

Citi's 2023 Global Technology Conference

Company Participants

- Charles Lamanna, Corporate Vice President, Business Apps & Platform

Other Participants

- Analyst
- Tyler Radke, Citi

Presentation

Tyler Radke {BIO 20483599 <GO>}

And I'm really looking forward to this conversation. We got Charles Lamanna from Microsoft. I'll let Charles introduce him in -- himself in a minute, but Charles looks over the Dynamics 365 business, which I think is kind of an underappreciated area of the Microsoft growth story. There's a lot of things to be excited about. But Charles, first, thanks for making the trip out here, surviving the humidity and heat that we have here in New York. But could you just start off, share your background. I know you've been at Microsoft a couple of different times, just your history at Microsoft and then the roles and responsibilities that you have in your current role?

Charles Lamanna

Absolutely. First, thanks for having me. Super excited for the conversation today. I've been at Microsoft two times, so right out of university for a short stint. Then I did my own company. I was founder of something called MetricsHub, which was acquired by Microsoft a little over 10 years ago. That company was focused on public cloud cost management and health monitoring, let's say in the very early days of IaaS and PaaS. Worked in Azure for about five years, integrating that, working on some other things. But I've been in business applications at Microsoft the last five and a half, six years. So that's Dynamics 365, that's Power Platform, and kind of across that journey, we've seen a pretty broad shift at what that business looks like for Microsoft and I think an exciting way. And despite all of that, I'd say, I still think of myself as a developer at heart. That's where I started my career, at least recovering developer.

Questions And Answers

Q - Tyler Radke {BIO 20483599 <GO>}

(Question And Answer)

Right. Recovering, yes. So Dynamics 365, it's obviously a broad encompassing business, right? There's pockets that are CRM, even some ERP, HR. Could you talk a little bit about the strategy for Dynamics 365? How it's evolved over time and how you see it expanding into other application markets?

A - Charles Lamanna

Absolutely. So I'd say kind of broadly break it into two parts, the answer to that. The first is, we look at Dynamics and business applications in general, and we get excited because our customers are asking us to help them transform their business processes. And to do that, you have to know what does it take to run a marketing campaign? What does it take to run a sales process? What does revenue generation look like in 2023? Or how do you manage your supply chain? Or how do I manage my financials? So very specific problems and workflows for each line of business in every single department. And customers look to us, and historically, we have great platforms to enable them to improve and solve those issues like Azure or you can use Office, right? But business applications make it possible for us to have an off-the-shelf, ready-made, fast time to value solution in all of those areas. So that's what business applications have been about for a while.

And we've been able to find a lot of success over the last five years, really by going through three, I think, main changes in how we think about the strategy. The first, we had to complete our move to the cloud. We weren't really there meaningfully five or six years ago, but now Dynamics -- with Dynamics 365, 100% SaaS, 100% hosted in public cloud, we've been there for a while. And the Dynamics revenue was over \$5 billion last fiscal year for us. And over 80% of that was in the cloud. That is a big shift and that happened because of those investments and really modernizing in a meaningful way. And like when we talk about things like generative AI, the agility we're seeing in Dynamics born because of that cloud migration. So that's kind of one big change.

Second thing is in business applications, historically, there's a big focus on big monolithic investments. Like the full CRM or the full ERP or the full SCM, all the different acronyms out there. And that means there's high cost of adoption in the enterprise. You frequently are looking for one system for the whole company. And if you ever want to switch those things, it's a huge budgetary hit, way more in services than in software. What we've done is we've taken Dynamics and we've decomposed it into individual modules, which customers can easily adopt at a departmental or workflow level. So you don't have to replace your whole CRM. You can just use this in the contact center for one business. You don't have to move your entire supply chain over to us. You can move, say, your parts or your warehouse management and that type of thing.

So that modularization has allowed us to really break into very established markets without having to have a huge services cost. I mean the last thing, which is from a product perspective, the thing which has been the most exciting for us is we really got comfortable with the idea of being part of Microsoft. And Microsoft is not a business applications company, just like it's not a cloud infrastructure company. It's a lot of different capabilities under one roof. So we got very comfortable making Dynamics 365 integrate with the broader Microsoft ecosystem. So if you use Office

like Teams or Excel, the best way to connect your business applications to it is to use Dynamics 365.

Similarly, if you want to go manage your data warehousing or your analytics or an AI in Azure, Dynamics 365 is the best and easiest way to go do that. So that really kind of integrated, single Microsoft platform is something our customers have been hungry for and continue to be very hungry for. No data silos, kind of no walled gardens, that type of thing. So really those three things, I'd say like those are the big changes the last few years have really accelerated the business.

Q - Tyler Radke {BIO 20483599 <GO>}

Okay. Okay. Yes, and you talked about some of those big changes. One of the questions we get a lot from investors is just, if you look at the Dynamics 365 growth, it's actually accelerated. Meanwhile, some of your competitors, certainly in the CRM space have seen growth slow. So would you mainly attribute it to those internal investments that you made in the platform or maybe talk about what your -- how that's impacting your ability to compete and take share in kind of the respective categories?

A - Charles Lamanna

Yes, I mean so I'd say kind of that's laid the foundation for sure for the kind of the growth that we've seen. And I mean, over the last year, there's been a lot of generative AI momentum, too. And so I think that's also played a major part. But I think by getting to the cloud and being in the public cloud, just the agility we can have with updates and features and releases is super differentiated compared to a lot of other business application vendors. And if we kind of go look at that modularization, that's how we found a way to get out of the business of only talking about replace your whole CRM, replace your whole ERP, but instead let's start with this department, start with this function. And then we prove and we earn the right to get more departments and more functions.

Q - Tyler Radke {BIO 20483599 <GO>}

Yes. Yes. Okay. And that's kind of consistent across CRM or marketing or whatever kind of application you have.

A - Charles Lamanna

Absolutely, yes. And I think probably the shape is a little bit different. If it's, say, on the CRM or ERP side, like for CRM, it's much more end-to-end ownership of a process within a department or line of business. So all customer service, say, in a consumer business for a bank. Whereas the ERP it's sometimes like we call it like a multi-tier architecture where you have an ERP for your headquarters, but on the edge for, say, running your warehouses or manufacturing plants, you may use Dynamics to just do that and post back to HQ. So slightly different shape, but same idea.

Q - Tyler Radke {BIO 20483599 <GO>}

Yes. So talking about generative AI. I think it's hard to have a conversation about Microsoft without not bringing it up. But over the summer, we saw some pretty interesting demos and announcements around CRM, Copilot. And I know we were just talking before that we have a lot of events for the fall to look forward to, but how do you kind of see the -- I guess, what should investors look forward to this fall in terms of generative AI capability specific for Dynamics? And then how is the feedback been from customers since the launch of it?

A - Charles Lamanna

Yes. So I mean, the biggest thing is, I think we're past the point of -- I mean, we're still going to do announcements, but we're past the point of just say announcements and demos and press releases. There's an immense amount of generative AI product in market, generally available in Dynamics. We shipped our first GPT-3 powered feature even before GPT-3.5 back in early 2021 to market. So we've been at this for a while and we now have some incredible customer stories, some incredible adoption examples. And I think a lot of our conversations around Dynamics will be showing what people have done with the product. And like as one example, a blog post that we published this morning talking about how we've adopted Copilot for our CRM in Microsoft and the benefits that we've seen.

So we have one of the world's most complex customer support organizations, tens of thousands of people, hugely diverse products from Windows to Xbox to Azure. And we use our Copilot and 100 days of rolling out, we were able to see a 12% improvement in our department in all productivity. So basically how long does it take you to work customer support case. That level of productivity benefit in measurement by economists, statistically significant A-B testing type of thing. We haven't really seen in this area for 30 years since the original digitization in the personal computer. So -- and that's just kind of early innings. So that and what we're seeing with other customers adopt, you'll see more and more customer stories coming out as I think a lot what they'll look forward to. And then from a product perspective, we're just early innings for generative AI. So there's a lot of exciting stuff coming.

Q - Tyler Radke {BIO 20483599 <GO>}

Yes. Yes. And I think the Dynamics business, it's obviously have a ton of different customers, but could you just talk about the demand trends you're seeing? I mean, you're serving both SMBs with Dynamics, but I think increasingly enterprise, maybe departmental with enterprises. But how would you kind of compare and contrast what you're seeing on the demand front, just given the macro environment?

A - Charles Lamanna

Yes, so I mean one thing we are seeing more of is price sensitivity. And we hear this from customers that when they go evaluate a CRM or ERP, are they getting the value they expect for the price they're paying? And if you go look at the market, there's already very high per user prices, which are getting even higher in a lot of cases. And also you have things like AI being additional charges on top of that. So customers are being very discerning as they should be and make sure they're getting the return they expect from the product. So many of our customer

conversations start with what's it going to cost and what's the value I'm going to get from a productivity perspective on the other end. And this is a pretty different, say, environment in the past, or maybe it was, of course, I need a CRM, so I'm going to get a CRM, or of course, I need an ERP in the cloud, I'm going to get an ERP in the cloud.

The good news that we've been very encouraged by and influenced by our decisions is, we've done things like haven't increased the price of Dynamics 365 in the cloud. We think it's a very high per-user price already, very reasonable, fair price. And we've also gone ahead and included our Copilot capabilities for Dynamics in the existing enterprise license, which is the main license our customers buy.

Q - Tyler Radke {BIO 20483599 <GO>}

Like E3--

A - Charles Lamanna

Exactly, yes. So like if you get Dynamics 365 Enterprise, which is the standard SKU, that comes with a Sales Copilot or customer service Copilot or finance Copilot and so on. And that combination is largely influenced by kind of these conversations with customers. And that has allowed us to really nail that ROI. And I think in the entire time I've been in business applications at Microsoft, I've never seen an environment like right now where there's such an appetite for switching at a CRM or ERP level for this reason. So it all goes back to the value I get per dollar I spend.

Q - Tyler Radke {BIO 20483599 <GO>}

Yes. Yes. That's interesting. And I guess from a sales perspective, I know you're more on the product and roots are in development, but how are you -- how are kind of sales incentives structured for the Microsoft go-to-market organization, which obviously is one of the biggest on the planets? But is Dynamics or CRM getting more quota retirement or are you incentivizing the Dynamics business in any way to really drive that even more?

A - Charles Lamanna

Yes. So I mean, like our mainline sales organization at Microsoft is strongly incentive to drive business applications, which is Dynamics 365 and Power Platform. And so it's a mainline investment for us. We also have specialized sales resources globally, which are focused only on Dynamics 365 or the Power Platform. And I think the -- not like maybe a huge change from past years, but it's a top-line priority across the sales organization.

Q - Tyler Radke {BIO 20483599 <GO>}

Yes. So if we take a step back and just think about the TAM for Microsoft applications. I mean, you're touching a lot of different front office, back office, mid office, we'll call it, well over, probably in the hundreds of billions of dollars. How do you kind of think about, A, the addressability of Microsoft portfolio to capture that TAM? And then how does generative AI kind of accelerate that or even increase that TAM?

A - Charles Lamanna

So when we look at business applications, we've historically thought the TAM ballpark is \$150 billion per year. That's a substantial TAM. And I mean, that spans a lot of different categories, that's CRM, ERP, new CDP, HCM, even increasingly the blurring of like service management like ITSM and more. So that's kind of a very big opportunity, but we also include low code in there and RPA. So we kind of view that all as one business application because they all start by having offerings, which help our customers transform their business process, so \$150 billion.

Within that, we kind of think both Dynamics 365 and Power Platform are key growth engines for us. And like hopefully, we can talk a little bit more about Power Platform, but we think that's an area which really has a lot of upside for us, particularly with generative AI. And if you look at that \$150 billion, we're encouraged by Microsoft's opportunity inside of it because it's extremely fragmented, right? It's very different from a lot of other big software markets and categories that we participate in where it's very fragmented across that \$150 billion. And that really means kind of no one's run away with it.

We're also very encouraged because it's a very high margin business too, which is something that is always -- I mean, at that scale and high margin is great. But also we think it's going through a pretty profound transformation on many different fronts. I mean, the first one is you're seeing this big change where buyers are really focused on ROI, which is different. It's not just taken as a fact, you have to go upgrade your CRM ERP every year. And also our customers are looking for a new value proposition around productivity. And that's what generative AI is great for, productivity boost. So kind of the market is changing a lot. So you got high fragmentation, high opportunity, high margin, a lot of disruption. And we think that Microsoft is exceptionally well positioned to lead that disruption for this existing market, largely because it's about generative AI. It's about integrating with your broader IT estate, that type of thing. So yes, so I think it's big, it's getting bigger. Generative AI will only increase the technology spent further, but yes.

Q - Tyler Radke {BIO 20483599 <GO>}

Great. Well, that's a great segue because I did want to move to the Power Platform, which I know you're excited about. So maybe it'd be great to just kind of define like all the different products in Power Platform. I know Power is used in a lot of different Microsoft projects, but kind of how has that evolved? And then certainly with Fabric announcement out of build and in May, how are you kind of thinking about the next evolution considering that's kind of this new vision of integrating data analytics, Power Platform?

A - Charles Lamanna

Yes. So for folks that may aren't familiar with Power Platform, that's Power BI for self-service analytics and reporting, Power Apps for web and mobile application development, Power Automate for workflow and robotic process automation, Power Pages for website development and Power Virtual Agent for chatbots, so conversational agents. So a whole bunch of different capabilities all united by the

fact that they're what we call low-code. And low-code basically means, historically, it's drag and drop, a very visual authoring environment as opposed to having to drop down and write code, like JavaScript or C-sharp or Java, what have you or Python. And the benefit of it being low-code is your developers and IT professionals can be a lot more productive. We have some great studies out there where you can be 6x or 7x more productive in the solutions you build using low-code than not.

And also, you can start to empower business users to also create solutions. So someone in the finance department can use Power BI to analyze the last quarter without having to go through IT. Or someone in the HR department can create a web application, which people can use to do HR tasks without having to go turn around and get IT to do it. Or you can go, say, supply chain and core operations can use Power Automate to automate tasks. So this idea of full company creation and full company development is really critical to make it so that our customers can basically build the solutions they need. And what we've seen over the last decade is, there's pretty much an insatiable desire to create digital solutions in every single enterprise everywhere. And I don't think you'll find a CIO ever that says, I have enough resources and enough developers to build all the solutions I want.

Power Platform starts to make that more attainable. So that's kind of what Power Platform is all about. And -- but we shared it's over 33 million monthly active users, growing over 50% year-over-year, really just a massive user base, something that we think is only going to grow further. And we shared in the past, like this is a business measured in the billions of dollars as well in the cloud. And this Power Platform concept, we only coined it in early 2019. So very young product for us. And as we go look to kind of where this space goes to the future, we think this is a very large market opportunity. And we think it increasingly will be how a lot of IT development is done, a lot of digital transformation is done. But kind of all of that, though, of my product portfolio, that's going to be most reimaged with generative AI, it probably is Power Platform. That's really just because it starts to make it even more simple, even more straightforward to create solutions.

Q - Tyler Radke {BIO 20483599 <GO>}

Yes. So there's kind of three pillars, I guess, to Power Platform. You got Power BI, your data and analytics. You got the low-code, no-code development tools, and then kind of the automation or RPA, I guess. Where are you seeing, I guess, the most momentum from customers? And then how do you kind of think Fabric, which category kind of gets innovates the fastest with the Fabric announcement?

A - Charles Lamanna

Yes. So yes, I think that's exactly right. Like probably the biggest three categories are those three. And I think if you look at Power BI, Power Apps and Power Automate, we think we have the market leader in all three of those areas by adoption and usage and kind of lots of great studies out there reflecting that as well. So those are probably the three big categories. If you look at Fabric, Fabric kind of reflects what we hear from our customers. They ask us constantly, can you put more things in the Power Platform. Take more of these historically dev-only, data science-only concepts and make them more accessible through low-code. And for example, we expose

GPT models through Power Platform now. We expose very complex, say, like operations around analytics inside of Power Platform so far.

And then Fabric is kind of the next evolution of that. This idea of how do we take Power BI, great for reporting and analytics, and how do we expand it to encompass things like data warehousing, data storage, data movement? And how do we make it easier for developers in IT to work with business users to create these solutions? So like Fabric is kind of that natural progression. And I would say, you can probably expect us to keep doing an expansion in Power Platform because that's where customers come and push us to do. That I can't grow my dev team, I can't grow my budget, but I want to grow my output. I can do it in Power Platform faster and easier.

Q - Tyler Radke {BIO 20483599 <GO>}

Yes. One big driver of Office 365 broadly has been the frontline worker opportunity. How do you kind of think about the addressability of the Power Platform? And maybe you can hit on Dynamics, too, but just in the context of that frontline worker opportunity, which Microsoft has had a lot of success there.

A - Charles Lamanna

Yes. I mean, like one of the things that's been interesting is like frontline workers historically are very underserved market when it comes to digital technology. And that's because there's not a lot of apps built for them. And if you go look at IT app dev budget, if you kind of go, do I do back office development or customer-facing development or frontline worker development, this kind of always ends up playing like third fiddle. So what we really focused on doing with Power Apps is making it easy to create those mobile applications for frontline workers because they're really - they stand apart because they don't have a PC. They don't wheel around the computer, if you say work in a retail location or manufacturing plant or inside, say, like a hospital. So that mobile application development is very and it's very easy to do on Power Apps.

And we have some amazing stories out there with companies like Walgreens Boots in their retail location or some great examples like with IKEA for their retail location, or even say in the manufacturing plant scenario with GSK. So like those are all examples of frontline applications that historically were pen and paper or data entry, or I just call someone, become a true standardized mobile application. And we've kind of seen this renaissance of development focused on frontline workers using Power Apps. And it's not just the things our customers build, it's also what we ship out of the box. We have Dynamics 365 Field Service, which is very much focused on frontline workers, and that can help you do work orders, and track tasks, and has some mixed reality capabilities.

And what we've seen with Field Service is that together with the back office, say for scheduling and management of the workforce, has been a really strong combination for our customers. And kind of Power Apps plus Field Service, you can start to cover a lot of those scenarios that are out there that just historically had no digital support at all.

Q - Tyler Radke {BIO 20483599 <GO>}

Yes. Certainly it seems like a big opportunity and kind of one that maybe Microsoft is uniquely positioned to go after. We got about 18 minutes left. I know it's a packed room. So if there's any questions, feel free to raise your hand, but I'm sure we could keep going longer than 18 minutes here. One thing I did want to hit on, just given your background, you've worked on the Azure business and you referenced cost optimization kind of the original product you built. What's kind of your perspective? I know that you're not focused on that day-to-day, but what's kind of your perspective? You're out talking to a lot of customers just in terms of cloud optimizations. Are we at the tail end of it? Anything that you're hearing, just given that that's been a focus for you historically?

A - Charles Lamanna

Yes. I mean like I myself am a large Azure customer, even internally, and like we always go through constant optimization. I mean, the thing I would say is like, optimization is probably something that will always exist in public cloud. I mean it's always existed. I think the big question will be, will it swing more towards more digital solutions and less on optimization over time? One thing I am seeing and hearing consistently from customers is generative AI. And I know it's like everything is generative AI, but it really is changing the conversation because in the past, it was all about how do I go reduce my VMs, reduce my data warehouse, those types of things. Now it's much more, how do I bring more workloads to be AI enabled and how do I transform more functions and responsibilities in my company to be AI enabled?

And the reason customers are doing that shift is just because the other side has such a large productivity benefit. I mean, 10% productivity boost. I mean that's something you don't ever get really from a single technology implementation or single project. So there are lots of opportunities like that across the board. And the same thing is true for all the other software companies that build on Azure. They're then trying to integrate generative AI into their applications. Like every Microsoft product definitely has a Copilot today. All of our customers want to have a Copilot like experience as well. So that's changed the conversation definitely. So that's kind of one key aspect.

And maybe just the kind of the only thought I would have is like, generally what's great about the public cloud is the fact that you can do this optimization. It's not like you buy your servers, you got to wait for them for three, four years to depreciate. You can actually turn off servers and book the savings. That is the promise that we've been making in the public cloud for 10 years. And now customers are benefiting from it. I think when we come out of this, it will only help drive more workloads to the cloud because people have seen the opportunity there where you can actually kind of dial up and down as needed.

Q - Tyler Radke {BIO 20483599 <GO>}

Yes. You hit on an interesting point just around the ROI and productivity gains, obviously from Copilot, and certainly when we've talked to customers who are using Copilot, we hear great feedback, but obviously no one wants to pay more. So in an

area like knowledge workers where certainly as a user, you can appreciate the productivity it gives. How are you seeing customers measure or justify that ROI? Is it in terms of hours or happiness of the organization? Just talk to like the hard measuring tools they're using to justify these investments in Copilot?

A - Charles Lamanna

Yes. I would say definitely not in a climate where I think employee happiness is maybe the main motivator. Like the -- and it's going to depend from department-by-department. I think this is one of the great benefits of having like these different business applications is we really understand what does productivity look like for a seller. I mean that's revenue per head, right? How fast do you close deals and what's the revenue generated per seller. What does productivity look like for customer support? How many cases do you work per day and what's the cost per case?

Every -- if I go to basically any company, they know those two metrics and what we're able to do is, say, rollout Copilot and measure the before and the after. And that's something that we -- like I mentioned at Microsoft that we've done and we can very clearly look and say, okay, the kind of the composition of the workforce can change in terms of expertise because Copilot can really augment new hires and things like that. And we can also really boost productivity by closing more cases per day. So that's kind of one example. And then if you go to like finance or supply chains, how many finance employees do you have per dollar of revenue that you generate. Or for supply chain, what's the -- how much inventory do you keep, how long does it take to fulfill an order, how often do you deliver in full on time? These are all business metrics that I think if you were to go to any CFO, CRO, CIO, they just know them like that. And Copilot moves the needle on those.

And I kind of -- maybe I've been a little bit pessimistic to say like, historically, it's very hard to show the benefit. With Copilot, it's not very hard. With customers that we work with, we roll these things out, those metrics improve. And I think that when I talk about that new buying environment of wanting more ROI and more productivity benefit, that's what you're going to see from customers. I'll only adopt the CRM if you show me more RPA, more revenue per head, per seller. I'll only adopt this case management tool if you show me more case resolved per day. So that's kind of the shift very much across the board.

Q - Tyler Radke {BIO 20483599 <GO>}

Okay. Okay. That's helpful color. So your CFO has talked about how AI will be one of Microsoft's fastest growing or the fastest growing business to \$10 billion. How do you think about the contribution from Dynamics and the Power Platform to that \$10 billion target?

A - Charles Lamanna

Yes. So I think -- so the first thing is like, as you could tell, we are very, very bullish on what AI means to Microsoft. And I think if you go look, like what we hear from customers, the appetite is just immense. And so if we look at business applications specifically, I think it will have like a overweighted contribution to that compared to, say, historical cloud revenue at Microsoft. What exactly that looks like, there's a lot of

things moving right now, so hard to say. But we're really seeing it happen because of three things in business applications. The first, like I mentioned earlier, we put our Copilot for Dynamics 365 in our existing applications, not an additional fee. Benefit of that is we can sell more of our bread and butter. And like we have a lot of share to gain and we have many years in a row where we've outgrown the market. And we think this will really help us accelerate our core offerings. So we will just win more deals, sell more deals, be more competitive, and we're already seeing that. So kind of just our core products will go faster.

Second, we do have some add-ons where it makes sense, which are AI oriented as part of Dynamics 365 or Power Platform. So for example, in Power Apps, we have something called AI Builder, which is how you can use AI models in your application. And you get a certain amount of credits with it, but if you want to do a lot of AI, you have to buy AI add-ons. And for that, we now support GPT, which draws down a lot of that AI capacity. And we're seeing rapid adoption around AI Builder, for example, inside of Power Apps. So we'll see add-ons and attachments where it makes sense. And the third thing is we have entirely new AI-first products. So Microsoft Sales Copilot, it's been generally available for a while. That is a product which is not a CRM. In fact, it works with any CRM, and it just makes your sellers more productive wherever they work. Whether that's in Outlook, whether that's in Teams, whether that's Windows, whether that's on the go, Sales Copilot makes them more productive by having an AI assistant to help them to have better conversations, prepare for meetings better, understand accounts better, those types of things.

In these new AI-first applications, we think are a huge opportunity for us because they're net new revenue lines and they're also entirely greenfield markets. I go to a company, they don't have a Sales Copilot today. Not like a CRM where you have to kind of have that constant, how does it connect to Microsoft CRM, that type of thing. So we think all three of those will drive a lot of revenue for biz apps in the near term. Like in the next 12 months, it's primarily going to be our core bread and butter products selling more and those add-ons. I go to three years, it's going to increasingly be those AI first products. And like GitHub Copilot is a great example of that.

Q - Tyler Radke {BIO 20483599 <GO>}

Right. Right. You hit on kind of some greenfield opportunity maybe with Sales Copilot. Could you just talk a little bit more about that and kind of how big that opportunity could be?

A - Charles Lamanna

Yes. Like so Microsoft Sales Copilot, we charge \$40 per user per month if you connect to a non-Dynamics 365 CRM. And it's included with our \$95 per user per month Dynamics 365 user license. And I think every single seller in a pretty short period of time will have a Sales Copilot like that. So we think -- so kind of P times Q, we think that's a big opportunity for us. And that's why like if you see a lot of the announcements going all the way back to the modern work announcements for Copilot back in March, Sales Copilot was a major feature in that announcement. So we think there's huge opportunity around these Copilots, which work with any

business application vendor and bring generative AI value where the user spends the most time, which in the case of a CRM is usually not in the CRM, right? It's actually inside of Office.

Q - Tyler Radke {BIO 20483599 <GO>}

Right. And ultimately the \$40 could be a way to onboard the broader Dynamics license for that organization.

A - Charles Lamanna

Yes.

Q - Tyler Radke {BIO 20483599 <GO>}

Okay, I guess as you -- I mean, you hit on an interesting point earlier on like, clearly, budgets are tight. Microsoft I think has really benefited from this environment in terms of the consolidation potential, like you've seen that in security, you've seen that certainly across Power BI and data and analytics. But you could argue maybe you haven't seen that yet in the application side and in CRM or marketing or ERP. I guess, what's kind of your confidence level that maybe that's what could happen over the next three to five years? And I guess, is AI the catalyst to maybe drive that similar consolidation wave in the application layer like we've seen on the productivity and Power Platform?

A - Charles Lamanna

Yes, so like the -- I mean, at a high level, if we look at, say, those modules that I talked about earlier, say, customer experience, service, finance and supply chain, we've been able to do over \$1 billion in each of those. And for many years running now, we've been gaining market share relative to our competition across all of those. So I think we have something, which is working in market and growing kind of in this climate in a way which we're happy -- I think we're pretty happy with. As we go to the future, we think there's real opportunity for a few reasons. The first, we think that we can hit a really great price point for Dynamics that other companies maybe struggle to hit. And that's just in terms of how efficiently we run and how efficiently Microsoft goes to market. So that's -- we think that is going to be a huge asset in business applications because \$95 per user sounds like a lot relative to, say, maybe something like Office 365, but that's actually a very low list price compared to a classic CRM or ERP.

So we do think price is something which is interesting. And the second is, the value we include in that is we have all the standard cloud-based CRM and ERP bells and whistles, but now we have a leadership, a pretty clear leadership position for generative AI in business applications included in that great price. So if you kind of look at those two things, a great set of prices, a great set of value, really leading the way on that next generation of business applications. Those two things together, we think will really help us go drive more standardization and more adoption with Dynamics. And as we think about Copilot in general, one of the things that we've talked about a lot is we think Copilot starts to blur the lines between productivity applications and business applications.

And you've probably seen that in some of our events where in the past you'd have a, say, we talk about Outlook and Teams and Excel. And then in a different event, we talk about Dynamics and Power Platform. We now have events where we talk about both of those things together. And the reason is because with a Copilot, if I'm, say, in Excel and I want to analyze some financial data, I don't want to have to go to my ERP and export data and go to the web and search information. My Copilot can just bring that data to me right in context for my analysis inside of Excel. If I'm writing an e-mail to a customer, I don't want to go leave Outlook to my CRM to look up the accounts and pricing. I want Copilot to bring that data right where I'm working. And this idea of less application switching and more data intelligence brought to where I work, which for most office and business workers is Office, is going to be a really big benefit for Microsoft more broadly. So I'd say, I think there's some price value considerations, then there's also some product category merging and blurring that's happening, too.

Q - Tyler Radke {BIO 20483599 <GO>}

Got it. Yes. On the competitive side with on the CRM business, you highlighted your price point and your nearest competitor that is having a big conference next week also announced a price increase. I guess, have you seen any increased engagement with customers that maybe have large customers that have renewals on the table for Q3, Q4? Are you kind of seeing that an increased appetite for customers to re-platform as a result of the price increases elsewhere and kind of your attractive price point in the Copilot functionality?

A - Charles Lamanna

Yes. I mean like the shorter is like, yes, I don't think we've had these level -- like I mentioned earlier, these level of switching conversations in the entire five, six years I've been in business applications, they've never been higher than they are right now. And I would say like, every conversation that I'm having, say, CEO, CIO, CFO, boils down to two things. What's the total cost over the next five years from Microsoft versus other vendors? And it's a very favorable equation when you do that. I'd say the CFO really likes that equation in the Dynamics favor. And the second thing is, the last 20 years were defined by Cloud CRM. The next 20 years will be defined by AI CRM. Who do I think is actually the leader in AI CRM? Right now, that's Microsoft. So -- and that's what we have the most products in market, the most usage, the most adoption. So those two things work really much in our favor to create a moment and a reason to switch today.

And like just some of the stats to show kind of how much adoption there is. We shared this last quarterly earnings. We have over 63,000 organizations already using Copilot in production. That was 75% growth quarter-over-quarter. I mean that -- I don't know what the other numbers are, but I'm quite confident that is near the top of Copilot adoption or of any generative AI features out there. And the reason the adoption is so large is it's been in market for years. We were early with GPT. We have great partnership with OpenAI and others for foundation models. And we've included it in our existing pricing in SKUs. There's no waitlist. There's no gate. You don't have to pay to use Copilot Dynamics 365. You can use it today. So those three things have really allowed us to expand that installed base.

And as you go to the future of AI CRM, we think it's -- that's the only thing we're going to look at. Just like you don't really evaluate an on-premise CRM today. You only get like no enterprises. I want to go get an on-premise CRM, the only thing about cloud CRM. Going forward, people are only going to consider AI CRM. There will be nothing else. And for that reason, that's why we put it in the existing licenses. So anyway, so I think there's kind of a few different trends happening, but yes, definitely top of mind for our customers.

Q - Tyler Radke {BIO 20483599 <GO>}

Awesome. Well, maybe in the last two minutes, I did just want to get your perspective on--

A - Charles Lamanna

Yes. All right.

Q - Analyst

The high cost of running these LLMs is fairly widely known. And to some extent, it's reflected in the pricing of Copilot in Office 365. Can you talk a little bit about the roadmap going forward? I would assume that we're sort of looking at maximum costs at the moment because there's only one hardware vendor that can provide the hardware. Can you talk about Microsoft's anticipation of the future costs as these LLMs go mainstream across Microsoft's platforms?

A - Charles Lamanna

Yes, I mean just like the -- so the first thing I would say is, it's going to depend heavily on the business, so like the intensity of usage. So like, if I want to run an LLM for every e-mail I get, that's very high usage compared to, say, running an LLM for every sales call that I do. So there is going to be some difference based on the product, how much GPU usage you use. The second thing is, one of the things that we've learned because we've been at this for a while and like, say, in biz apps is like you don't always need to use the biggest models for everything. So one of the things we did about a year ago, we did a fine-tuned version of GPT-3.5 for Power Platform so that we can use basically natural language to create workflows and applications.

And that fine-tuned model, we use something called LoRa, low rank adaptation, is able to run on a GPU skew below the A100. So I think what we're going to see is, you'll see a proliferation of more models, which work with more diverse set of GPU SKUs to kind of get that cost equation right. And right now for Biz Apps, very specifically where I kind of live and breathe, I would say we think that the work we've been doing the last couple of years actually puts us in a very unique position to offer a lot of LLMs at a very low cost because of the fine tuning, because of our unique open AI partnership, because of the work we've done in the application. So -- yes, so I think I would just say, things will get faster, things will get cheaper, things will get more efficient. That's definitely been the trend the last year and a half.

Q - Tyler Radke {BIO 20483599 <GO>}

Yes. Maybe in the last minute, just talk to the audience about the key events or product releases expect in the second half of the year, because I know there's a lot, and then what your three biggest priorities are heading into next year?

A - Charles Lamanna

Yes, I think we got a couple big events. I think basically every month through the end of the year as a company, so I'd say, you'll be -- there'll be no shortage of announcements and capabilities. And if you were to say kind of like the three big things that we're focused on, Copilot, Copilot, Copilot is probably the half of the truth. Like I'd say the majority, if not the super majority of all feature work at my team is in some form Copilot related. And just because even problems, which you wouldn't think are Copilot enabled, if you kind of look at it still be different, are very transformed and improved if you take that Copilot lens. So yes, so gen AI is indeed at the heart of what we're doing.

Q - Tyler Radke {BIO 20483599 <GO>}

Yes, great. Well, thanks so much for joining us and thanks to the crowd. This is great. Awesome.

A - Charles Lamanna

Thank you. Thanks, everyone.

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