

Barclays Global Technology, Media and Telecommunications Conference

Company Participants

- Chris Suh, GM & CFO, Cloud & AI

Other Participants

- Raimo Lenschow, Analyst, Barclays

Presentation

Raimo Lenschow {BIO 4664646 <GO>}

Alright, let's start. I know people are still kind of flocking in, because we have the -- the changing overs [ph] are tight here, at our conference. Chris, good to see you again.

Chris Suh {BIO 17955231 <GO>}

Good [ph] to see you.

Raimo Lenschow {BIO 4664646 <GO>}

It's -- now in a different role. Maybe let's start with, actually, what's the current role for you? How would you define it?

Chris Suh {BIO 17955231 <GO>}

Sure, sure. And thank you Raimo for having me here. It's good to see you -- good to be back in the saddle as I was telling Mike earlier today. So I've been in the current role for two years -- just about two years, and currently I am the Head of Finance or the CFO for our Cloud and the AI division. I think most of you will be more familiar with that as largely synonymous with the external reporting segment, we call the Intelligent Cloud. That encompasses certainly Azure, which gets a lot of attention, but also our portfolio that includes Windows Server and SQL Server, as well as business applications, which actually gets reported in a different segment, but that's also under my responsibility area. And then as you alluded to, the five years previous to that I was doing the Head of IR job, and so it's good to be back out here.

Raimo Lenschow {BIO 4664646 <GO>}

Yes. Okay, perfect. And then as you know now from before, but also now like -- so Azure is a big -- it was one of the big growth opportunities for Microsoft and everyone is kind of excited about it. But the problem that everyone has is, is to kind of frame it. Like what's the ultimate opportunity. Have you -- now that you're kind of on the other side, in a way, have you come up with like a better way or like or a way, actually, to kind of help us on that one?

Chris Suh {BIO 17955231 <GO>}

Sure. It is. It's such a unique business. It's such a unique -- maybe it's not so unique. It's a unique time in the industry. And I think I feel super fortunate to be able to participate in it. Every company on the planet is sort of thinking about this, what to do with their digital state and how to think about transforming and moving their work flows to the cloud. And so it's sort of the -- really once in a generation sort of time to like find itself.

And I think Microsoft uniquely is benefiting in a couple of ways. Obviously, there are the secular trends that I talked about. So you have this sort of big population of customers who are thinking about how to move to the cloud, for both cost savings, but also to access services and sort of modernize their IT environments and think about accessing security and management features in a way that maybe wasn't accessible to them previously, and so you have these structural tailwinds, if you will, and so you have this growing market. We uniquely then continue to be very -- continue to deliver a great value proposition by having this very sort of end-to-end cloud solution story, and by providing sort of the digit -- all the assets and all the partnership that we've had for many, many years and that structurally is helping us. And so the TAM is very large. We can sometimes try to put dollars on it, but I would just say, we're not gated by anything from a market standpoint, it's just our opportunity to execute on it and to capture that.

Raimo Lenschow {BIO 4664646 <GO>}

That's a German trying to do -- trying to do baseball now. Like, how do you do it -- like, how will you think about that? Like, it seems like -- I think we (inaudible) last week at the re:Invent, talked about like 4% workloads are actually in the cloud versus kind of 96% still on-premise. Like where do you see that kind of that point in the journey?

Chris Suh {BIO 17955231 <GO>}

I wouldn't disagree with the sentiment, which is the vast majority of workloads remain not yet in the cloud. And so we are in the early days of the transition. As I said, we feel like we're in a great position, because of the rich, longstanding, trusted relationship that we've had with the vast majority of these companies who still are running predominantly on-premises, and so as they think about who their most trusted strategic IT partner will be, I think we have a very good shot at being that partner. I think we're in the best position to do so. And so, we are very much in the spur, the long game, and as a result I think we feel great about our market position.

Raimo Lenschow {BIO 4664646 <GO>}

Yeah. And then talk a little bit about the evolution of Azure over the last few years, because you know like -- someone had -- the AWS guys had a little bit of a headstart. Whereas if I look at customer conversations I'm having now, over the last few years, things are really changing, and now your customer relationship is coming through, but from you being on the inside now, like how has that evolved or how is that evolving?

Chris Suh {BIO 17955231 <GO>}

Yeah. It's interesting. The market has evolved. And as I said, I think we feel very good about our position and the momentum in our business. And now we are at significant scale and still growing at a very high rate, 63% as you know, in the last quarter. But in some sense, like our value proposition and our differentiation hasn't changed so much. So from the start we viewed ourselves as a very strategic partner, as I said, to these customers. And that means the ability to offer this very sort of broad stack of cloud solutions, whether that's from Azure on the infrastructure side, through applications and office dynamics, and all the way through our M365 offerings. And so, we have this ability to help customers solve solutions in a very comprehensive way.

Secondly, the cadence of innovation. I mean, we continue to launch new products and continue to expand the portfolio, to solve all the problems that we talked about. But thirdly and maybe most importantly has been our commitment to a hybrid approach, and that's been very consistent since day one. And I think you've seen a lot of our competitors sort of embrace hybrid, which I think is a validation that -- our view of the world is the one that's playing itself out in that way. But hybrid to us has always meant, like hybrid to the core means it's informed the way that we built and architected products. It's informed the way that we've brought services to market. It's really about the consistency of that experience from on-prem to the cloud, to the edge, and because we've been sort of embracing and committed to hybrid from day one, I think that's a real differentiator. I think we're really the only true hybrid provider out there that can provide that consistency and the set of solutions from on-prem to cloud to the edge, and I think that continues to resonate with customers, and as we sort of continue to have these long strategic conversations with enterprise customers that tends to be our number one differentiator.

Raimo Lenschow {BIO 4664646 <GO>}

And then talk a little bit about, as well, on the Azure side and (inaudible). On the Azure side, like, we call -- such as -- kind of sometimes call it the premium services. Can you talk a little bit about the mix that you see, because we have some of the -- I think the mobile product is part of that like, how is Azure evolving from like the different product offering?

Chris Suh {BIO 17955231 <GO>}

It's a good question and we get this one with some frequency. Azure as a product family, it's going to continue to evolve. In some sense, it's like you've -- I think of an analogous to Office in some ways, right, because Office historically was synonymous with Excel, PowerPoint, Word. And then over time now it's -- this Office365 offers expansive things like collaboration and communications, as well as productivity. And so, in that sense, like there are some analogies that say Azure will continue to evolve. Today, I think it's most commonly thought of as sort of the core services within Azure, or our infrastructure and our IaaS and SaaS offerings. That has been the fastest growing part of the number that you see, when we talk about our Azure growth externally, that's the faster growing portion of it, it's the larger dollar contributor. It continues to be consumptive based, and so you will see growth within customers like year-on-year, like they continue to move more workloads, they continue to build applications and consume more services. And so that continues to grow with some sort of less limited by, let's say, number of employees or number of seats or number of users. And so the consumptive part of the businesses is a part we are really excited about, obviously.

And then we have another category of revenue within that Azure business that we call either SaaS or we call it per user at times. Most commonly thought of as EMS, as our Mobility -- Enterprise Mobility suite and Power BI, that's all part of that. That's a per user construct that is sort of gated by different dynamics in the consumptive part of the business. It's still seeing good -- great momentum, and we saw seat growth this last quarter in the 30 -- 35% plus, I think 36% this last quarter and a very big base. And so -- but that usage growth -- we like that business, we have many per user models outside of Office, within the Office -- outside of Azure, within the Office business and the Windows business. But you'll see that growth continue to moderate with seat growth, if you will, that's different from consumptive. But really the whole thing is important to us, and that's sort of the benefit of being this very comprehensive cloud provider.

Raimo Lenschow {BIO 4664646 <GO>}

Yeah. And then the -- I mean if you look like IaaS, PaaS I think in the long run will probably be the bigger partners to users, because they have -- you have like a finite number. Like -- so, over time, like that should give you like a positive mix effect.

Chris Suh {BIO 17955231 <GO>}

It does, it does. It's larger today and it's growing faster and so it's weighted heavily toward the consumptive part of the business. As it continues to grow faster than the per user base, the mix will continue to mix up, to your point. And so if you fast forward X number of years, three, five years or whatever the number is, then -- because a good part will be even a bigger portion of it. It will start to replicate that.

Raimo Lenschow {BIO 4664646 <GO>}

Can you talk also like -- a little bit about the premium services. Like where are we -- I would assume like, you have advantage over some of the other corporates [ph], because you have already so much from your heritage as a software company, where

everyone else is like, either trying to steal it from an open source vendor and trying to make money out of that or just try to develop it. Where are we on that journey on premium services for you guys?

Chris Suh {BIO 17955231 <GO>}

Yeah. It is a journey. Right. It's an interesting sort of space, because as I talked about before, like customers really, they are not trying to solve one problem. They are not trying to solve for like, hey, how do I move my compute environment and that's sort of the only thing that they're trying to solve for, as we think about these long-term relationships, like when we -- when a customer commits to Azure for five, seven years for multi-billion dollar, they are thinking very holistically about all the services, whether we can internally call them core or premium, it's sort of indifferent to the customer. They have things that they're trying to solve for. And so we're seeing there -- the core -- the infrastructure side of the business is our more mature businesses, it's the larger business just naturally. And therefore it's reflecting growth rates that are more mature. And then -- but we are seeing very fast growth in sort of our data services, our -- all these premium services that we talk about.

And so I'd say that we're starting to -- they are still much smaller, but they are mixing that way, because of the growth rates that you're seeing. I mean if we really think about where customers are in that journey, and I talked about like sort of the multi, sort of billion dollar type commitments. I mean it is, it is a long-term journey. They don't move everything at once. They move sort of slowly in a sense. They move a workload or we work with them to migrate something. They evaluate what that is, we optimize. And so you see this curve that goes like this and then it sort of optimizes and then we figure out like what they were going to use and what they're not going to use and how they then grow. And so you see the curve go like this. It's not a straight line and up to the right. And so from that context, it's very early days. And migration is sort of the first play for customers, when you think about all the Windows and SQL environments that are running outside of the cloud, migrating that into Azure. We've got these great hybrid offers that let them preserve their value and then migrate that. And then after they move their environments in, then sort of the next step of the innovation, where they're doing app modernization or legacy modernization or literally building new native cloud applications, like that seems to be the next phase. And then of course innovating on higher scale things, like SAP workloads and Kubernetes and all of the things that we're seeing. And so those are like sort of phases in the customer journey and they're all sort of part of the customer engagement that we have.

Raimo Lenschow {BIO 4664646 <GO>}

I mean you touched on migration, that was my next question actually. It's funny like, as you are becoming like a -- or maybe you or (inaudible), you always have been a trusted partner for many of your clients, and it seems to be coming through, because we are tracking like the incremental dollar that you gaining and that number is actually increasing, if you look at the bigger field there. And we saw like one of your competitors last week kind of trying to point out like oh please, you need to adopt more like, a better scale. Like how is that relationship kind of working into that, you

know that trust (inaudible) you have with your clients and do you see that coming through in terms of how the contracts are looking, like size of the contracts, how they're getting structured etcetera?

Chris Suh {BIO 17955231 <GO>}

We seen a lot of positive momentum there. I think you've heard Amy Hood, our CFO, talk about during our earnings calls. We talked about the number of -- let's say \$10 million plus deals that are being signed by customers. It's a great sign of trust in us, and the intent to be a long-term partner. And we use \$10 million sort of an arbitrary line, but there is deals I think that you all are familiar with, that is exceeded into the nine figures. And so those are -- those aren't, they're not buying a solution, they're buying a partner, or they are buying into a partnership, strategic partnership, which is fantastic.

So we are seeing, like I said, we are seeing great momentum there. I think we feel great about that. It is -- it's so early, that's the thing. I mean like we've signed billions of dollars of commitments from customers, and the real work still left in front, is to then partner with those customers, figure out what their roadmap is for their transformation, and work with them, both from an architecture standpoint and technical standpoint to either migrate something or to spin up a new project and to get those, what we call internally, we talked about getting meter spinning, because that's how we measure consumption, but to get the meter spinning, there is a lot of real work to be done with the customer, and it's fantastic that they're committed to us, to work with them on that journey.

Raimo Lenschow {BIO 4664646 <GO>}

Yeah. Okay, perfect. Let's shift gears a little bit. When you bought GitHub, it kind of fitted right into kind of the Microsoft DNA, because it was always being steep [ph] almost it was all about the developer. I think that gets you kind of deeper in there. Now the question is more like around, Azure and development, have you seen an impact from GitHub being part of the organization, how does that feed into Azure, help us there a little?

Chris Suh {BIO 17955231 <GO>}

I like the way you frame that Raimo. Developers have been a really important and rich part of our history. Our success to date has been in partnership with a very rich developer ecosystem. And so you're exactly right. It is a really important priority for us. We've had success with our -- before GitHub, we've had a very successful developer ecosystem writing in Azure initially. But I think what GitHub brings -- by the way get GitHub operates independently. I think you know that as well, like this is part of -- sort of the new model that Satya and Amy have sort of implemented with companies like LinkedIn then and with GitHub, they operate independently. And yet there is still obviously a connection, because Nat, who runs GitHub, reports to Scott Guthrie, and the LinkedIn business reports directly to Satya.

So there is strategic alignment, and yet they operate independently. And so I think that's a really nice symbiotic balance between the two, because get GitHub at its core, continues to be about their developers and their developer ecosystem and that has been really healthy, we've continued to see I think -- Satya talked about it in our last earnings. We continue to see momentum growth there, the number of developers have grown approximately 30%, in the time that -- just in the one year that we've -- they've been part of the Microsoft family. So the momentum there as a standalone is really fantastic.

Now as we think about -- like in some sense in the last year, what I think the biggest benefit to Microsoft has been, more cultural than anything. Meaning like this notion that Microsoft is an open platform. This notion that we're a great partner, even with companies that we compete with. We can compete with the customer and go to market together, and I think we can do that in a way that is graceful and makes sense to us now. So I think the notion that, we've opened Microsoft up, and we've opened ourselves up to a whole population of developers that previously weren't really thinking about writing in Azure, predominantly, I think is a super positive move forward on sentiment, and sort of the health of the ecosystem. And so that's what's important.

Raimo Lenschow {BIO 4664646 <GO>}

I need to be careful on time. (inaudible). So the one thing that where you started to move ahead of the competition, is like in terms of the international buildout. You mean you have more data centers. I know it's still true, but you have more data centers and then (inaudible) group combined internationally. Talk a little bit about that strategy and now that you have the footprint, what does it mean in terms of like adoption?

Chris Suh {BIO 17955231 <GO>}

Yeah. So we do have more data center regions. And so I think that's a very -- we don't actually know how many datas like...

Raimo Lenschow {BIO 4664646 <GO>}

Yeah, sorry. Yeah, in terms of application.

Chris Suh {BIO 17955231 <GO>}

But that has been our consistent strategy from the beginning. We've been very broad globally, thinking about our data center footprint. We've always been of the belief that, in the long run putting the data centers into places where customers want to consume the data and provision the services, is a strategic advantage. And so we've built out that datacenter footprint broadly, with 54 regions around the world, that is more regions than all of our competitors.

We think that's a long-term strategic advantage, we think that it's important right to do that. That also though means, it does add complexity to the build-out, when we think about the ability to provision those services, though, even though it's more complex and it takes -- the interesting challenge of course is that, we always -- it takes good signal, because it takes months of lead time to build the data center. And so you have to have good signal, and you're in more geographies and you are -- so you have to get precise in that signal of what -- where you're going to be in terms of capacity needs, six months from now, 12 months from now, 24 months from now, you have to do that in a sort of -- in a very disperse geographic way. And so those are -- just makes the execution of it more of a challenge, but I think we've done a pretty good job.

Raimo Lenschow {BIO 4664646 <GO>}

The like -- as now, CFO I need to kind of ask you a couple of financial questions as well. You do get the questions around the gross margins a lot, and we talk about the substantial increases or improvements over last couple of quarters. What do you think, what are the factors that investors should look at, as you think about your gross margin profile in the long run?

Chris Suh {BIO 17955231 <GO>}

Sure. I think first and foremost, we try to be fairly transparent about the progress of our commercial cloud gross margins all up. That's the most important -- as a company, that's the most important measure that we have on gross margin, and you've seen those continue to march up consistently over time, which reflects the progress we've made across all the businesses. That said, as you know, the Office businesses -- Office 365 businesses at a more mature growth phase, and a more mature phase of its lifecycle, and therefore its margins are closer to their north star. And so, when you see the commercial cloud numbers continuing to improve, that's really largely driven right now, by the improvement that you're seeing in Azure, just where we are in our lifecycle. And it's 61% which I think is our last quarter for the commercial platinum, I mean that's a pretty healthy number across the whole stack.

That said, we still think that there is continued room for improvement. It really is predicated on the things that we've talked about, which is our -- sort of our ability to continue to expand the data center footprint globally, and how much ahead of demand and how good that signal is in all the geographies, so that you sort of optimize having enough capacity months down the road, but also, not over capacity and that gets expensive and inefficient. It's also our ability to continue to make improvements on the efficiency of the stack, between the hardware and the software. And then there is a bunch of decisions that are more tactical in nature build versus leased, how you sort of do efficiency of power management, etcetera, etcetera, that all goes into the -- how you drive real margin improvement. I would say that, given all those moving parts, we're still confident in our ability to say, structurally our margin structure -- we have no like -- we don't believe a different world exists between us and other hyperscalers, in terms of our ability to reach industry leading margins. It's just the path that it may look a little different for us and for others, but yes.

Raimo Lenschow {BIO 4664646 <GO>}

And then on that subject like as you talk to kind of tech hardware vendors, god bless them, the -- do you kind of -- on the last few quarters, started to complain about like, oh the hyperscalers pulling back a little bit, and it was like a negative kind of demand signal for them. But then if I look at your CapEx numbers, there is no change. Actually, you continue to kind of keep investing at a very healthy pace. Is that kind of more a factor of that, you kind of understanding better, like how to build your data centers, and it's going to be more white label and stuff like that? Or how are these two comments correlated?

Chris Suh {BIO 17955231 <GO>}

It's a great question, and I can't really speak to sort of -- pretty much. I could tell you what we see from our side. Like, we continue to invest in all the stuff that we just talked about, in terms of our expansion. We continue to invest ahead of the demand signals and so there is no sort of waning of demand, let's say, there's plenty of demand. We're always going to try to optimize -- we are always going to try to optimize the way -- the efficiency of our spend. And so that means, sort of that could mean, investing in our own sort of capabilities to build out data centers in a different way, and our efficiency in doing so. So from our standpoint, I can't reconcile the comments, I could just say that, CapEx continues to be a big investment for us. We see plenty of demand out there on the horizon, that lets us continue to make those investments.

Raimo Lenschow {BIO 4664646 <GO>}

Perfect. And I will see you at 22nd place. So, wow, good timing.

Chris Suh {BIO 17955231 <GO>}

Thank you very much.

Raimo Lenschow {BIO 4664646 <GO>}

Thank you everyone for joining.

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