

## UBS Global TMT Conference

### Company Participants

- Jared Spataro, Corporate Vice President, Modern Work

### Other Participants

- Karl Keirstead, UBS

### Presentation

#### Karl Keirstead {BIO 1542979 <GO>}

Okay. Great. Let's continue on. I'm really honored to have Microsoft with us today. We've got Jared Spataro, the CVP of the whole Modern Work Group at Microsoft. Jared, thank you and thank you, Tender and April for this morning's breakfast and for encouraging you to come.

#### Jared Spataro {BIO 17854733 <GO>}

My pleasure to be here. Thanks for being here.

### Questions And Answers

#### Q - Karl Keirstead {BIO 1542979 <GO>}

(Question And Answer)

Yes. Jared, do you want to maybe to set the context describe what the Modern Work portfolio looks like? I think everybody would understand that it leans very heavily M365, Office Teams. But maybe you could describe that portfolio and it might sharpen our questions a little bit later in the session.

#### A - Jared Spataro {BIO 17854733 <GO>}

Yes. You bet. Going into the pandemic, most people thought of the business that I run now essentially is Office 365, that was the main source of value for us. During the pandemic, that changed in a pretty significant way. Not only did we see Teams emerge, I think we'll talk a bit about that becoming a major force in commercial software, but we also saw customers coming to us and asking us for more help in different areas.

So today when you think about this business, you should think about everything that is used to deliver a productive work environment for employees that starts with the

device, hence the OS for us Windows on top of the device, the management software on top of that, it's all the apps that come as a part of Microsoft 365, so those would be the things you think of Office, Word, Excel, PowerPoint, Outlook. And then it's the services, the cloud services that work as well. And then over the course of the pandemic, people have asked us to help them with their meeting rooms, help them with their office space. We branched out even from just personal productivity into really corporate productivity now to it.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Well, that's if I sum that up, that's a pretty big part of Microsoft right there.

**A - Jared Spataro** {BIO 17854733 <GO>}

It's an exciting place to be, very exciting place to be.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

You mentioned, Jared, the pandemic. So why don't we start there actually because I'd love to understand a little bit better how the pandemic changed that part of the portfolio? I'm sure it had some pressure points, but I can think of several areas where it sort of pulled it along. It obviously created a pretty incredible PC demand acceleration that would have helped Windows OEM. Probably off-the-seat growth has certainly breathed life in the Teams, but maybe you could frame how the COVID crisis affected your portfolio.

**A - Jared Spataro** {BIO 17854733 <GO>}

You bet. You've hit, what I'd say on lot of the big themes, but let me expand on them for just a moment.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Yes.

**A - Jared Spataro** {BIO 17854733 <GO>}

So let's start first with Teams going into the pandemic, we're about 20 million monthly active users. Our most recent public statement on Teams has been over 270 million monthly active users on Teams. We'll talk a bit about how they use Teams and what they do with it. During the early part of the pandemic, what we really saw from our customers was just the need to react quickly. Everybody was sent home from this kind of what we would call information worker jobs, and so they came to us looking for help as to how to think about how to quickly move to Teams or quickly think about how to rewire their business is the way I'd talk about it.

There was very, very healthy PC demand, as I would say we saw the resurgence of the big screen. And people -- up to that point, it's hard to remember now, but at that point, all the momentum in my part of the business had been around smaller screens, and there's been so much talk of phones and tablets and what they would do to essentially kind of take over the world. Now I think during the pandemic, we've

seen a moderation of that. We've seen kind of every device find its place. Phones certainly are very important. Tablets can be very helpful. But I also feel like we've seen PCs and that PC form factor become very important, and people understanding how important it is.

So those things happened. I'd also, Karl, mention one other thing we've seen a change in patterns really of how people actually get their work done about six months ago. We finally saw the number of minutes spent in chat in Teams surpass the number of minutes that people spend in Outlook. I need you to pause there for a moment because we've been trying to unseat Outlook in email as kind of a primary communication medium for decades now, all of us have been. We've all predicted the death of email. So it's a very, very significant milestone to see people starting to tip towards a new way of communicating.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Well, Jared, my team accuses me of being a bit of a luddite in terms of technology, but I am now actively chatting in Teams, so I'm part of that trend finally.

**A - Jared Spataro** {BIO 17854733 <GO>}

If Karl is there, that means the world is there.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

And Jared, you touched a little bit on it, but now that we're sort of 2.5 years past that pandemic catalyst, how is -- how are things changing and potentially moderating? Is there any, what I would loosely call, post pandemic growth normalization that your portfolio is seeing? I think the most pronounced one that you could point to was probably Amy's guidance for the Windows OEM business where that's clearly coming off with a little bit of a sugar rush. But are there any other changes, even subtle ones that are happening now that you would put in the category of incredible sort of two-year run and now growth might be moderating slightly?

**A - Jared Spataro** {BIO 17854733 <GO>}

Well, I get to ask two questions by customers today. Question number one, how do I adapt to the new patterns and practices of work? They're just simply trying to figure out, okay, now that this has happened, now that we threw the tools into the business, what's the future look like and they come to us for a lot of advice there. And then the second thing that's happening is we determine how do

I do more with less? So there certainly is a consolidation phase. Now that consolidation phase we felt coming anyway because they were such an investment, people turned all sorts of different, we would call them, point solutions and they want to rationalize those, but with the changing macroeconomic context, it really accelerated that consolidation base that we've seen.

So whereas previously probably about six months to nine months ago, I was trying to derive consolidation. I was in there saying, hey, did you know that with Teams, you

don't need to have some of these other vendors? Today, those customers come to me. We very frequently have customers proactively come to me and say, hey, I'm using Zoom, I'm using Slack, but there's no reason for me to double pay, as I think about rationalizing my IT budget, what can you do for me? And that's music to our ears.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Yes. Maybe unpack that a little bit because I think one of the bull cases on Microsoft is that in an economic downturn, Microsoft will probably be a wallet share gainer due to vendor consolidation. So Jared, maybe I'd love to ask you, it sounds like there's tangible evidence of that, so maybe you could elaborate. And where is your share gaining? You just gave the example of perhaps in the video conferencing side. Are there other parts of the Microsoft portfolio where the (Technical Difficulty) environment is motivating customers to knockout point solutions and consolidate more on Microsoft. So where are you seeing that?

**A - Jared Spataro** {BIO 17854733 <GO>}

Well, I'll start at least with my perception, the macroeconomic context when it comes to IT budgets. IT budgets continue to be very important, but they're under -- make no mistake, they're under pressure for sure. So if I go up that stack that I enumerated, we see it on almost every area. We see it as people think about how they're managing devices' state, you've hit that already. We see it as they think about as an example management.

So for me Intune, Microsoft Intune is a huge part of the business, very important part of the value prop of Microsoft 365. We'll get into that a little bit more. But we see a lot of consolidation there because remember the competitors are in a little bit of flux right now. VMware tends to be a competitor, but they are in flux, maybe the customers come to us and say, gosh, we can't tell where this is going, can you help us with our management strategy, that's management in both devices, so mobile devices as well as PC-oriented devices.

We certainly see it. To be very specific, with Zoom and Slack, we see people coming to us and saying, video conferencing and in chat that they're interested in consolidation. So up and down the portfolio, we really see a lot of people digging in and saying how can we help? Now for us and we'll talk about Microsoft 365, that's one of the things I really would love to talk with you about. We've got a great story, our story -- we've gone in and done work with our customers with Forrester Research, we say, you can save more than 60% just on licensing costs alone, let alone streamlined IT processes if you move to Microsoft 365 when compared to point solutions. That message at this moment is playing very, very well.

The other place that I'd say that you might not think that there's opportunity would be in our frontline worker. We'll talk more about that and F&B, so small and medium-sized businesses. It's not to say these businesses aren't seeing opportunities in the market. It's just that they need to get more efficient than they've ever been.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Jared, I know the cyber security portfolio might not formally be part of your group, but obviously in E5's use, it's a very important driver. Are you also seeing evidence of this vendor consolidation, not just in maybe opportunities to take out Cisco WebEx and Zoom? Are you seeing in the cyber security side too? And do you mind elaborating on where specifically you might be seeing that?

**A - Jared Spataro** {BIO 17854733 <GO>}

For sure. Yes, so think of what we're doing right now in security is essentially taking on a very fragmented space with a consolidation play. That's been our play in security since the beginning. Not only do we secure our own software, so not only do we secure things like email or Teams, but we go beyond that. And we have great offerings when it comes to identity, when it comes to apps, when it comes to devices and securing those devices, we take a zero-trust approach to it.

So our play is to come in. It is a part just to put it in context of how we sell it. It's part of Microsoft 365 E5 or ME5, as you'll hear us refer to it, and it is the single biggest driver of ME5 growth is security. Security and then compliance and then after compliance, we have phone system as well. So when you start to put together those value props, you get something very, very compelling for our customers.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Okay. Let's keep going on these macro changes. That's probably the dominant subject these days because the environment is so fluid, and most software companies' growth rates are under a little bit of pressure. So within the Modern Work portfolio, Jared, could we pause a little bit and talk about where Microsoft might be seeing some pressure? I think, Amy and the IR team have talked a lot about some SMB pressure, but could you elaborate where the pressure points are in your portfolio?

**A - Jared Spataro** {BIO 17854733 <GO>}

Yes, you bet. So specifically in earnings what we said was that we saw moderation in new deal volume outside of E5.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Okay.

**A - Jared Spataro** {BIO 17854733 <GO>}

So moderation in new deal volume outside of E5 --

**Q - Karl Keirstead** {BIO 1542979 <GO>}

E3, let's say.

**A - Jared Spataro** {BIO 17854733 <GO>}

Correct. So let me unpack that E3 component because I think that's important. Just to give you a sense of what that SKU lineup, maybe you know it already, but it looks like we have (Technical Difficulty) from the E3 level up to E5. And the softening that we saw in that new deal volume ends up being at that E3 layer. Now from my perspective, you can imagine we dig into this when we start to see it. There really are two components to it. There certainly is macro.

So when you think about people saying, gosh, all right, am I ready to make this purchase? That certainly is impacting what we're doing and you mentioned SMB, but it's not just SMB for us. For us, it's moderately sized companies that we typically service not through our direct sales force, but through our partner sales force as this would be through our cloud solution provider channel is the way that we service these folks.

And then there's a portion that's not macro, if I'm totally honest with you. There's a portion that's execution for us. Sometimes we get a little bit high on the E5 train and we put everything we've got behind E5 and forget that we've got a two-stroke engine in this business. We've got an E3 component, we've got an E5 component. So as we went to look at what was going on, there was a macro issue that we saw. There also was an execution issue that we're working hard to address this quarter and going forward as well.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Jared, one of the other macro-related issues we're all monitoring is the degree of layoffs across the global economy. It's been a little bit more acute I think on the tech sector. Thankfully, you guys haven't been a big part of that, but others have. So maybe the question I'm getting at is across Office and broadly M 365, what's the sensitivity of this portfolio to headcount growth across the economy? Obviously, if it picks up, it's not a good thing. But I presume that there's some measure of minimum seats that clients commit to, so it can't come under too much pressure. So maybe a little color on the sensitivity to layoffs, given that that's a hot topic for those listening?

**A - Jared Spataro** {BIO 17854733 <GO>}

We watch it very closely as everybody does. We watched that jobs report that just came out. We watch the industries that are growing and those that are shrinking right now. Let me just back up for a second before I talk sensitivity, just to remind you, this business, largely speaking, is a (Technical Difficulty) business. That's what it is. So it is a price times quantity business. When you think about quantity in the enterprise space, we are largely in a place where we are very well penetrated.

And what we mean by that is you either have Office 365 or you're moving to Microsoft 365. In that enterprise space, the play for me more than anything else is two-fold. Number one, it is the price component. So we're trying to drive up ARPU. And it's a brand new queue in enterprise that is frontline worker. That's brand-new for us. It really has taken off, it was accelerated during the pandemic, and that's what you should understand that it is counterintuitive.

In fact, three months in the pandemic, I paused everything related to frontline work, thinking nobody's going to invest in that given all the tumult. That's not what happened. And I restart that thing up in the next 60 days after I told everybody to stop it because what we saw is digital transformation was accelerated so much for the first time ever across industries, people were putting devices and putting new cloud services into the hands of frontline workers, and they needed help, and that provided a really interesting boost for us.

So as you think about how sensitive are we, well, we are sensitive to headcount, but as we see it in the enterprise, I don't feel like there's a big change there. The sensitivity comes in our ability to continue to get frontline workers and SMBs. SMB is typically where you'll see kind of that immediate impact of a macro crunch. But interestingly enough, we have not seen what I've been waiting for in terms of an SMB slowdown in those seat. If you look at our recent reporting for Q1, 14% year-over-year growth in seat, you would think driven largely by FLW and SMB that you would see an immediate slow, we are watching for that slow down. That's not what happened. So we keep a hawk eye on it as well in the jobs report that we all just looked at from the U.S., it looked pretty good actually.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Yes. Maybe that's a reminder not to over index on the tech-specific headcount cuts we're seeing, given the breadth of the Office suite.

**A - Jared Spataro** {BIO 17854733 <GO>}

You really do have to think that at this point given the breadth of this business, we are servicing the economy very, very broadly at this point.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Yes.

**A - Jared Spataro** {BIO 17854733 <GO>}

And that gives us the ability to have puts and takes as we think -- see things go. Now again, we watch certain sectors like SMB, I'll watch that and you should continue to watch that. But so far, it's just been mixed signals macro economically.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

So if those macroeconomic signals turn worse, which I think a lot of investors assume they might and the queue deteriorates, I'm not asking you for a prognosis, but let's say it does, then the key becomes a lot more important. So let's talk about that actually.

**A - Jared Spataro** {BIO 17854733 <GO>}

All right.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Because that's a big part of the story here.

**A - Jared Spataro** {BIO 17854733 <GO>}

Yes.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

So maybe a couple of elements of that. Obviously Microsoft announced a fairly material Office 365 price increase, can you elaborate a little bit on how that's rolling in?

**A - Jared Spataro** {BIO 17854733 <GO>}

You bet. Price increase and I'll talk a little bit about the value of ME5 too, but I'll start with price increase just for a second.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Okay.

**A - Jared Spataro** {BIO 17854733 <GO>}

So the price increase became effective the 1st of March. It was the first price increase we had ever done, not just like in a long time. It was the first we had ever done since we've had Office 365. We felt like we were waiting for the right time when we had enough value. We'd introduced 25 new apps, introduced over 1,400 new capabilities.

We had gone through the pandemic, we had done a lot of establish, we felt like a lot of goodwill, particularly with our enterprise customers. We issued a lot of free trials during that, I mean there's a lot going on. And so we took the opportunity at that point to say we think we're delivering value for what we have here and we increased price.

As you think about this price increase rolling out, however, it's really important to kind of essentially look at the details of the business. First, there is a temporal aspect to this price increase. It does not become effective in any particular account until they renew post-price increase, so post 1 March, their agreement with Microsoft.

So we've got a lot of timing to play out in how these agreements are renewing. Those agreements tend to be three years, sometimes they're up to five years long. So there's a component of staggered pricing that's happening. There's also a component here of which SKUs were included. If you were to look in the announcement that we'd published under my name, we are very specific. I'll give some examples, we didn't increase price on ME5.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Right.



**A - Jared Spataro** {BIO 17854733 <GO>}

We actually were driving people to ME5. We also didn't increase price on what we would call kind of our standard tier in the SMB space. We didn't increase price on our standalone. So there were some places we chose not to increase price. When we did that, you can rest assured we try to be very, very data-driven on what would drive people to the right places in the overall SKU line-up.

And the last thing I'll say is, as you think about kind of that component, the SKU line-up component, is that there's a kind of a ratable revenue component here where you're going to recognize the revenue over time as well. So when you take the SKU component, when you take the agreement renewal component, then you take a ratable revenue component, it's going to play out over time. It will be a big driver for us, that's why we could. But don't think that it's something that will happen immediately.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Yes. Jared, with the team, we spent many days disaggregating that blog post to try to back into what the blended Office 365 price increase was. So I spent a lot of time on that. And let's talk about another ARPU driver and you touched on it earlier and that's the E5 mix shift. So beyond the straight-up price increase, you've got an amazing ARPU growth catalyst in the form of the E5 SKU, which I think Microsoft announced was I think 12% of seats now?

**A - Jared Spataro** {BIO 17854733 <GO>}

That's right.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

So where could that 12% go, realistically? Not -- it's not -- never going to be 100%, but what's the trajectory of that E5 next do you think, even if you want to frame it qualitatively?

**A - Jared Spataro** {BIO 17854733 <GO>}

We think we're very early in the journey with ME5. So I'll answer the question, and then I'll back out and give you the picture for a second. So let's pick up on that data point, 12% of the Office 365 install base is ME5 today, 12%. Now I say it that way because we think that it can go very high. Let me tell you about the drivers of why I think that. The number one driver for E5 is security.

We talked about this idea of consolidation of security. Security demand continues to increase for us, and security continues to be more and more complex for companies to administer. So we feel like, man, we've got a real driver there that doesn't feel like it's going to let up in the coming months.

The second driver for us ends up being compliance. Now that also is a really interesting opportunity for us, particularly as we think about consolidation. The third

driver of E5 is phone system. We haven't talked very much about that, but as people are moving their usage of communications on the Teams, very natural thing for them to do is then move their phone system from typically an on-prem version of the PBX to the Teams phone system in the cloud.

So qualitatively without giving any forward-looking kind of specifics, I would just simply say, 12% is very early in the journey here. As we think about where that ME3 base could go to ME5, I couldn't see a reason why most customers wouldn't want that value, and we'll continue to push it. It isn't something that I feel like only a proportion or a certain percentage of the base would be.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Yes. So maybe we pivot a little bit to the M365 story. For you, you've been leading it, living and breathing it. But for a lot of investors, we've been delivered Office 365 metrics and now you can not so subtly see Microsoft pivoting the conversation to M365. So it does feel like that M365 bundling story is not only a big success, but is bigger part of the messaging. So can you talk a little bit about that shift from O365 to M365 in terms of messaging not only to investors, but to your customers?

**A - Jared Spataro** {BIO 17854733 <GO>}

It's a very interesting one. Think of this for a moment. With Office, the word Office, the brand Office, we had what I considered to be one of the most successful brands in history of business. And yet, as you indicate, over the course of the last few months, during this calendar year, what we've opted to do is to shift away from one of the most successful brands in the business towards this Microsoft 365 brand. And it's -- I think it's very natural for people who are watching to ask why in the world would you do that.

Here's what we found over the years and I've been working particularly in this business for almost 17 years, so I feel like I've got some history here. We have tried for years and years to convince people that we could put more value into Office. But what we found is the brand was so successful that we actually couldn't open people's minds and expand the box, the space that they had. When we asked people about Office, you know what is Office 365? They say, Word, Excel PowerPoint. Sometimes enlightened folks would say, Outlook. But beyond that, I couldn't get them to say Teams, I certainly couldn't get them to say security, I couldn't get them to say frontline worker. It was (inaudible) who needed to use Excel essentially is what they thought.

So a big part of what we're doing here is expanding the box into which we can put value. And what happened during the pandemic is our customers came to us and say, we look at what you can do, we would like to partner with you to do more than just kind of information work on productivity. We want to think about the productivity of our entire enterprise, top to bottom from the C-suite to the shop floor. Can you help us think about that? So that's branding wise as part of what we've done.

What that allows us to do now that we have M365 as a vehicle is to be very creative than about how we offer that value. We have an E3 SKUs as we talked about, we call

that our core SKU. We have an E5 SKU, that's our premium SKU. But we also have these FSKUs, these frontline worker SKUs that allow us to go down and literally provide, for instance, the airlines and the airline crew at Delta Airlines with the ability to use a SKU that is having them use our value in a way I couldn't have imagined six years ago.

So it opens the playing field for us in terms of how we interact with our customers. It gives us a new vehicle, and it really creates a new head space. That's what we're most excited about. And you mentioned earlier with only 12% of the Office 365 base penetrated, we really are in the early innings of this growth.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Yes. Jared, maybe one more on Office per se. You do have another competitor out there, where Google is your employee productivity software rival. On their most recent call, they talked about having 8 million paying customers. We don't know how many users they have. But is any of the guidance for 17% Office 365 growth coming at Google's expense? Is there any market share tailwinds that you've got relative to Google?

**A - Jared Spataro** {BIO 17854733 <GO>}

The answer to that is absolutely. Absolutely is how we think of it. Let me again break down the 17 percentage points of growth for us. So of that 17 percentage points of growth, we talked a lot about ARPU, but remember this is a P&Q business. 14 points of that growth are actually new seats, are driven by the new seats. And where are those new seats coming from, just again to remind you, from frontline workers and from SMB.

And those are two places, SMB has been a place that we have really competed with Google over the years, and that's a place that we're making really nice headway right now. And frontline workers is a place that we feel like in so many ways we have them, I would say, outflanked right now.

Now I have to pause here to say why in the world would you say you have them outflanked. They don't have a Teams' equivalent. For all the machinations over the course of the last couple of years that have happened, they have not been able to get their track together when it comes to communications. And it's so important for you to understand how strategic the communications portion of the portfolio is. Communications creates a daily habit that people come back to whether you're on the front line or you're at a desk.

And when we have that daily habit, we can do so much. So if you were a customer and I were pitching Teams to you today, I'd say, Teams, our solution for meet, call, chat, collaborate and automate. And it turns out you want to see how we drive things like power platform growth, well, it's through Teams. You want to see how we get really ensconced into people's business processes, well it's through Teams and the automation that we're doing. So we just have an arsenal now that makes it the asymmetric warfare, and this is an opportunity for us to take advantage of that.

The other 3 percentage points, those points come from ARPU growth, and lots to talk about there. We haven't hit on Rooms. We haven't -- there's more to do. But it's really important to recognize that we've got this awesome opportunity with seats.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Yes. So perfect segue. Let's talk about Teams. Let's talk about that communications piece, enough on Office?

**A - Jared Spataro** {BIO 17854733 <GO>}

Great.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

You mentioned that Teams used to have MAUs of something like \$20 million. \$270 million -- over 10x. Where can we go from here? Is \$270 million starting to get a little bit maxed out, Jared, and it'll be a little bit more about adding new features to Teams, or do you see the seat TAMs are having potential?

**A - Jared Spataro** {BIO 17854733 <GO>}

I'd break it down by segment is a way to understand it. In the Enterprise segment, man, we're starting to get to the point that we have great penetration. We talked a little bit about consolidation wins that we will see continue to blow for us. So we are seeing people, as an example, move off of Zoom, move off of Slack. We've got some great examples of that. Unisys is a great example. I'll just give you quickly say, I have a little bit of color with Unisys. They were Skype business pre-pandemic. During the pandemic, like so many companies they moved to Zoom very quickly. They're like, we can't figure out Teams.

But in February of this year, we won them back onto the Teams platform. They went through a three month deployment, and now they've shifted the entire company to Teams, and so we're excited about that. But that's the Enterprise segment. I mean, it's largely going to be winning lost ground and driving ARPU. But the real opportunity past that \$270 million will be SMB and FLW. For us, those are the places that are uncharted territory. As I look to the future, without giving you any details, as I look to the future, you should think that my installed base will go from being an information worker dominated installed base to over the coming years, we will become FLW SMB dominated. The world -- the nature of the business will change in really interesting exciting ways.

I get excited about that because when we do the right thing for those folks, it actually accrues up nicely we would say to the information worker, sometimes we can be overly complex for the information worker, but some really great work happening in there. With Teams one more thing I'll say, in the Enterprise space, I'm really excited about the fact that we're retaining those users. I won't comment on all the specifics with Zoom, but you definitely see a pandemic up and a post-pandemic down. We're really seeing retention of our users.

But we are seeing the shift where meetings has been the dominant driving workload, we would call it. Meetings is shifting out of being the driving workload and chat is shifting to be number one, and that's what we predicted. We thought that real-time collaboration would be dominant during the pandemic, post pandemic, what we would call, something more like asynchronous collaboration would really be the driver and we're seeing those usage pattern shift in pretty significant ways.

And on the conference calls, Satya reiterated, 20% increase in Teams users who are using more than four aspects of Teams, talked about over 60% growth in users who are now using third-party or home-grown solutions that are embedded into Teams. We're seeing over 50% growth in phone PSTN. So just some really, really good opportunities for us as people continue to use Teams more deeply.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Jared, you'll be happy to know that in contrast to Unisys, UBS at least in my department was Skype for the longest time.

**A - Jared Spataro** {BIO 17854733 <GO>}

Wow.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

And we made the direct leap to Teams. We didn't go off ramp and then back up.

**A - Jared Spataro** {BIO 17854733 <GO>}

Appreciate that.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

And I'm very happy to be on Teams.

**A - Jared Spataro** {BIO 17854733 <GO>}

Wonderful. I appreciate that.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Let's talk about what you just said about Teams, how things are changing, from meetings being a dominant use case to more chat and phone. And I'm particularly interested on the phone side, and I think a lot of investors are too because there is a number of other companies out there that are Zoom's pushing in a phone, we've got to your place like RingCentral, et cetera. Could you offer any color, stats whatever would make the case most compelling about how the Teams phone side is becoming a dominant use case?

**A - Jared Spataro** {BIO 17854733 <GO>}

Phone, what an interesting space. Let me just talk about the phone market as it exists today, and I'll give you my sense of where trends are taking in the future. So phone

today for many companies has been based on PSTN or these old ways of calling out through the telco companies to phone end points. And we see companies continuing to invest there.

What's happening right now, during the pandemic, they moved a bunch of communication, including meetings through other modalities. And as they've moved those to other modalities, and when you talk about this idea, it would be more or less a consolidation phase, phone is number one. It feels like in the enterprise companies list of things to consolidate. There's cost savings there, and there's end user benefits. So essentially what we see happening is companies coming to us and saying, hey, we're a Teams user, we now like to actually connect our phone system up to Teams so that we have Teams essentially representing our call control, and allowing us to have to open-up new use cases with phone, so excellent opportunity.

Most of the time, historically, what companies have done is they have assigned a phone number to every employee, at least every information worker employee and depending on the scenario every frontline worker employee, frontline worker sometimes will get pooled numbers.

One of the big trends that we're seeing, though, is companies starting to say, wow, hold on a second. Do, I really need to have a phone number for John, if all of a sudden we moved everything to the cloud. So going forward, we think that there are some really important trends in phone that will shift and blow in the direction of an offering like Teams. Number one, we think a lot of traffic is what we know, a lot of traffic is shifting from that PSTN network to voice over IP network.

That is already happening en masse within a company. Very rarely if you're using Teams or you picking up a phone and using a PSTN to call your colleague, it's not happening. It's voice-over-IP. Increasingly that's happening between companies because federation of Teams tenant deployments allow you to no longer have to go through the PSTN network, but again, do voice-over-IPs, that's very exciting for us. So there's a change happening there.

But the other really big change that we see happening is companies now that they're starting to move into the cloud are realizing, wow, I can get pretty sophisticated about my phone usage. Meaning, I can really rethink who I issue phone lines to. I can really rethink how we're using phones and that is the future of phone. We think as it melds together with these other, we would call them other communication modalities, you open up really, really interesting things to do.

So I'll just give you one example. Imagine being able to call a call center rep, start a call with that person, have he or she say to you, you know what, can you just like video me real quick and show me the problem with your product and moving up from that call that was a voice call to video, that's what Teams phone allows you to do is to have that modality together and so lots of companies are very open interested in that.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Jared, I asked you earlier about vendor consolidation trends. You mentioned, you're certainly seeing on the meeting side, you called out Webex and Zoom. Are you starting to see that vendor consolidation trend on the phone side too away from point solutions? Is that a thing that's really kicked in of late?

**A - Jared Spataro** {BIO 17854733 <GO>}

It has. It has. We - it wasn't this past quarter, I think Andrew have to help me. But just recently, we talked about how many actual phone licenses we have out there activated from licenses we have and I'm not going to say the number because I can't remember off the top of my head, but we have talked about that and we can give you a reference for that. It definitely, the consolidation of phone has started to happen for us. We think it'll be more important. The easiest way for you to think about this though is, we find the prime candidates are those who are high now - high monthly active users of Teams. They very quickly tip to phone. That's our easiest route to move to.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Got it. I have got a couple of more for Jared in our last six minutes, seven minutes. But if any of you in the audience have questions, you've got a QR code in front of you, just scan it to submit your question, I'll get it on my laptop, and I'll ask it to Jared if we haven't covered it yet. So while we're collecting those, maybe a couple of more for you. So we have one of our team members in Seattle at the Ignite conference, listening for some new announcements.

And there were some cool stuff on Teams, where you talked a lot about Teams Premium, talked a lot about Microsoft Loop. So when you think about Teams on the new product side, cool stuff that's you and your team are excited about, what are the couple that you would encourage investors to watch carefully that could be big growth opportunities over the next five years?

**A - Jared Spataro** {BIO 17854733 <GO>}

Let me just ground you on the ones that are in market right now or that we've just announced and then I'll talk about where we're headed. So as you think about monetization of Teams, we have got these great sockets. How do you monetize those phone? Rooms, we haven't given much airspace to Rooms, but important to recognize if you are a Teams user, you are going to move to oftentimes to our Rooms systems. And then finally, something we call Teams Premium. This was an ability for us to add additional capabilities specifically related to meetings, so how you do premium capabilities of meetings. Those are our three market growth opportunities.

I simply start the answer of the question there because, man, there is still a lot of runway with those three. Past that, what you are going to see us doing, what we really feel like is the big investment area is AI. I think 2023, you are going to hear so much hype about it and what's happening with open AI and the GPT-3 model, et cetera. But there really is value here as you think about taking that AI out of its kind of almost like every power position that it has right now and applying it directly into the scenarios where people get their work done. So a lot of what you will see from us in Teams will be the application of AI to getting your work done.

In essence, Teams Premium, a lot of what you would have heard was actually AI capabilities applied in this particular case to meetings. So we hope to establish a new work pattern that we would call JOMO, the joy of missing out when it comes to meetings. We are going to create ways for you to record meetings and then have AI go in, and literally, have an assistant tell me if you should even bother with this meeting. Did they ever mention your name, was it anything that you care about, if it was, what portion should you go listen to? There is a lot of value there. So we see AI augmenting human capability in that way.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Got it. Jared, one more for me. The Azure story is so central to Microsoft. There are so many full things to talk about with you that I haven't even uttered the word Azure yet, but maybe we could address that part of the Microsoft portfolio. And in particular, to what extent are all the things you've just talked about with me pulling along Azure consumption? What's the Azure angle to the modern work portfolio?

**A - Jared Spataro** {BIO 17854733 <GO>}

I touched briefly on management. So EMS, our management suite actually drives Azure revenue directly, but that's a part of Microsoft 365. So we'll start there, just to show you some of the overlap. We also touched on security and security is super important because our security offerings span the modern work portfolio and then over into the Azure portfolio the way we think about it. So we typically don't see people just use my portion of security.

They will also move over into things like Azure Sentinel when they move to Microsoft Security portfolio. So that's the second one. And the third one is when we didn't get much of a chance to talk about we're trying to revolutionize end user compute with an offering that we call Windows 365, and that also accrues up to the Azure numbers and is a big growth area for us. So those three are the most concrete that I would say.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

And as everybody models the seat-based or EMS portion of Azure, Jared, as we look over the next couple of quarters, are there any variables that we should keep in mind as we think about the EMS growth, for instance? I think it has a fairly high correlation with the Office 365 go-to-market cadence. So should we sort of be thoughtful about the O365 cadence and sort of make a direct correlation to how EMS might trend? Or are there other variables that we should keep in mind?

**A - Jared Spataro** {BIO 17854733 <GO>}

Structurally, I'd do this. EMS is a portion of Microsoft 365 and E3. And we have two motions as we think about getting to E3. The first motion is what we would call dark to cloud or dark to Office 365. We have lots of opportunities still to move people off their on-prem installs, mostly down the market and in developing markets into the cloud. Sometimes we move them straight to ME3, but oftentimes they will go to OE3, so watch that.



And then the second component is we will move them from O to M, and that's where the EMS numbers really come to pick up. So that's structurally, if you understand that, you can be watching our ability. And again, where is that opportunity, where is that coming from. Well, it's going to be down market, it's going to be in developing nations.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Perfect. Really helpful. Jared, one from the audience. How does LinkedIn, which we haven't talked about yet, fit into the modern work portfolio at Microsoft, your whole bundled sales strategy?

**A - Jared Spataro** {BIO 17854733 <GO>}

It's -- I would say we're at this point where we scrambled for a couple of years with Modern Work to get ourselves into a new place. Again, you have to think that customers thought that I was a purveyor of productivity tools and there was not much else. So I have been working really hard to reposition myself. We talked about that repositioning. Now that we are here, we talked about customer consolidation, customer opportunity. We see a lot of opportunity within Microsoft.

So LinkedIn is the world's largest professional network, but I also think of it as the directory for professionals around the world, that's how we connect and work with each other. There is so much opportunity as we think about that directory of people's profiles, of their identities and what we can do with a communications tool like Teams. So I don't have anything to announce, but we just think that there are great opportunities for us and now take a step back as we look to the future as well. And LinkedIn is a fantastic asset.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Jared, we're out of time, but that was a really interesting conversation. You are -- you have got ownership of some of the more exciting parts of the Microsoft portfolio. So it's been a fun year for you, I'm sure to see this growth profile play out. But thanks for coming all the way to New York to be at our event and happy holidays to you and your family.

**A - Jared Spataro** {BIO 17854733 <GO>}

Thank you. My pleasure to be here. Bye-bye.

**Q - Karl Keirstead** {BIO 1542979 <GO>}

Thank you. Perfect.

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