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, 2020**

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**
2.125% Notes due 2021	**MSFT**	**NASDAQ**
3.125% Notes due 2028	**MSFT**	**NASDAQ**
2.625% Notes due 2033	**MSFT**	**NASDAQ**

Securities registered pursuant to Section 12(g) of the Act:

NONE

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 24, 2020**
Common Stock, $0.00000625 par value per share	7,583,440,247 shares

MICROSOFT CORPORATION

FORM 10-Q

For the Quarter Ended March 31, 2020

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,	
	2020	**2019**	**2020**	**2019**
Revenue:				
Product	**$ 15,871**	$ 15,448	**$ 49,894**	$ 48,966
Service and other	**19,150**	15,123	**55,088**	43,160
Total revenue	**35,021**	30,571	**104,982**	92,126
Cost of revenue:				
Product	**3,376**	3,441	**11,647**	12,975
Service and other	**7,599**	6,729	**22,092**	19,523
Total cost of revenue	**10,975**	10,170	**33,739**	32,498
Gross margin	**24,046**	20,401	**71,243**	59,628
Research and development	**4,887**	4,316	**14,055**	12,363
Sales and marketing	**4,911**	4,565	**14,181**	13,251
General and administrative	**1,273**	1,179	**3,455**	3,460
Operating income	**12,975**	10,341	**39,552**	30,554
Other income (expense), net	**(132)**	145	**62**	538
Income before income taxes	**12,843**	10,486	**39,614**	31,092
Provision for income taxes	**2,091**	1,677	**6,535**	5,039
Net income	**$ 10,752**	$ 8,809	**$ 33,079**	$ 26,053
Earnings per share:				
Basic	**$ 1.41**	$ 1.15	**$ 4.34**	$ 3.39
Diluted	**$ 1.40**	$ 1.14	**$ 4.30**	$ 3.36
Weighted average shares outstanding:				
Basic	**7,602**	7,672	**7,619**	7,679
Diluted	**7,675**	7,744	**7,693**	7,759

Refer to accompanying notes.

COMPREHENSIVE INCOME STATEMENTS

(In millions) (Unaudited)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2020	**2019**	**2020**	**2019**
Net income	**$ 10,752**	$ 8,809	**$ 33,079**	$ 26,053
Other comprehensive income (loss), net of tax:				
Net change related to derivatives	**(36)**	(33)	**(42)**	(93)
Net change related to investments	**3,508**	714	**3,665**	1,334
Translation adjustments and other	**(541)**	67	**(607)**	(252)
Other comprehensive income	**2,931**	748	**3,016**	989
Comprehensive income	**$ 13,683**	$ 9,557	**$ 36,095**	$ 27,042

Refer to accompanying notes.

BALANCE SHEETS

(In millions) (Unaudited)

	March 31, 2020	June 30, 2019
Assets		
Current assets:		
Cash and cash equivalents	**$ 11,710**	$ 11,356
Short-term investments	**125,916**	122,463
Total cash, cash equivalents, and short-term investments	**137,626**	133,819
Accounts receivable, net of allowance for doubtful accounts of **$446** and $411	**22,699**	29,524
Inventories	**1,644**	2,063
Other current assets	**8,536**	10,146
Total current assets	**170,505**	175,552
Property and equipment, net of accumulated depreciation of **$41,512** and $35,330	**41,221**	36,477
Operating lease right-of-use assets	**8,448**	7,379
Equity investments	**2,660**	2,649
Goodwill	**42,064**	42,026
Intangible assets, net	**6,855**	7,750
Other long-term assets	**13,696**	14,723
Total assets	**$ 285,449**	$ 286,556
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	**$ 9,246**	$ 9,382
Current portion of long-term debt	**3,748**	5,516
Accrued compensation	**6,254**	6,830
Short-term income taxes	**3,296**	5,665
Short-term unearned revenue	**27,012**	32,676
Other current liabilities	**9,151**	9,351
Total current liabilities	**58,707**	69,420
Long-term debt	**62,862**	66,662
Long-term income taxes	**28,888**	29,612
Long-term unearned revenue	**3,385**	4,530
Deferred income taxes	**185**	233
Operating lease liabilities	**7,248**	6,188
Other long-term liabilities	**9,673**	7,581
Total liabilities	**170,948**	184,226
Commitments and contingencies		
Stockholders' equity:		
Common stock and paid-in capital – shares authorized 24,000; outstanding **7,590** and 7,643	**79,813**	78,520
Retained earnings	**32,012**	24,150
Accumulated other comprehensive income (loss)	**2,676**	(340)
Total stockholders' equity	**114,501**	102,330
Total liabilities and stockholders' equity	**$ 285,449**	$ 286,556

Refer to accompanying notes.

CASH FLOWS STATEMENTS

(In millions) (Unaudited)	Three Months Ended March 31, 2020	Three Months Ended March 31, 2019	Nine Months Ended March 31, 2020	Nine Months Ended March 31, 2019
Operations				
Net income	**$ 10,752**	$ 8,809	**$ 33,079**	$ 26,053
Adjustments to reconcile net income to net cash from operations:				
Depreciation, amortization, and other	**3,118**	2,926	**9,292**	8,758
Stock-based compensation expense	**1,338**	1,172	**3,940**	3,462
Net recognized losses (gains) on investments and derivatives	**52**	(95)	**(140)**	(470)
Deferred income taxes	**(206)**	(320)	**(436)**	(740)
Changes in operating assets and liabilities:				
Accounts receivable	**891**	460	**6,778**	7,258
Inventories	**181**	12	**419**	710
Other current assets	**94**	(14)	**(179)**	(864)
Other long-term assets	**124**	(517)	**(726)**	(969)
Accounts payable	**546**	(197)	**(8)**	(1,032)
Unearned revenue	**(736)**	20	**(6,564)**	(4,543)
Income taxes	**765**	276	**(3,042)**	(879)
Other current liabilities	**695**	649	**(1,136)**	(1,017)
Other long-term liabilities	**(110)**	339	**725**	350
Net cash from operations	**17,504**	13,520	**42,002**	36,077
Financing				
Repayments of debt	**(3,000)**	0	**(5,518)**	(3,000)
Common stock issued	**342**	274	**1,003**	834
Common stock repurchased	**(7,059)**	(4,753)	**(17,177)**	(14,910)
Common stock cash dividends paid	**(3,876)**	(3,526)	**(11,272)**	(10,290)
Other, net	**(1,052)**	404	**(805)**	(835)
Net cash used in financing	**(14,645)**	(7,601)	**(33,769)**	(28,201)
Investing				
Additions to property and equipment	**(3,767)**	(2,565)	**(10,697)**	(9,874)
Acquisition of companies, net of cash acquired, and purchases of intangible and other assets	**(329)**	(269)	**(871)**	(2,107)
Purchases of investments	**(15,910)**	(5,846)	**(58,311)**	(42,255)
Maturities of investments	**17,247**	5,893	**47,559**	14,889
Sales of investments	**2,810**	1,424	**14,559**	30,831
Net cash from (used in) investing	**51**	(1,363)	**(7,761)**	(8,516)
Effect of foreign exchange rates on cash and cash equivalents	**(64)**	18	**(118)**	(94)
Net change in cash and cash equivalents	**2,846**	4,574	**354**	(734)
Cash and cash equivalents, beginning of period	**8,864**	6,638	**11,356**	11,946
Cash and cash equivalents, end of period	**$ 11,710**	$ 11,212	**$ 11,710**	$ 11,212

Refer to accompanying notes.

STOCKHOLDERS' EQUITY STATEMENTS

(In millions) (Unaudited)	Three Months Ended March 31, 2020	Three Months Ended March 31, 2019	Nine Months Ended March 31, 2020	Nine Months Ended March 31, 2019
Common stock and paid-in capital				
Balance, beginning of period	**$ 79,625**	$ 77,556	**$ 78,520**	$ 71,223
Common stock issued	**342**	274	**1,003**	6,521
Common stock repurchased	**(1,492)**	(1,218)	**(3,649)**	(3,433)
Stock-based compensation expense	**1,338**	1,172	**3,940**	3,462
Other, net	**0**	7	**(1)**	18
Balance, end of period	**79,813**	77,791	**79,813**	77,791
Retained earnings				
Balance, beginning of period	**30,739**	16,585	**24,150**	13,682
Net income	**10,752**	8,809	**33,079**	26,053
Common stock cash dividends	**(3,865)**	(3,518)	**(11,627)**	(10,592)
Common stock repurchased	**(5,614)**	(3,538)	**(13,590)**	(11,482)
Cumulative effect of accounting changes	**0**	0	**0**	677
Balance, end of period	**32,012**	18,338	**32,012**	18,338
Accumulated other comprehensive income (loss)				
Balance, beginning of period	**(255)**	(2,013)	**(340)**	(2,187)
Other comprehensive income	**2,931**	748	**3,016**	989
Cumulative effect of accounting changes	**0**	0	**0**	(67)
Balance, end of period	**2,676**	(1,265)	**2,676**	(1,265)
Total stockholders' equity	**$ 114,501**	$ 94,864	**$ 114,501**	$ 94,864
Cash dividends declared per common share	**$ 0.51**	$ 0.46	**$ 1.53**	$ 1.38

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 2019 Form 10-K filed with the U.S. Securities and Exchange Commission ("SEC") on August 1, 2019.

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, including uncertainty in the current economic environment due to the recent outbreak of a novel strain of the coronavirus ("COVID-19").

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 other-than-temporary impairments, are recorded in other comprehensive income. Debt investments are impaired when a decline in fair value is judged to be other-than-temporary. Fair value is calculated based on publicly available market information or other estimates determined by management. We employ a systematic methodology on a quarterly basis that considers available quantitative and qualitative evidence in evaluating potential impairment of our investments. 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 duration and extent to which the fair value is less than cost. We also evaluate whether 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. In addition, we consider specific adverse conditions related to the financial health of, and business outlook, for the investee, including industry and sector performance, changes in technology, and operational and financing cash flow factors. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded in other income (expense), net and a new cost basis in the investment is established.

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 quarterly 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 earnings with the corresponding hedged item. Gains and losses representing hedge components excluded from the assessment of effectiveness are recognized in earnings.

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 primarily include certain over-the-counter 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

As of March 31, 2020 and June 30, 2019, long-term accounts receivable, net of allowance for doubtful accounts, was $2.5 billion and $2.2 billion, respectively, and is included in other long-term assets in our consolidated balance sheets.

Recent Accounting Guidance

Recently Adopted Accounting Guidance

Financial Instruments – Targeted Improvements to Accounting for Hedging Activities

In August 2017, the Financial Accounting Standards Board ("FASB") issued new guidance related to accounting for hedging activities. This guidance expands strategies that qualify for hedge accounting, changes how many hedging relationships are presented in the financial statements, and simplifies the application of hedge accounting in certain situations. We adopted the standard effective July 1, 2019. As we did not hold derivative instruments requiring an adjustment upon adoption, there was no impact in our consolidated financial statements. Adoption of the standard enhanced the presentation of the effects of our hedging instruments and the hedged items in our consolidated financial statements to increase the understandability of the results of our hedging strategies.

Recent Accounting Guidance Not Yet Adopted

Financial Instruments – Credit Losses

In June 2016, the FASB issued a new standard to replace the incurred loss impairment methodology under current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. We will be required to use a forward-looking expected credit loss model for accounts receivables, loans, and other financial instruments. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. The standard will be adopted upon the effective date for us beginning July 1, 2020. Adoption of the standard will be applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the effective date to align our credit loss methodology with the new standard. We have evaluated the impact of this standard in our consolidated financial statements, including accounting policies, processes, and systems. We continue to monitor economic implications of the COVID-19 pandemic; however, based on current market conditions, we do not expect the impact to be material upon adoption.

Accounting for Income Taxes

In December 2019, the FASB issued a new standard to simplify the accounting for income taxes. The guidance eliminates certain exceptions related to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period, and the recognition of deferred tax liabilities for outside basis differences related to changes in ownership of equity method investments and foreign subsidiaries. The guidance also simplifies aspects of accounting for franchise taxes and enacted changes in tax laws or rates, and clarifies the accounting for transactions that result in a step-up in the tax basis of goodwill. The standard will be effective for us beginning July 1, 2021, with early adoption permitted. We are currently evaluating the impact of this standard in our consolidated financial statements, including accounting policies, processes, and systems.

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.

PART I
Item 1