Wells Fargo Tech Summit

Company Participants

- Ron Markezich, Corporate VP of Office 365 Marketing

Other Participants

- Philip Alan Winslow, Senior Analyst, Wells Fargo Securities, LLC, Research Division

Presentation

Philip Alan Winslow {BIO 6300579 <GO>}

All right. Good morning. Before we begin, I do have the safe harbor statement to read. Microsoft may make some forward-looking statements during this presentation. And you should refer to their SEC filings for the risk factors relating to their business. And that's true whether you're here in person or listening on the web. So Ron, thank you for joining us here in Park City this year so -- and being for the first track here to kick off the sessions. So I guess, maybe just to kick things off a little something for everything -- everybody in the room here, maybe if you can introduce yourself, give us some of your background, tenure at Microsoft, et cetera.

Ron Markezich {BIO 15128633 <GO>}

Great. My name is Ron Markezich. I just hit 20 years at Microsoft last Friday, did a number of jobs. I was -- started in IT, started as a customer at Microsoft -- inside Microsoft for about six years. I became CIO at Microsoft. Started what we now call Office 365 14 years ago as CIO, grew that business in incubation for about six years, ran our U.S. enterprise sales force for five years. And now I'm responsible for our Microsoft 365 commercial business. So Microsoft 365 would include Office 365, Windows and Enterprise Mobility plus security suite.

Questions And Answers

Q - Philip Alan Winslow {BIO 6300579 <GO>}

Great. Awesome. Well just to get things started, too. I mean, Microsoft has obviously gone through a lot of change over the past few years. From your perspective, obviously having been there 20 years now, if you could provide a little bit of color on the evolution of the company and the culture and the impact Satya and Amy have had on the direction and culture of the company.

A - Ron Markezich {BIO 15128633 <GO>}

Yes. I think the -- if I look at when Satya came in, one of the first things he did was get us grounded on a mission that was fresh and new for the company. I think if you look at when Microsoft started in a mission being PC on every desk and in every home, we largely accomplished that mission. I think there's a period of time there where we didn't have that North Star that we're all marching towards. And so getting us grounded on a mission to help every person, help every organization on the planet achieve more was something that's super helpful because it's aspirational. It was focused not on revenue and making money, although that's super important, that's why we're in business. But focus on making people's lives better and making organizations more successful and really focusing from inside to outside how our products and solutions help people. That was a big one. The other one was really a focus on diversity and inclusion in Microsoft. We hear a lot about that. And tech companies are starting to share data. But it was more beyond just the data, just how do we integrate diversity and inclusion into our products, how do we have a mindset that our job at Microsoft is to make sure everyone can participate in this movement that's happening in this world, this new tech industrial revolution. And that was core. You might have seen recently something like even the Xbox Adaptive Controller to help people with disabilities use the Xbox. Or even if you look inside our products that have core accessibility capabilities, you add a picture into PowerPoint, you have alt text in there for people that are visually -- can't see the picture. And so that was core for us just in terms of the mindset of the company. The third one I'll say is you might hear a lot of this Microsoft runs on trust, especially as we move to cloud services, which we've been in the process of literally for 14 years. Trust is such a key component because you become part of that organization, the supply chain, delivery chain, part of how they operate. And so things like our Cybersecurity Tech Accord. We rally tech companies around getting some policies and principles, the principle that privacy is a fundamental human right. Some of the stances we've taken in -- publicly, in the courts, have been all part of making sure customers can trust us and that we have the principles and policies in the company that we treat customers' data that it's their data. They own it. We don't monetize the data. We have a business model that focus on customer success, not our sole success. So I think those 3 things would be key.

Q - Philip Alan Winslow {BIO 6300579 <GO>}

Great. Then obviously, being a veteran at Microsoft, 20 years, maybe you can talk about how your approach has changed to specific business or specific market.

A - Ron Markezich {BIO 15128633 <GO>}

Yes. I think it's interesting, having been a customer at Microsoft early on and now being part of the organization that serves our customers broadly, I think the biggest change at Microsoft in terms of how I've approached it is really around customer signal, customer listening and reaction to customers. When we're purely a software company with ship cycles of three years, it was really hard to get customer signal. When I was CIO, we used to sit down with Bill Gates once every other month for 2 hours just to talk about, as CIO, as a customer of Microsoft product, how could our products get better, which is a horrible signal, customer as one. Now as we move to cloud services through Azure, through Microsoft 365, you get such great signal from customers across segments, geographies, industries, et cetera. And what -- the change has really been around our ability to be agile in that customer feedback. And

the way in which Satya has reengineered the engineering organization and improve the agility and the time to respond to feedback is the biggest change I've had where if I looked at 10 years ago, I'd say, "Oh, we've got this thing we've got to do. It might show up in our product that ships in three years." Now we're looking at, "Hi. we need to make sure we support ethical walls for financial services companies in Microsoft Teams. Boom, it's on the road map." And we deliver that very quickly.

Q - Philip Alan Winslow {BIO 6300579 <GO>}

Great. Maybe you can touch on from a sales perspective with customers, just about the general tone in the relationship between your customers and Microsoft, sort of what are you hearing, what's the feedback been from customers?

A - Ron Markezich {BIO 15128633 <GO>}

Yes. It's -- first of all, the Microsoft Cloud is something customers will say -- if they're not there, it's not a question of whether they'll go there or not. It's a question of when. Certainly, our penetration on Office 365 and Azure has been remarkable, especially in our commercial large enterprise segment. And you might see in the past, 10 years ago, customers will say, oh, I don't know if I want to sacrifice security by moving to the cloud. Now they say, I've got to move to the cloud to get the secure environment I need. The mindset certainly has changed. We saw that with some of the hacks that happened that were largely publicized 5 or six years ago. The whole industry shifted to saying, you know what, Microsoft Cloud is more secure. I've got to get there to help my security posture. We see a lot more in terms of customer tone, how do I invest more in my employees. If you look six years ago, you might have seen customers say, how do I squeeze the turnip even more, get more productivity out of people. How do I take that laptop and instead of a 4-year life, make it a 6-year life? And how do I get a cheaper laptop? That certainly has changed where the expectation of employees -- they have great tools, they have great hardware, great services. And customers -- our customer, the industry has to invest in the employees to keep them, retain them, attract those employees because their expectations for tech is much higher. And so getting them the best and the latest. The third thing I'd say is every company is a tech company. And so they're all searching for how do I avoid disruption. Even companies in the -- what they thought had huge moat to recognize that I'm going to get disrupted. And it's not going to be the CEO that has all the answers. How do I tap into the ingenuity of the entire organization?

Q - Philip Alan Winslow {BIO 6300579 <GO>}

One more high-level question before we drill down on O365 and Microsoft 365. But last year, you went through a big sales re-org at Microsoft. And I'm wondering if you could talk about sort of the core tenets of the change. And how has that changed the dialogue with customers, particularly in your area of focus, O365, M365?

A - Ron Markezich {BIO 15128633 <GO>}

Yes. There's a few things we need to do. We needed to get deeper technical expertise in our field as our product portfolio has broadened. I mean, you look at Azure, Azure is a compilation of about 50 different services. Microsoft 365, we run from taking over -- allowing you to run your PBX in the cloud to set a security

component. So we needed to have deeper expert -- technical expertise in the field. We also needed to organize more around industry. So many of our solutions become tailored by industry differently. If you look at our Dynamics business, that's certainly different by industry. But even Microsoft 365, there's a number of flavors by industry that customers will want to implement. And we need that expertise in the field around that. We also changed our comp model significantly to comp much more around usage at our customers. So top-down, there are some people that are 100% comped on usage. Even our people that are comped on revenue have an aspect of usage. We didn't want -- we want to make sure we didn't just sell licenses that we actually were incenting our people to get customers to use the product that they bought and owned. Then we did a lot around our partners to better segment our customers. So it was clear where we were hunting and selling with Microsoft employees and where the white space was with the partners. Then we had coordination across those. Then last one we invested -- we've been investing, we'll continue to invest quite heavily on is our inside sales organization to carry our -- to help with our breadth of customers and to partner with those partners that sell to those breadth of customers.

Q - Philip Alan Winslow {BIO 6300579 <GO>}

Yes. All right. We'll come -- we'll circle back to M365 in a second. Let's drill into the commercial side of Office 365, which obviously has been a great success that you just mentioned here for the company. And if I flashback to the 2017 financial Analyst Meeting, Amy talked about an 8% CAGR for Office commercial installed base from fiscal '15 to fiscal '17. Now in my opinion, that's a sign of TAM expansion. We were talking about that type of unit CAGR. What's really driving that sort of net new user growth that we're seeing because of Office 365, the piracy, new users, first-line workers, et cetera, what is driving that? And how do you think about that going forward?

A - Ron Markezich {BIO 15128633 <GO>}

Yes. Predominantly, new customers, new users. And we always get this question, when we meet with folks like you, it's like, hey, how can Office 365 grow so much? I thought your penetration's pretty high. And it's amazing how much white space still exists out there for Office 365. And I'd look at it at least on the user side in a couple of perspectives. One, certainly the first-line workers, focusing on housekeeping staff here at the hotel, folks that work the slopes up in Deer Valley or Park City, people that picks grapes in Napa Valley. There's a whole set of first-line workers that never had technology. Depending on how you measure them, it could be 2 billion to 3 billion people in the world that are employees or workers of some sort that really, for the most part, don't have technology. We've really focused our engineering efforts on meeting the needs of that population. In the past, we had tried to just take what we offered for information workers and made it cheaper and slim down for these first-line workers. And that didn't work at all. What we've done now is we've actually created capabilities in the service specifically targeted at those first-line workers. Things like shift capabilities, shift sharing, HoloLens to help people with support in the field so they can tap into an expert back at headquarters, a number of those scenarios. So that's TAM, that subscriber expansion and the population that frankly never subscribed to anything from Microsoft. Then there's customers. We've made great progress in certain segments. But there's a lot of room to go in other

segments, certainly emerging markets, smaller businesses, customers that tend to not move as quickly. We've made great progress just recently in the large banks, the G-SIFIs where there have been holdouts because of regulatory reasons. We've done some things in the U.S., having private clouds for government so that we can meet all the U.S. regulations. We've done things like data centers that are go-local in certain countries so that government in those countries feel more comfortable moving to Microsoft Cloud. We've done things in the emerging markets using an app called Kaizala that allows you to essentially communicate with an organization through just cell numbers. They don't even have to be in the directory, just the phone number, you can reach out to those. So we're doing solutions to meet these segments that haven't yet moved to the cloud to give them a compelling reason to move and to meet their needs both regulatory as well as their business process needs.

Q - Philip Alan Winslow {BIO 6300579 <GO>}

Now Office 365 commercial growth has been outgrowing seat growth as obviously you guys have been reporting. To me, that shows obviously the mixup in the mix up in the skus you're seeing -- and the questions I get from a lot of investors and I like to ask you about is about how do you think about sort of ARPU growth going forward and that migration up to the higher end SKUs Office 365? Like where are we? How do you think through that?

A - Ron Markezich {BIO 15128633 <GO>}

We're in early days. We launched Microsoft E5, our E5 SKU, which would be our premium SKU, which have advanced security capabilities, advanced compliance, have a lot of advanced voice capabilities for instance like moving your PBX to our cloud with our phone system and in Power BI as well. That, we've seen great uptake that -- for that for larger customers. And great early days. But the opportunity is still ahead of us on E5. That's helped -- certainly helped our ARPU growth. There's a lot of focus on E5. But even if we take it down to E3, we've seen a huge move from customers that kind of bought in at a stand-alone workload like Exchange Online or our E1 workload moving to E3. And so what our strategy is, is to help a customer meet their needs by getting into Microsoft 365 at one of our levels and then move them up the chain. And we've seen a lot of success at moving up that chain, either from E1 to E3, from stand-alones to E3 and now E3 to E5. But there's still a lot of room to go, getting the customers to E3, getting new customers, new users as well as getting them up to E5.

Q - Philip Alan Winslow {BIO 6300579 <GO>}

And speaking of new features, let's talk about Teams. And wondering if you could talk about just a momentum you're seeing there. And how do you think about sort of continuing to differentiate Office 365? Obviously, Teams being a sort of recent addition to the package. But how do you think about sort of continuing to differentiate Office 365? So Teams and then kind of the go forward.

A - Ron Markezich {BIO 15128633 <GO>}

Yes. Teams is super important to us because it is the hub for teamwork in Microsoft 365. It's the one place to go. And it bridges the gaps across generations. So a lot of -- like looking at this room, a lot of us probably start our day in Outlook, look at our email, calendar. I could tell you, my kids never go to Outlook. I'm sure your kids never go to Outlook. And they -- your kids love probably things like these GIFs and videos and stuff that I think is a waste of time. But that's a large way in which they communicate. Microsoft Teams brings that together. So you have generations working together in a productive way, which is so needed today because if you look at the workforce, the generations that exist are teaming together. And they have very different styles in which they use technology. Not only that, it's that hub for teamwork that brings everything together in Microsoft 365, whether that's your OneNote, your online meetings, your one-on-ones, your artifacts from a meeting that go back in time. If you join a team, you don't want to -- how many of you have joined the team and said, hey, send me all those emails from the past so I can get up to speed on this new team I'm on. Now you join the team, all the content for that team and the history of that team, they're available to you. When you leave the team, you never and no longer have access to all that information on that team because you lose access to that site, Microsoft Teams. So it's super important for us that hub for teamwork. But it's also a new way for people to work. A lot of times, you'd say, hey, Office 365, you've got Word, Excel, PowerPoint. I'm kind of stuck in my old habits. Microsoft Teams gets people out of their old habits and helps them work in a modern way. All these things combined -- Microsoft Teams, actually less than two years in the market, where actually it's the fastest-growing business application in the history of Microsoft. The growth has been phenomenal. The responses have been phenomenal. Customers like Accenture, I'll give you an example. They made Microsoft Teams available, didn't advertise it, didn't do any internal marketing. Now they have about 145,000 users every month on Microsoft Teams, just organic growth. So we see that quite common. We've also made a version of Microsoft Teams available for free because we see it as a great on-ramp into Microsoft 365 for customers that don't yet own Microsoft 365. They can start using Microsoft Teams, getting real value out of that. There's not -- it's not a trial. There's not an end date. They could stay in there. But we're seeing the conversion rate to subscribers be very high for folks that use the free version.

Q - Philip Alan Winslow {BIO 6300579 <GO>}

Yes. I actually speak millennial. And I only communicate with my team in emojis (inaudible) animated ones on Skype for Business.

A - Ron Markezich {BIO 15128633 <GO>}

A modern way...

Q - Philip Alan Winslow {BIO 6300579 <GO>}

I'm a fan of the vanishing ninja, a big fan of that. But let's transition over to Microsoft 365. And I'll ask a couple more questions then open it up to the audience and pause. But back at Build, I thought it was really interesting because I'd describe it as almost sort of a reposition of Microsoft 365. It's not just simply sort of a bundle, Windows 10, O365 and enterprise mobility and security. But rather it's a platform for developers and it blends web application and -- web and traditional application

environment. So how do you think -- how are sort of -- inside of Microsoft, how you think about 365? And how do you sort of position that as a platform?

A - Ron Markezich {BIO 15128633 <GO>}

Yes. We really -- Microsoft 365, to be fair, we started it a number of years ago as enterprise cloud suite. And it was just a packaging thing. You get a 5% extra discount if you buy the full thing. The uptake was huge. We were super surprised at how strong the uptake was with really no marketing behind it, not a great name. It was confusing what it even was. But then, part of this, when I talked before about kind of the outside-in view of the culture at Microsoft, we realized the reason customers were buying it as a suite wasn't really for the 5% discount, although they'd gladly take that. It's because that's how they used it. Every customer uses Office 365, EMS and Windows together. They don't like to buy them as separate packages. Historically, we as a company had engineered these 3 different products. And so then we sold them and license them as 3 different things. So when we started as a license and packaging thing, we actually changed the whole company over a year ago to engineer and organize around Microsoft 365. So we have 1 engineering leader that owns all the engineering in Microsoft 365. First time we've had a Windows and Office together in 1 engineering organization. And we're really taking kind of that outside-in view. We prioritize work across Windows, Office and EMS. We ensure when we open up a go-local data center, it supports Windows Office and EMS. Our update policies are consistent across the 3. And it's all designed the way around customers and how they would take these products and give them to their users and how their users would use them.

Q - Philip Alan Winslow {BIO 6300579 <GO>}

One last question. And I'll open it up to the audience. But when you talk about M365, how does it fit in with your cloud strategy and the whole strategy around digital transformation? And sort of how is this tracking? And in particular, one of the questions I get from investors, too, is the end of support of Windows 7 is coming up in 2020. How does this fit in with Microsoft 365?

A - Ron Markezich {BIO 15128633 <GO>}

Yes. Well first, when we talk to customers, it was really with digital transformation. And we have our cloud, with Microsoft 365, Azure and Dynamics as the lead cloud to help customers digitally transform. Microsoft 365 is how you can empower your employees and really help them tap into the ingenuity of those employees to help you stay competitive. The way -- if I hit -- kind of hit just Windows 7 end of life really quick. One of the parts that Microsoft 365 is helping customers do is really take Office and Windows and make them cloud delivered. So allow you to take Office 365 ProPlus and have it update your clients across whether you're using iPad, iOS, Android, Windows, Mac, give you those updates then. So that we can manage those clients on you and make sure you always have the latest and greatest. Windows 10, same thing, allow you to have us manage the clients so you always have the latest and greatest. We see a large shift for customers that are on Windows 7 with that coming up to end of life using that to shift to what we could call the modern device or modern desktop. So they always have the latest and greatest across Office, Windows and EMS on those devices and desktops.

Q - Philip Alan Winslow {BIO 6300579 <GO>}

Awesome. I'll pause for a minute to see if there are any questions from the audience. Just go ahead and raise your hand, otherwise, I'll finish off my Q&A. All right, we're getting people revved up. It's still a little early here. They're still getting caffeinated. So I'm going to ask one of my favorite questions. It's about Edge. And so anybody that's read my stuff knows I'm a big Edge guy. So we've written obviously a lot about it. But talk about how Microsoft 365 fits into the whole intelligent Edge, intelligent cloud strategy.

A - Ron Markezich {BIO 15128633 <GO>}

Yes. It's core to both. When you think about Office 365 ProPlus or Windows 10 or Windows Defender ATP, which gives you security on your client, that is all about Edge, getting signal from the Edge, making sure you've got the latest capabilities from a productivity perspective. But also ensure we have signal to help customers with their security posture, even help customers with their -- measuring the productivity and effectiveness in the way they use the tools. We did a -- we have a secure score. We give every customer a secure score, tells them where they can improve their security posture. And we get that by understanding what's happening at the edge and what's happening at the core. That could include (AD) signals, Windows signals, Office signals, signals in Azure. And so we take that altogether, give them a security score. We'll do the same thing with the productivity score. We'll launch a productivity score for customers so they can see individually how can I be more productive. And also as a manager, you can see in an anonymous way, how can I make my team more productive. You can see as an organization leader, how do I make my organization more productive. And that's all signal we're getting from the intelligent cloud and intelligent edge that come together.

Q - Philip Alan Winslow {BIO 6300579 <GO>}

All right. And sticking with the theme of Intelligent Cloud. Obviously, EMS reach, I think, was 88 million in Q2 in terms of installed base. One of the things that Amy talked about is like, hey, look, it's still tied to human. So to speak, versus sort of the open-endedness so to speak of Azure. But how do you think about sort of just penetration of EMS inside of that O365 installed base? And sort of like, I guess, where we are on the life cycle?

A - Ron Markezich {BIO 15128633 <GO>}

Yes. EMS, you have to think about EMS as EMS E3 and EMS E5. EMS E3, we see superstrong attach rate to Office 365. And what we do see is most customers moving to Microsoft 365 because they all want Windows 10 for those users. So great -- and Microsoft 365 in a short period of time is actually a multibillion-dollar business. And so great growth and attach there. EMS E5 is also critical, though. And with EMS E5, we have a lot of security capability that expands, things like advanced threat analytics that I've mentioned, signal that allows you to anticipate where attacks might be coming to address things before an attack happens; has Microsoft Cloud app security. So you can look at all the cloud apps that are used within an organization, manage those and control those. It's the age-old problem of a CIO, how do I manage all this shadow IT? Well now, shadow IT, you don't even need a

server. You just sign up for cloud service. You can use Microsoft Cloud app security to manage all that shadow IT cloud app that exist with your environment. And so what Azure AD Premium P2, they allow you to have policy for GDPR to set automatic classification on documents. So super popular, especially if customers look to meet GDPR requirements. So all of that, we think of EMS E3 strong attach to the Office certainly per user. But lots of headroom with EMS E5 because it's earlier days there. The last one in terms of per user, we are experimenting with some things that are not per user. First is we have something called Microsoft Workplace Analytics that allows you to take the Microsoft Graph and understand how your organization works together, the connections, the interrelationship. We actually don't do that as a per user. We do that as more of a value-based pricing. And so we'll come out with more things that are more value-oriented pricing versus just being tied to per user.

Q - Philip Alan Winslow {BIO 6300579 <GO>}

Cool. Last question for you here, too, is kind of the forward -- I guess, road map sort of Microsoft 365 because there are a lot of areas I can imagine -- sort of you kind of continue to pivot the suite into, whether it be identity access management, message security, virtual desktop, et cetera. It seems like there are multiple areas. How do you think between sort of building some of it organically, acquiring versus partnering in some of these? Like where do you draw the line?

A - Ron Markezich {BIO 15128633 <GO>}

Yes. It's really a balance. I think we do all 3. And we don't -- we would not say 1 of the 3 is a priority. They're all important. We've got a number of partners that integrate with Microsoft. If you just look in Teams and look to add in new apps into Teams, lots of partners out there and continuing to grow. If you look at even security, lots of partners that we work within the security space that we integrate with Microsoft 365. But at the same time, EMS E5, we made some important acquisitions to build out that product in terms of the security capabilities. And they were all of these -- Microsoft Teams, we built in organically. And we felt that was a super good decision because we feel really good about how that fits in with strong integration across all of Office 365 from day 1. So it's really a balance across all of those 3. And they're all 3 very important.

Q - Philip Alan Winslow {BIO 6300579 <GO>}

All right. 30 minutes actually just finished up here. It went fast. So thank you, everyone, for coming. And thank you, Ron for kicking off the track 1.

A - Ron Markezich {BIO 15128633 <GO>}

Thanks for coming. Appreciate it. Thanks, Phil.

Q - Philip Alan Winslow {BIO 6300579 <GO>}

Appreciate it, man. Thank you.