2%
Severance, hardware-related impairment, and lease consolidation costs	**0**	0	*	**1,171**	0	*
Adjusted operating income (non-GAAP)	**$ 22,352**	$ 20,364	10%	**$ 65,440**	$ 62,849	4%
Net income	**$ 18,299**	$ 16,728	9%	**$ 52,280**	$ 55,998	(7)%
Severance, hardware-related impairment, and lease consolidation costs	**0**	0	*	**946**	0	*
Net income tax benefit related to transfer of intangible properties	**0**	0	*	**0**	(3,291)	*
Adjusted net income (non-GAAP)	**$ 18,299**	$ 16,728	9%	**$ 53,226**	$ 52,707	1%
Diluted earnings per share	**$ 2.45**	$ 2.22	10%	**$ 6.99**	$ 7.41	(6)%
Severance, hardware-related impairment, and lease consolidation costs	**0**	0	*	**0.13**	0	*
Net income tax benefit related to transfer of intangible properties	**0**	0	*	**0**	(0.43)	*
Adjusted diluted earnings per share (non-GAAP)	**$ 2.45**	$ 2.22	10%	**$ 7.12**	$ 6.98	2%

* *Not meaningful.*

LIQUIDITY AND CAPITAL RESOURCES

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

Cash, Cash Equivalents, and Investments

Cash, cash equivalents, and short-term investments totaled $104.4 billion and $104.8 billion as of March 31, 2023 and June 30, 2022, respectively. Equity investments were $9.4 billion and $6.9 billion as of March 31, 2023 and June 30, 2022, respectively. Our short-term investments are primarily intended to facilitate liquidity and capital preservation. They consist predominantly of highly liquid investment-grade fixed-income securities, diversified among industries and individual issuers. The investments are predominantly U.S. dollar-denominated securities, but also include foreign currency-denominated securities to diversify risk. Our fixed-income investments are exposed to interest rate risk and credit risk. The credit risk and average maturity of our fixed-income portfolio are managed to achieve economic returns that correlate to certain fixed-income indices. The settlement risk related to these investments is insignificant given that the short-term investments held are primarily highly liquid investment-grade fixed-income securities.

Valuation

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

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

Cash Flows

Cash from operations decreased $5.6 billion to $58.8 billion for the nine months ended March 31, 2023, mainly due to an increase in cash paid to employees and suppliers and cash used to pay income taxes, offset in part by an increase in cash received from customers. Cash used in financing decreased $13.1 billion to $32.5 billion for the nine months ended March 31, 2023, mainly due to a $7.4 billion decrease in common stock repurchases and a $7.3 billion decrease in repayments of debt, offset in part by a $1.2 billion increase in dividends paid. Cash used in investing decreased $7.0 billion to $13.5 billion for the nine months ended March 31, 2023, due to a $19.4 billion decrease in cash used for acquisitions of companies, net of cash acquired, and purchases of intangible and other assets, offset in part by a $9.1 billion decrease in cash from net investment purchases, sales, and maturities, a $2.1 billion increase in additions to property and equipment, and a $1.2 billion increase in other investing to facilitate the purchase of components.

Debt Proceeds

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

Unearned Revenue

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

The following table outlines the expected future recognition of unearned revenue as of March 31, 2023:

(In millions)		
Three Months Ending		
June 30, 2023	$	**17,505**
September 30, 2023		**9,695**
December 31, 2023		**7,025**
March 31, 2024		**2,678**
Thereafter		**2,698**
Total	$	**39,601**

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

Material Cash Requirements and Other Obligations

Income Taxes

As a result of the TCJA, we are required to pay a one-time transition tax on deferred foreign income not previously subject to U.S. income tax. Under the TCJA, the transition tax is payable in interest-free installments over eight years, with 8% due in each of the first five years, 15% in year six, 20% in year seven, and 25% in year eight. We have paid transition tax of $7.7 billion, which included $1.5 billion during the nine months ended March 31, 2023. The remaining transition tax of $10.5 billion is payable over the next three years, with $2.7 billion payable within 12 months.

Provisions enacted in the TCJA related to the capitalization for tax purposes of research and experimental expenditures became effective on July 1, 2022. These provisions require us to capitalize research and experimental expenditures and amortize them on the U.S. tax return over five or fifteen years, depending on where research is conducted. The final foreign tax credit regulations, also effective on July 1, 2022, introduced significant changes to foreign tax credit calculations in the U.S. tax return. While these provisions are not expected to have a material impact on our fiscal year 2023 effective tax rate on a net basis, our cash paid for taxes would increase unless these provisions are postponed or modified through legislative processes.

Share Repurchases

For the nine months ended March 31, 2023 and 2022, we repurchased 55 million shares and 67 million shares of our common stock for $13.8 billion and $20.2 billion, respectively, through our share repurchase programs. All repurchases were made using cash resources. As of March 31, 2023, $26.9 billion remained of our $60 billion share repurchase program. Refer to Note 15 – Stockholders' Equity of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

Dividends

For the nine months ended March 31, 2023 and 2022, our Board of Directors declared quarterly dividends of $0.68 per share and $0.62 per share, respectively. We intend to continue returning capital to shareholders in the form of dividends, subject to declaration by our Board of Directors. Refer to Note 15 – Stockholders' Equity of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

Other Planned Uses of Capital

On January 18, 2022, we entered into a definitive agreement to acquire Activision Blizzard, Inc. ("Activision Blizzard") for $95.00 per share in an all-cash transaction valued at $68.7 billion, inclusive of Activision Blizzard's net cash. The acquisition has been approved by Activision Blizzard's shareholders. We are continuing to engage with regulators reviewing the transaction and are working toward closing it in fiscal year 2023, subject to obtaining required regulatory approvals and satisfaction of other customary closing conditions.

We will continue to invest in sales, marketing, product support infrastructure, and existing and advanced areas of technology, as well as continue making acquisitions that align with our business strategy. Additions to property and equipment will continue, including new facilities, datacenters, and computer systems for research and development, sales and marketing, support, and administrative staff. We expect capital expenditures to increase in coming years to support growth in our cloud offerings and our investments in artificial intelligence infrastructure. 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.

CRITICAL ACCOUNTING ESTIMATES

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

Revenue Recognition

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

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

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

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

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

Impairment of Investment Securities

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

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

Goodwill

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

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

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

Research and Development Costs

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

Legal and Other Contingencies

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

Income Taxes

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

Inventories

Inventories are stated at average cost, subject to the lower of cost or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. Net realizable value is the estimated selling price less estimated costs of completion, disposal, and transportation. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. These reviews include analysis of demand forecasts, product life cycle status, product development plans, current sales levels, pricing strategy, and component cost trends. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue.