Microsoft Cloud Strength Highlights Second Quarter Results

*Commercial cloud annualized revenue run rate exceeds $$17.0 billion*

**REDMOND, Wash. — January 26, 2017 —** Microsoft Corp. today announced the following results for the quarter ended December 31, 2016:

* Revenue was $24.1 billion GAAP, and $26.1 billion non-GAAP
* Operating income was $6.2 billion GAAP, and $8.2 billion non-GAAP
* Net income was $5.2 billion GAAP, and $6.5 billion non-GAAP
* Diluted earnings per share was $0.66 GAAP, and $0.83 non-GAAP

Microsoft completed the acquisition of LinkedIn Corporation (“LinkedIn”) on December 8, 2016. Financial results from the acquired business are reported in the Productivity and Business Processes segment. For the second quarter of fiscal year 2017, the results of LinkedIn, including amortization of acquired intangible assets, contributed revenue, operating income, net income, and diluted earnings per share of $228 million, $(201) million, $(100) million, and $(0.01), respectively.

“[CEO quote],” said Satya Nadella, chief executive officer at Microsoft.

The following table reconciles our financial results reported in accordance with generally accepted accounting principles (“GAAP”) to non-GAAP financial results. Microsoft has provided this non-GAAP financial information to aid investors in better understanding the company’s performance. Additional information regarding our non-GAAP definition is provided below. All growth comparisons relate to the corresponding period in the last fiscal year.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Three Months Ended December 31,** | | | | |
| ($ in millions, except per share amounts) | | **Revenue** | **Operating Income** | **Net Income** | **Diluted Earnings per Share** | |
| **2015 As Reported (GAAP)** | | **$23,796** | **$6,026** | **$5,018** | **$0.62** | |
| Net Impact from Windows 10 Revenue Deferrals | | 1,710 | 1,710 | 1,128 | 0.14 | |
| **2015 As Adjusted for Windows 10 Revenue Deferrals (non-GAAP)** | | **$25,506** | **$7,736** | **$6,146** | **$0.76** | |
| **2016 As Reported (GAAP)** | | **$24,090** | **$6,177** | **$5,200** | **$0.66** | |
| Net Impact from Windows 10 Revenue Deferrals | | 1,976 | 1,976 | 1,315 | 0.17 | |
| **2016 As Adjusted for Windows 10 Revenue Deferrals (non-GAAP)** | | **$26,066** | **$8,153** | **$6,515** | **$0.83** | |
| Percentage Change Y/Y (GAAP) | | 1% | 3% | 4% | 6% | |
| Percentage Change Y/Y (non-GAAP) | | 2% | 5% | 6% | 9% | |
| Percentage Change Y/Y (non-GAAP) Constant Currency | | 4% | 8% | 10% | 13% | |

Microsoft is providing the following table to help investors compare results for the second quarter of fiscal year 2017 to the guidance previously provided for the quarter, which excluded LinkedIn.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Three Months Ended December 31,** | | | | |
| ($ in millions, except per share amounts) | | **Revenue** | **Operating Income** | **Net Income** | **Diluted Earnings per Share** | |
| **2015 As Adjusted for Windows 10 Revenue Deferrals (non-GAAP) from Table Above** | | **$25,506** | **$7,736** | **$6,146** | **$0.76** | |
| **2016 As Adjusted for Windows 10 Revenue Deferrals (non-GAAP) from Table Above** | | **$26,066** | **$8,153** | **$6,615** | **$0.83** | |
| LinkedIn Results Including Amortization of Acquired Intangible Assets | | $228 | $(201) | $(100) | $(0.01) | |
| **2016 As Further Adjusted for Windows 10 Revenue Deferrals, Excluding LinkedIn Results (non-GAAP)** | | **$25,838** | **$8,354** | **$6,615** | **$0.84** | |
| Percentage Change Y/Y Excluding LinkedIn Results (non-GAAP) | | 1% | 8% | 8% | 11% | |
| Percentage Change Y/Y Excluding LinkedIn Results (non-GAAP) Constant Currency | | 3% | 11% | 12% | 15% | |

Microsoft returned $6.5 billion to shareholders in the form of share repurchases and dividends in the second quarter of fiscal year 2017.

“I am pleased with our results this quarter. We see strong demand for our cloud-based services and are executing well on our long-term growth strategy," said Amy Hood, executive vice president and chief financial officer at Microsoft.

Revenue in Productivity and Business Processes was $7.4 billion and increased 10% (up 12% in constant currency), with the following business highlights:

* Office commercial products and cloud services revenue increased 5% (up 7% in constant currency) driven by Office 365 commercial revenue growth of 47% (up 49% in constant currency)
* Office consumer products and cloud services revenue increased 22% (up 21% in constant currency) and Office 365 consumer subscribers increased to 24.9 million
* Dynamics products and cloud services revenue increased 7% (up 9% in constant currency) driven by Dynamics 365 revenue growth
* LinkedIn contributed revenue of $228 million for the period beginning on December 8, 2016

Revenue in Intelligent Cloud was $6.9 billion and increased 8% (up 10% in constant currency), with the following business highlights:

* Server products and cloud services revenue increased 12% (up 14% in constant currency) driven by double-digit annuity revenue growth
* Azure revenue increased 93% (up 95% in constant currency) with Azure compute usage more than doubling year-over-year
* Enterprise Services revenue decreased 4% (down 2% in constant currency) with declines in custom support agreements offset by growth in Premier Support Services and consulting

Revenue in More Personal Computing was $11.8 billion and decreased 5% (down 4% in constant currency) driven primarily by lower phone revenue, with the following business highlights:

* Windows OEM revenue increased 5% (up 5% in constant currency), ahead of the PC market
* Windows commercial products and cloud services revenue increased 5% (up 6% in constant currency) driven by annuity revenue growth
* Search advertising revenue excluding traffic acquisition costs increased 10% (up 11% in constant currency) driven by increased revenue per search and search volume
* Gaming revenue decreased 3% (down 1% in constant currency) with lower Xbox console revenue offset by Xbox software and services revenue growth

**Acquisitions and Divestitures**

Microsoft completed the acquisition of LinkedIn on December 8, 2016 and the sale of its feature phone business in November 2016.

**Business Outlook**

Microsoft will provide forward-looking guidance in connection with this quarterly earnings announcement on its earnings conference call and webcast.

**Webcast Details**

Satya Nadella, chief executive officer, Amy Hood, executive vice president and chief financial officer, Frank Brod, chief accounting officer, John Seethoff, deputy general counsel and corporate secretary, and Chris Suh, general manager of Investor Relations, will host a conference call and webcast at 2:30 p.m. Pacific time (5:30 p.m. Eastern time) today to discuss details of the company’s performance for the quarter and certain forward-looking information. The session may be accessed at <http://www.microsoft.com/en-us/investor>. The webcast will be available for replay through the close of business on January 26, 2018.

**“As Adjusted” Financial Results and non-GAAP Measures**

During the second quarter of fiscal year 2017 and the second quarter of fiscal year 2016, GAAP revenue, operating income, net income, and diluted earnings per share include the net impact from Windows 10 revenue deferrals. During the second quarter of fiscal year 2017, GAAP revenue, operating income, net income, and diluted earnings per share include the results of LinkedIn. These items are defined below. In addition to these financial results reported in accordance with GAAP, Microsoft has provided certain non-GAAP financial information to aid investors in better understanding the company’s performance. Presenting these non-GAAP measures gives additional insight into operational performance and helps clarify trends affecting the company’s business. For comparability of reporting, management considers this information in conjunction with GAAP amounts in evaluating business performance.

*Net Impact from Windows 10 Revenue Deferrals.* With respect to our non-GAAP measures related to Windows 10 revenue, we believe these measures bridge investor information and minimize potential confusion during the brief period between the time Windows 10 revenue recognition moved from upfront to ratable, and the adoption of the new revenue standard, when Windows 10 will again be recognized predominantly upfront. The net change in Windows 10 revenue from period to period is indicative of the net change in revenue we expect from adoption of the new revenue standard.

*LinkedIn Results.* With respect to our non-GAAP measure related to LinkedIn results, we believe this measure will help investors compare actual results for the second quarter of fiscal year 2017 to the guidance previously provided for the quarter, which excluded LinkedIn. We do not anticipate providing this non-GAAP measure in the future as our guidance will incorporate expected results for LinkedIn.

These non-GAAP financial measures should not be considered as a substitute for, or superior to, the measures of financial performance prepared in accordance with GAAP.

**Non-GAAP Definitions**

*Net Impact from Windows 10 Revenue Deferrals.* Microsoft recorded net revenue deferrals of $2.0 billion during the second quarter of fiscal year 2017 and net revenue deferrals of $1.7 billion during the second quarter of fiscal year 2016, related to Windows 10.

With the launch of Windows 10 in July 2015, Windows 10 customers receive future versions and updates at no additional charge. Under current revenue recognition accounting guidance, when standalone software is sold with future upgrade rights, revenue must be deferred over the life of the computing device on which it is installed. This is different from prior versions of Windows, which were sold without upgrade rights, where all revenue from original equipment manufacturer (“OEM”) customers was recognized at the time of billing, i.e., upfront.

When Microsoft adopts the new revenue standard, predominantly all Windows OEM revenue will be recognized at the time of billing, which is similar to the revenue recognition for prior versions of Windows. Additional information regarding the new revenue standard is provided below. Microsoft reflects the recognition of Windows 10 revenue at the time of billing in “As Adjusted for Windows 10 Revenue Deferrals (non-GAAP)” revenue to provide comparability during the short period where Windows 10 will be recognized over the estimated life of a device, i.e., ratable, rather than at the time of billing.

*LinkedIn Results.* For the second quarter of fiscal year 2017, LinkedIn contributed revenue, operating income, net income, and diluted earnings per share of $228 million, $(201) million, $(100) million, and $(0.01), respectively. Microsoft excludes the results of LinkedIn and reflects the recognition of Windows 10 revenue at the time of billing in “As Further Adjusted for Windows 10 Revenue Deferrals, Excluding LinkedIn Results (non-GAAP)” to compare results for the second quarter of fiscal year 2017 to the guidance previously provided for the quarter, which excluded LinkedIn.

**New Revenue Standard**

In May 2014, the FASB issued a new standard related to revenue recognition. Under the new standard, revenue is recognized when a customer obtains control of promised goods or services and is recognized in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The FASB has recently issued several amendments to the standard, including clarifications on disclosure of prior-period performance obligations and remaining performance obligations.

The guidance permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the cumulative catch-up transition method). We currently anticipate adopting the standard using the full retrospective method to restate each prior reporting period presented.

The new standard will be effective for us beginning July 1, 2018, and adoption as of the original effective date of July 1, 2017 is permitted. We currently anticipate early adoption of the new standard effective July 1, 2017. While our ability to early adopt using the full retrospective method is dependent on system readiness, including software procured from third-party providers, and the completion of our analysis of information necessary to restate prior period financial statements, we remain on schedule and have implemented key system functionality to enable restated financial information. Our progress includes nearing completion of retrospectively adjusted financial information for fiscal year 2016.

We anticipate this standard will have a material impact on our consolidated financial statements, and continue to make progress in assessing all potential impacts of the standard, including any impacts from recently issued amendments. We have reached conclusions on all key accounting assessments related to the new standard. However, we are still assessing impacts from guidance issued by the FASB Transition Resource Group as part of their November 2016 meeting. We will continue to monitor and assess the impact of changes to the standard and interpretations as they become available. The most significant impact of the standard relates to our accounting for software license revenue. Specifically, under the new standard we expect to recognize Windows 10 revenue predominantly at the time of billing rather than ratably over the life of the related device. We also expect to recognize license revenue at the time of billing rather than over the subscription period from certain multi-year commercial software subscriptions that include both software licenses and Software Assurance. Due to the complexity of certain of our commercial license subscription contracts, the actual revenue recognition treatment required under the standard will be dependent on contract-specific terms, and may vary in some instances from recognition at the time of billing. We expect revenue recognition related to our hardware, cloud offerings including Office 365, and professional services to remain substantially unchanged.

We continue to believe that the net change in Windows 10 revenue from period to period is indicative of the net change in revenue we expect from the adoption of the new standard.

**Constant Currency**

Microsoft presents constant currency information to provide a non-GAAP framework for assessing how our underlying businesses performed excluding the effect of foreign currency rate fluctuations. To present this information, current and comparative prior period non-GAAP results for entities reporting in currencies other than United States dollars are converted into United States dollars using the average exchange rates from the comparative period rather than the actual exchange rates in effect during the respective periods. The non-GAAP financial measures presented below should not be considered as a substitute for, or superior to, the measures of financial performance prepared in accordance with GAAP. All growth comparisons relate to the corresponding period in the last fiscal year.

**Financial Performance Constant Currency Reconciliation**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Three Months Ended December 31,** | | | | |
| ($ in millions, except per share amounts) | | **Revenue** | **Operating Income** | **Net Income** | **Diluted Earnings per Share** | |
| **2015 As Reported (GAAP)** | | **$23,796** | **$6,026** | **$5,018** | **$0.62** | |
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| **2016 As Adjusted for Windows 10 Revenue Deferrals (non-GAAP)** | | **$26,066** | **$8,153** | **$6,515** | **$0.83** | |
| **2016 As Further Adjusted for Windows 10 Revenue Deferrals, Excluding LinkedIn Results (non-GAAP)** | | **$25,838** | **$8,354** | **$6,615** | **$0.84** | |
| Percentage Change Y/Y (GAAP) | | 1% | 3% | 4% | 6% | |
| Percentage Change Y/Y (non-GAAP) | | 2% | 5% | 6% | 9% | |
| Percentage Change Y/Y Excluding LinkedIn Results (non-GAAP) | | 1% | 8% | 8% | 11% | |
| **Constant Currency Impact** | | **-$339** | **-$228** | **-$257** | **-$0.03** | |
| **Constant Currency Impact Excluding LinkedIn** | | **-$333** | **-$223** | **-$251** | **-$0.03** | |
| Percentage Change Y/Y (non-GAAP) Constant Currency | | 4% | 8% | 10% | 13% | |
| Percentage Change Y/Y Excluding LinkedIn Results (non-GAAP) Constant Currency | | 3% | 11% | 12% | 15% | |

**Segment Revenue Constant Currency Reconciliation**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Three Months Ended December 31,** | | | |
| ($ in millions) | | **Productivity and Business Processes** | **Intelligent Cloud** | **More Personal Computing** | |
| **2015 As Reported (GAAP)** | | **$6,690** | **$6,343** | **$12,473** | |
| **2016 As Reported (GAAP)** | | **$7,382** | **$6,861** | **$11,823** | |
| Percentage Change Y/Y (GAAP) | | 10% | 8% | (5)% | |
| **Constant Currency Impact** | | **$(108)** | **$(112)** | **$(119)** | |
| Percentage Change Y/Y (non-GAAP) Constant Currency | | 12% | 10% | (4)% | |

**Selected Product and Service Revenue Constant Currency Reconciliation**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Three Months Ended December 31,** | | | |
|  | | **Percentage Change Y/Y (GAAP)** | **Constant Currency Impact** | **Percentage Change Y/Y (non-GAAP) Constant Currency** | |
| **Office commercial products and cloud services** | | **5%** | **2%** | **7%** | |
| **Office 365 commercial** | | **47%** | **2%** | **49%** | |
| **Office consumer products and cloud services** | | **22%** | **(1)%** | **21%** | |
| **Dynamics products and cloud services** | | **7%** | **2%** | **9%** | |
| **Server products and cloud services** | | **12%** | **2%** | **14%** | |
| **Azure** | | **93%** | **2%** | **95%** | |
| **Enterprise Services** | | **flat** | **(3)%** | **(5)%** | |
| **dows OEM** | | **5%** | **0%** | **5%** | |
| **Windows commercial products and cloud services** | | **5%** | **1%** | **6%** | |
| **Search advertising excluding traffic acquisition costs** | | **10%** | **1%** | **11%** | |
| **Gaming** | | **$0.66** | **(1)%** | **(4)%** | |
| **Gaming** | | **(3)%** | **1%** | **(1)%** | |

**Commercial Cloud Annualized Revenue Run Rate**

Commercial cloud annualized revenue run rate is calculated by taking revenue in the final month of the quarter multiplied by twelve for Office 365 commercial, Azure, Dynamics 365, and other cloud properties.

**About Microsoft**

Microsoft (Nasdaq “MSFT” @microsoft) is the leading platform and productivity company for the mobile-first, cloud-first world and its mission is to empower every person and every organization on the planet to achieve more.

**Forward-Looking Statements**

Statements in this release that are “forward-looking statements” are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially because of factors such as:

* intense competition in all of Microsoft’s markets;
* increasing focus on services presents execution and competitive risks;
* significant investments in new products and services that may not be profitable;
* acquisitions, joint ventures, and strategic alliances may have an adverse effect on our business;
* impairment of goodwill or amortizable intangible assets causing a significant charge to earnings;
* Microsoft’s continued ability to protect and earn revenues from its intellectual property rights;
* claims that Microsoft has infringed the intellectual property rights of others;
* the possibility of unauthorized disclosure of significant portions of Microsoft’s source code;
* cyber-attacks and security vulnerabilities in Microsoft products and services that could reduce revenue or lead to liability;
* disclosure of personal data that could cause liability and harm to Microsoft’s reputation;
* outages, data losses, and disruptions of our online services if we fail to maintain an adequate operations infrastructure;
* government litigation and regulation that may limit how Microsoft designs and markets its products;
* potential liability under trade protection and anti-corruption laws resulting from our international operations;
* laws and regulations relating to the handling of personal data may impede the adoption of our services or result in increased costs, legal claims, or fines against us;
* Microsoft’s ability to attract and retain talented employees;
* adverse results in legal disputes;
* unanticipated tax liabilities;
* Microsoft’s hardware and software products may experience quality or supply problems;
* exposure to increased economic and operational uncertainties from operating a global business, including the effects of foreign currency exchange;
* catastrophic events or geo-political conditions may disrupt our business; and
* adverse economic or market conditions may harm our business.

For more information about risks and uncertainties associated with Microsoft’s business, please refer to the “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Risk Factors” sections of Microsoft’s SEC filings, including, but not limited to, its annual report on Form 10-K and quarterly reports on Form 10-Q, copies of which may be obtained by contacting Microsoft’s Investor Relations department at (800) 285-7772 or at Microsoft’s Investor Relations website at <http://www.microsoft.com/en-us/investor>.

All information in this release is as of January 26, 2017. The company undertakes no duty to update any forward-looking statement to conform the statement to actual results or changes in the company’s expectations.

**For more information, press only:**

Rapid Response Team, Waggener Edstrom Worldwide, (503) 443-7070, [rrt@waggeneredstrom.com](mailto:rrt@waggeneredstrom.com)

**For more information, financial analysts and investors only:**

Chris Suh, general manager, Investor Relations, (425) 706-4400

Note to editors: For more information, news and perspectives from Microsoft, please visit the Microsoft News Center at <http://www.microsoft.com/news>. Web links, telephone numbers, and titles were correct at time of publication, but may since have changed. Shareholder and financial information, as well as today’s 2:30 p.m. Pacific time conference call with investors and analysts, is available at <http://www.microsoft.com/en-us/investor>.