

Deutsche Bank Technology Conference

Company Participants

- Rajesh Jha, EVP of Office Product Group

Other Participants

- Karl Emil Keirstead, Director and Senior Equity Research Analyst, Deutsche Bank AG, Research Division

Presentation

Karl Emil Keirstead {BIO 1542979 <GO>}

Okay. Good afternoon, everybody. Let's get started. I'm Karl Keirstead, on the Deutsche Bank software team. We are delighted to have Microsoft keynote for the 2nd year in a row at DB's tech conference. And delighted to have Rajesh Jha, who heads up the entire Office business for Microsoft be our lunch keynote. Thank you. So much.

Rajesh Jha {BIO 6218647 <GO>}

It's great to be here, Karl.

Karl Emil Keirstead {BIO 1542979 <GO>}

I promised to read a little message before we start. Before we begin, Microsoft may make some forward-looking statements. I wish you would 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 with that, we have a lot to talk about.

Questions And Answers

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

I thought maybe I would start with a question that's actually not specific to the Office business. But Microsoft at large. As everybody here knows. And knows acutely, if you've been holding the shares from the '20s up to the mid-'70s, it's been an amazing, amazing run for Microsoft in the last couple of years. And sometimes it's hard for us on the outside to appreciate the change going on in Microsoft since Satya came aboard. But I know your clients ask you about it. So maybe you could share, as an insider, I think you've been at Microsoft for what, 27 years, something like that?

A - Rajesh Jha {BIO 6218647 <GO>}

That's right.

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

What your observations are about the organization and the energy, level since Satya came aboard? It feels like a pronounced change. But we'd love to hear your views.

A - Rajesh Jha {BIO 6218647 <GO>}

Yes, sure. I mean, like you mentioned, Karl. I came to Microsoft straight out of school many, many years ago. We won't count exactly how many. But the thing, of course, any -- it always comes down to having a clear strategy and executing to that strategy but you just can't overstate the importance of culture. And Satya has been, has been very clear about the culture that he wants to see at Microsoft and he's driven that by personal example. You all have seen the work from Carole Dweck on growth mindset. On the whole, I mean, it may seem superficial. But he really tries to live it. He tries to get his senior leadership team to live it. And the idea here is that you're always learning. You don't start from a presumption of knowing what's right. And that is now for me, it is, I would say, a large part of the organization. The other thing that Satya has really driven is a strong sense of accountability on the engineering teams where just holding us accountable, where revenue is often a trailing indicator of the work you do. And having the engineering team take more direct accountability for driving user satisfaction and usage growth. And as long as you're working and executing clearly to the strategy, then the right business is also going to happen. Also the way we executed the senior leadership team, I probably don't see Satya one-on-one very often. I mean he's always available, should I need to. But we get together at senior leadership team every Friday, most every Friday. And so the idea is all the hard conversations are done in the open. It's done as a team. And it's done with the mindset that we are always trying to learn and trying to get better. And it is, again, very easy to underestimate the impact of something like that. But it's really borne great results. Our employees are satisfied. And people are focused on their work and I feel that we are pulling as one, one leadership team.

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

And it certainly feels to me on the outside that Microsoft is starting to attract some fresh, top-tier talent, not that you -- that process stopped. But when I check with recruiters about where top-tier engineers, top-tier data scientists are going, Microsoft is making that list again.

A - Rajesh Jha {BIO 6218647 <GO>}

Now it's great to see. I mean, we've always been able to attract talent. But now if I take a look at the diversity of talent that we are able to bring in, folks from different open-source frameworks, folks in productivity, on data, on AI. We feel great about the talent at Microsoft and also the talent that already exists and harnessing that in a more productive way.

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

Yes. Good. So maybe let's turn to a couple of the big drivers going on in the tech space today. I know everybody in the audience is following in and 2 that certainly are popping up a lot, over the last several years are cloud. And more recently, AI and Machine Learning.

A - Rajesh Jha {BIO 6218647 <GO>}

Sure.

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

So the cloud journey is a key part of the unit you're running.

A - Rajesh Jha {BIO 6218647 <GO>}

Yes.

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

Because the transition of the traditional Office business to a cloud-hosted Office 365 one might be the single biggest thing going on inside Microsoft for a lot of observers. And maybe, before diving into exactly that transition, I'd love to ask you, broadly, about SaaS or cloud adoption? When we look at the results that a lot of your peers are putting up, whether it's Salesforce or Workday or ServiceNow or, frankly, even the SaaS units inside Oracle and SAP, it feels like everybody, including Microsoft, is seeing a stronger adoption curve, just in the last year or so. So as you talk to clients, Rajesh, what do you think is the catalyst for -- it feels like SaaS adoption to have picked up as acutely as it has in the last year? What's happening out there? It's even occurring inside Deutsche Bank, where we're publicly embracing Salesforce and Workday as well. What do you think is happening at large?

A - Rajesh Jha {BIO 6218647 <GO>}

I'd say, of course in Microsoft we've been all in on the cloud. And not only has it been good for us, it's been great for our customers because our customers can now take advantage of our global hyperscale enterprise-grade cloud. But the biggest payoff for our customers has been the rate of innovation on the cloud is probably in order of magnitude, if not more, faster. And I mean, with Office, specifically, we are seeing great adoption. I would say, we have now upwards of 100 million active users in the cloud, commercially. And this is across different platforms, more than 90 million iOS and Android office users. We are seeing increasing usage of our core workloads, not just exchange in mail, by OneDrive. And SharePoint and Yammer and Skype. But also our newer workload like Team. And some of the, the SaaS is movement, how the mix shift from on-premises into the cloud. And with Office, we are -- I think, we shared this data a couple of months ago, at the Financial Analyst Briefing. But for Office, we are now 50% commercial Office within the cloud. And we think by FY '19, we'll have 2/3 of commercial Office in Office 365 and exchange will be north of that 70%. So there is a bit of a mix shift for sure. But also the cloud in many ways is democratization of -- it's not just economies of scale, which is obvious, also economies of skills. Today, there are many segments where you take the sophisticated capabilities that many vendors produce. It's hard for our customers to go stand those things up. And be able to consume it, even if they find the capital

overlay for it. When you deliver it over the cloud, you naturally start out with a very consume-as-you-go model, a simple model. And so with Office 365 now, we are starting to see small businesses that couldn't really run a lot of our capabilities like Skype Conferencing or OneDrive and SharePoint. They can now actually consume that. And in emerging markets, we see the same thing. So there are couple of secular trends, which are economies of scale, economies of skills and, of course, device proliferation, where the consumption now isn't down to you being on-premises. You can consume it from any device.

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

Yes. Those factors certainly feel like they're picking up steam of late.

A - Rajesh Jha {BIO 6218647 <GO>}

Yes.

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

And Rajesh, on the second one around, AI in general, we always listen to Satya. On the stage, he's always talking about these trends. How does the enterprise spend on AI and Machine Learning, how -- it feels super early stage. But how do you think those mega trends impact the Office business? How might a customer apply AI to Office, for instance?

A - Rajesh Jha {BIO 6218647 <GO>}

Well I think AI is going to be pervasive. It is starting to already be there with Office. Every single day, we have tens of billions of signals that come to our cloud, as our users use Office. And now all of these signals actually belong to the customer. This doesn't belong to Microsoft but we are able to take these signals and give value back to our end users and our customers, who, who do I work with? What documents do I look at? Who am I going to meet next? What's trending in my work group or in my organization? What messages are flowing through the system? All of these are signals. And today, if you take a look at, let me give you a couple of examples. If you take a look at PowerPoint, we now are at the point where we can have end users have a digital designer in the cloud, working on their behalf, telling them the right content. If I'm actually producing some content, it knows what is the relevant content in the enterprise process that I should be linking or reusing. It helps me picking the right design template, getting the styles right in Word. In PowerPoint, again, like, more and more workplaces are diverse and globally co-located. And PowerPoint, I don't know if you guys have seen some of the recent demos of the PowerPoint Translator. But I could be talking here. And I have real-time transcription and translation into one of tens of languages. With Word, it's like you have your professional editor, in the cloud, working on your behalf making sure your content is professional, that the tone is gender-neutral, that's geopolitically appropriate. With Excel, I throw in something like a country label. And I can tell Excel, "Hi. recognize that as an entity." So if I now go into the cell next to it. And I type GDP. Excel will auto populate the GDP next to it. It doesn't treat it like a text string anymore. We can tell it to treat it like entities.

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

That's neat.

A - Rajesh Jha {BIO 6218647 <GO>}

In Outlook, we have AI that knows who do I work with? Who am I close to, organizationally? And what should I prioritize or focus on? Am I spending my time correctly in meetings? If you send me a note, Karl, saying, "Can you send me the deck from yesterday?", Outlook will soon suggest for you what that deck might be. You can right-click on it. We'll detect the natural language query. You can right-click on it and it will suggest the right thing. And if you don't get it right, that's a signal back to us. And a billionth signal back to us, just so we can get our relevance correct. And this is not just about end users, AI working for end-user. For IT professionals, we see signals flowing through our cloud and office. We see signals flowing through Windows, Enterprise. We see signals flowing through directory and networks. And so we're able to triangulate all of these signals. And suggest to the SISO, hey, these patterns look suspect or maybe you want to turn on to FA for these set of folks, or for the encryption policy for these set of folks. I mean, I could go on. But I think AI is going to be incredibly pervasive. Now some of these AI capabilities are going to just be in the existing products and make them better. Some AI capabilities. So we've got this thing called -- it's not, it's in early preview right now. Something we called Workplace Analytics. That, we think is a value-added service that will add to Office 365. Now, what does Workplace Analytics do? I talked about AI, for end-users, AI for IT. Workplace Analytics is for people who are decision makers. Leaders for organizations, HR, sales professional. I'll give you a couple of examples. Last year, I bought 3 companies. So obviously, what's top of mind for me is "Hi. are these companies that I acquired, are they getting progressively more integrated, with the rest of the team?" And the Workplace Analytics, what it does is, it takes a look at the communication pattern between groups of people, collaboration patterns, meetings patterns. And sure enough, I found that one of the three was actually starting to drift further apart. And so it was easy for me to go and get the right processes and connections in place. One of our customers, early customers who work with analytics, they discovered that the correlation between their salesperson efficiency was directly correlated to the size of the internal network. Not so much, how much time they spent with the customer, that matters. But not as much as the size of internal network. So they did their reorg around that core factor. So AI is going to permeate, I think, existing experiences, generate new capabilities. It all starts with the fact that if you have data, if you have high-quality signals, if you're able to iterate on that quickly, learn and experiment and get the right relevance, then you can create value back for your users and your customers. And that's why cloud is so much more, inherently, in a way, they've been on-premises because these models, these AI models, these Machine Learning models, they have to be iterated, they have to be personalized, they have to be creative. Nothing's more annoying than having an assistant getting it wrong for you. Even if they get it wrong 1 out of 3 times, you lose your trust in that. So the UI has to be done tastefully. And so on. I mean we are very bullish in what we can do, in terms of generating user value and customer value, with AI on our existing infrastructural office. And I think LinkedIn is the other data set. If you think about the fact we have 0.5 billion people. And people's Rolodexes in LinkedIn. And who follows whom. And what speech do you click on in your work context. So yes, AI's going to be big.

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

I'm excited to see how the AI trend affects Microsoft, going forward. So I'll be watching.

A - Rajesh Jha {BIO 6218647 <GO>}

We're on it, Karl.

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

Sounds like you are on it. Let's zoom in, maybe at some of the broader themes, of cloud and AI, zoom in a little bit into Office.

A - Rajesh Jha {BIO 6218647 <GO>}

Sure.

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

So inside Microsoft, this is a roughly \$25 billion business. I think if you are a standalone, you'd probably be a top 5 software company. Growing at 6%, this past quarter, on the -- at least, on the commercial side. That's a terrific growth rate. So Rajesh, can you run through what a couple of the key growth drivers are for Office. I'm sure you've got some continued seat growth, as ubiquitous as you are. You've got ARPU growth maybe driven by the transition to some of these newer versions. What's driving that commercial growth of 6%?

A - Rajesh Jha {BIO 6218647 <GO>}

It's what you said, Karl. I mean it's both seat growth and ARPU growth. But before I get into that, let me just share what I think is more foundational which is, we are very anchored in what our mission is with Office. With Office, we want to empower every individual, every organization to succeed. Whether you're in a work context, your home context, whether you're in school. And we are really grounded, actually, creating experience with a product that people love and they trust. Want to enable communication, collaboration, creativity in letting people work anywhere, work on cross-devices. So when you started a mission like that. And you take a step back on that. So the first thing, I would say is monetization of Office. If you get people engaged in your product because they love it, because they trust it, because it does the right things for you, then you earn the optionality to monetize. Without usage, without earning the trust and love of end-users, that is not an option. So we start -- we are very grounded. And are rebuilding the right experiences. And so with Office, we are going to take advantage of it, not just AI, as I talked about. But also natural user interface increasingly, mobility patterns. So we stopped to think about Office, being relevant in different segments. So one of the ARPU drivers for us -- I mean, letting, actually a seat growth driver, let's -- we have, like I said, about 50% of our commercial Office in the cloud with Office 365. And by FY '19, we think we'll be about 2/3 of our way there in the customer transition to the cloud. But it's not just a mix moving to the cloud from on-premises. Office is an incredibly horizontal product. So do you think about, what does a small business want from Office, in terms of

productivity, communication and collaboration. When you go to markets like Kenya or Indonesia or India, where people's only devices -- these are information workers. Their devices are going to be phones. What does Office mean to those users? When you think about baggage attendants, working in the airlines, the folks who work in a corporate office, their needs we understand today. But if you are a worker in a fast food restaurant, if you're a baggage attendant, baggage handler, if you're a cleaning staff at a hotel; what does Office mean to those folks? So as we've started to create new services, we've launched Microsoft Kaizala in India, we are -- seeing how -- I mean, the early reception's been good and then we'll launch it in a few more emerging markets. We've got this frontline SKU in Office 365. We aimed at the -- not the information workers. We're thinking about a specific small business SKU. We're adding more value there. So we've seen seat growth, because now it's affordable to these folks. So they don't need capital overlay. But more importantly, they've got the right product and the right services. So we both see an expansion in seat growth, overall. And if you remember our analyst briefing from a couple of months ago, the Office Commercial seats have grown 8%. So it's not just a movement to the cloud, the overall base is expanding.

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

Yes. And that's amazing, just how ubiquitous Office is, that you're still growing seat counts about that clip.

A - Rajesh Jha {BIO 6218647 <GO>}

Oh, yes I think the -- when you stop to think about all the billion people who are first-line workers or front-line workers, these small businesses who were never able to afford and run Office. There's a lot we can do there. Now, in terms of ARPU driver, the first users who moved from on-premises into the cloud for Office, they wanted professional-grade e-mail with exchange online and Outlook. But like I said, as they started to get engaged, as they started to use it, they've started to increasingly opt in into our hero SKU, which is E3, which has not just messaging and calendaring. But document storage; modern intranet sites, that work on your phones with SharePoint; conferencing with Skype; Yammer. We've added Microsoft Teams to the hub for collaboration. And over the last 2 or three years, it's been great to see the uptake on our SKU. So customers are now moving to a cloud, not for one workload. But increasingly for our hero SKU. Then as you know, we've added E5, that has advanced security and compliance capabilities, that's got phone system in the cloud, that has business analytics in the cloud. And so the early momentum on E5 has been great. Now, some of the workloads in E5, we're going to see a longer sales cycle, things like PBX in the cloud. It's -- there are existing vendor contract that have to be worked through. But the Advanced Threat Protection, Lockbox, conferencing. These are super easy for our customers to switch on. And so that drives the ARPU. And the other thing I would say on ARPU is Microsoft 365 takes the user centricity of Office 365. And we're thinking about the entire needs of a modern workplace, by bringing management on cross devices with EMS. And in Windows 10 Enterprise in the desktop. That's going to be one of the ARPU drivers for us.

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

Okay. And Rajesh, on the transition of 365, you mentioned on the commercial side, Microsoft is already transitioned roughly 50% of the commercial base in fiscal '18. So how long do you think it might take to get that to 100%? And will it ever get to 100%? And for the customers that are not yet flipped on to Office 365, what are the most frequent, sort of, 2 or 3 objections that are keeping them on-prem, that you and the sales teams are chipping away at slowly and you'll eventually get to. But what are they? What are those holdups?

A - Rajesh Jha {BIO 6218647 <GO>}

Yes, I'd say, like I said, FY '19, we think 2/3 of our Office base is going to be in the cloud. For messaging, like Exchange Online Outlook will be 70%, something we've (backed hard). We are running about a year ahead of where we thought we would be two years ago. If you go back, I don't know, what we have shared exactly. But internally, we think we are running about a year ahead on the customers' transition. Now in terms of, all customers eventually move to cloud. Given our installed base and the diversity of the regulatory context of these customers' (inaudible) existence, I think it's a stretch to say all. But we tend -- like 2/3 of the customer. And there's a bit of a carrot in here, too. If you move to the cloud, you get a much faster rate of innovation because of the AI and the ML that we can go run and we see signals. In terms of what gets in the way for customers, I would say regulatory issues for public sectors, that's important. And so you will see with Microsoft Cloud, we are very, very intentional about being in the markets that make sense. And we think about it as one Microsoft Cloud. Azure, Dynamics, Office, we do business cases together. Should we go into this country? How much public sector does that unlock? And these things do make a difference. When you are a bank, which is global. And as you well know, you've got certain considerations that we have to work through. But we are chipping away. We want to serve our customers the best we can. And we think the way is cloud. It doesn't mean we are going to stop doing on-premises products. The OpEx investments that we make today on engineering, on billing for the cloud, or billing for on-premises, they are 90%, 95% shared. So yes, there's an additional test burden. But we are going to support our customers. Whether they're on-prem or the cloud, we want to make it really attractive for them to move to the cloud. And we are very humble about what are their blockers and we're just chipping away.

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

Yes. Good. I'm sure you'll get there. Let's talk a little bit about some of the adjacencies around Office, where Office can actually act as an accelerant. So one that I know is on the topic -- on the minds of everybody, is Azure, where you've had amazing success at Microsoft. And it feels to me like there's a -- there's synergies with the transition to Office 365. You even just mentioned that you internally think of this as one broader Microsoft cloud, although for reporting purposes, it's quite separate obviously. But it feels to me like these are self-reinforcing trends. In other words, customers that make the leap to cloud-deployed Office are probably more inclined to use Azure. And I'm sure there's a great cross-sell there. So do you mind describing those synergies, starting with Azure?

A - Rajesh Jha {BIO 6218647 <GO>}

Yes, sure. I mean, first, I would say, from an engineering perspective, Scott and I, we plan together in terms of a data center footprint. Where should we build these data centers. Where should we build the edges. And the networking investments because the customers, that is their expectation of us anyway. When they come to the cloud, they do end up using not the -- if I remember correctly, 90% of our customers today, 90% of Fortune 500 customers use at least one cloud for Microsoft. The interesting thing is 60% of them use at least 3 clouds for Microsoft. And so if you pause for a second and if you think about it, look, if you use Office 365, you're going to want to protect the directory. You're going to protect the devices and so you use Enterprise Management Suite, Enterprise Mobility Suite, Yammer. That's exactly what you would use to protect Azure as well. Dynamics and Office 365, we have integration, whether it be on our web launcher how we integrate or whether it'd be in Outlook and, if you were trying to extend a business process in Dynamics, you would use Power apps and flow. That's exactly what you would use to extend to Office 365. You can go into SharePoint. And you can create a business for office, workflow front end, the Power Apps, the right to data, back to Dynamics. And these are not things that we are contriving. These are things that our customers are naturally asking for. As they started to use Office 365, we sold the EMS. As they start using Dynamics 365, they want better integration with Office. So we do think the reason that 60% of our Fortune 500 customers use at least 3 clouds for Microsoft is because there's a natural synergy.

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

Yes, got it. Then on the -- maybe on the LinkedIn side. I think it was May 16 that you announced that deal. I don't think it got closed till a while later. But Microsoft has largely left LinkedIn alone, it feels like. So what is the synergy story that's pending, Rajesh, that we can look forward to? Either on the go-to-market or product integration? In what way is 1 plus 1 equals 3 on Office plus LinkedIn?

A - Rajesh Jha {BIO 6218647 <GO>}

Yes. We continue to be very, very excited about our LinkedIn. Our first priority, like you said Karl, is to continue to grow our engagement -- engage users and members on LinkedIn and engagement there, because I mean, that is a flywheel that we feel just has a natural momentum. And we want to do what we can to keep that growing. If you think about LinkedIn and Office, it's what we talked about during the time of acquisition. You bring in the LinkedIn identity and profile, together with the Office identity and profile. So I know the meetings, the trending documents, the trending -- the people you work with. And LinkedIn has the same context. And how can we bring that profile from LinkedIn or the identity and experiences together with the Office, in Office and Outlook. Those are things you will be seeing coming out shortly. If I'm in Microsoft Word and I'm creating a resume, which actually happens a lot, we can connect directly to the LinkedIn web services and get the trends to the skills and get that properly to write into Word and actually go a step further. While I'm creating the resume, why don't I not expose you to the jobs that may be relevant based on the construct of your resume? Take Dynamics and LinkedIn. We now have the Dynamics 365 for sales in our GTM and our product integration with our LinkedIn Sales Navigator. So a sales person can now use LinkedIn, 0.5 billion people, to find the relevant people to sell with or sell through and do the social selling. On Dynamics that recently we announced the Dynamics 365 for talent, where LinkedIn

recruiting and learning, you can bring that together so an HR professional can now get a complete life cycle of staffing, recruiting, on-boarding, training, retaining. So you'll see more and more, the integration we're doing in LinkedIn and Dynamics and Office.

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

Okay. Look forward to that. And on the organically built products, do you want to talk for a minute about Teams? That seems a pretty exciting product. You, I think, made some announcements just this week actually?

A - Rajesh Jha {BIO 6218647 <GO>}

Yesterday.

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

How big can that be?

A - Rajesh Jha {BIO 6218647 <GO>}

Teams can be huge because I do think we were seeing a pretty fundamental shift in the way the modern workplace is evolving. You take a look at the new generation of workers, their expectation of why they work and how they work is pretty different. They expect it to be inherently collaborative. And actually, as all of us know, most material work happens in the context of teamwork. So Office 365, there are a bunch of collaboration tools. But Teams, we think, is really the hub for teamwork for Microsoft. In the last four months, five months, we've grown from 50,000 customers using Microsoft Teams to over 125,000 customers. And the growth is just continuing to increase week-over-week. We continue to innovate and the nice thing about Microsoft Teams is we've engineered that so that the experience is cloud delivered. Even the UI's cloud delivered. So the rate of innovation, we think we can keep that level very high. Over the last few months, we've done mobile meetings. We've expanded the surface area for Extensibility Microsoft Teams. Yesterday, we announced perhaps the most frequent requested feature by our customers. Every customer interaction that I've had, what they want is, ability to have somebody outside their organization with the right ID policies and controls. But for these guest workers to be able to collaborate in the documents, be a part of the meeting, be part of a chat. And now that's all possible, as of yesterday, we started to roll that out. Now remember, the Microsoft Teams is available to anybody in our hero SKU E3. This isn't one of the products that we put in our E5 tier because we thought it was so foundational to the way the workforce is evolving, that we just address that by putting that in our core SKU.

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

Got it. That's exciting. On the -- you touched a little bit earlier on the Dynamics side just to complete the picture of adjacent businesses. I've always felt, frankly, that Microsoft has a massive opportunity to take on more of the SaaS space or call it the "business application market". Dynamics is a terrific start but it feels to me like there's further that Microsoft can go to become a real rival to Oracle and SAP and

the broader ERP space. Do you share that view that there is a bit of a whitespace opportunity for Microsoft to grab, whether it's organically built or via acquisitions?

A - Rajesh Jha {BIO 6218647 <GO>}

Let me -- as you've seen. And as I mentioned, 60% of our FORTUNE 500 use 3 or more clouds from us. We want to be really ground in what are we seeing from our customers? What are, like you said, are our adjacencies? Where do we have natural strengths? I talked about the billions of signals that come in, into our cloud with Office 365. So you take the Off -- the Microsoft Graph. You take the Dynamics user interactions, the schemas in Dynamics. You take the Office as a deep understanding of people and groups and documents and so on. And we construct a Microsoft Graph. So that's the source of our core and then we are going to evolve from that. But the other great addition to our cloud data assets, which I think is our core, is the LinkedIn Graph. Now Satya's talked about the intelligent cloud and the intelligent edge. In many ways, Office is the intelligent edge. But the other important node here is the intelligent data or the intelligent network. So you take the Microsoft Graph, you take the LinkedIn graph, that's our intelligent network. So we start from that core. Now if you take LinkedIn and Dynamics together, that's like a \$5 billion business: 70% in the cloud. Dynamics itself is growing 75% year-on-year. So we are very excited about the Dynamics business. (inaudible) being very ground in what we are seeing as our natural assets: would be Microsoft Graph and a LinkedIn graph. And the usage that we see from our customers. We'll go from there. I think the LinkedIn recruiting in Learning Solutions combined with the Dynamics 365 for talent, I think is an example of something that you should expect to see from us on bringing these assets together.

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

Makes sense. I'll ask you one financial question. I know you're going to look for (Mike Spencer) to give you a good answer. But I got a feeling you know it. On the gross margin side, inside Office 365, you obviously don't disclose what it is. But we try to back into it. And we feel like at some point in time, Office 365 gross margins should be able to get close to the pure play SaaS group. I don't think you're there yet. But what will it take, beyond just scale for you to get there and can you get the Office 365 gross margins up to, call it 75%, 80% level. Is that realistic?

A - Rajesh Jha {BIO 6218647 <GO>}

Let me answer your question. And not answer your question. But the first thing I'd say is when you take a look at some of these pure SaaS providers, they are more point solutions. Office 365, I talked about what our mission is, in terms of communicate, collaborate, create, analyze. So we are the full suite of services. Not all these services have the same margin structure. You take something like Skype, which is a transaction, a meeting. That has a different cost profile than something like infinite storage for documents or mail. Now, of course we want to take Skype there too, where every meeting, it's a very important artifact, where we probably want to record it, transcribe it, translate it, give you automatic notes. But you get my point which is the cost profile, we are such a wide range of services. The cost profile, the margin profile, for every individual feature is very different from each other. So that's why, I think, you shouldn't really be thinking about Office 365 as one of these point

solutions. We are a full suite of product (inaudible) needs. That being said, we absolutely are going to be best-of-class for what we do. There are a few things, of course, that are margin drivers for us. One is the premium SKU mix. And we've talked about just what a great journey it's been, for us to take our early customers from a single workload, which is about messaging and calendaring to an entire E3 suite. And then we want to get them to E5 capabilities and then we want to get them to the entire Microsoft 365. So that's basically the levels you should think about of how we can try the premium mix, which I think is the biggest factor in driving margins. The other one I would say, from an engineering perspective, we continue to drive CapEx and OpEx efficiency. More recently, we brought in our consumer mail back in. What used to be Hotmail or outlook.com and Exchange Online together. So we've taken the fixed costs of the 2 messaging systems and collapsed them together. And on the operational side, we are starting to see the scale play out for things -- the fixed costs on things like support and compliance. So I think we like where we are on the margins and I definitely think we have room to go, both with trying to bring in mix and just doing the engineering and the operational rigor.

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

Got it.

A - Rajesh Jha {BIO 6218647 <GO>}

But it's a wide range of services and not all the features are the same time.

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

Rajesh, just to close, the next Microsoft event that at least I'll be at, will be the big Ignite event at the end of September. I know that's not necessarily pure Office. That's a much broader conference. But I take it the focus of that event will be just continuing to drive product innovation. And pushing the cloud adoption. What are the couple of major themes that you can give us a quick preview on for that big Ignite event?

A - Rajesh Jha {BIO 6218647 <GO>}

Yes, first of all let me just say, we are all very grateful that the hurricane impact was a little less modest, I mean a little less severe than we thought. But still a pretty significant impact for a lot of folks so our prayers...

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

The event is in Orlando.

A - Rajesh Jha {BIO 6218647 <GO>}

Yes. So the prayers are with everybody in Florida. But Ignite is the world's largest event for IT professionals and enterprise developers. A couple of themes that you should expect to see at Ignite, for us to expand on: artificial intelligence, of course. From an infrastructure perspective, productivity perspective, business-application perspective, hybrid, cloud, how all of these things come together. You should expect to hear a lot of that and how that experience has evolved in a world where we have

billions of signals, again. So that's -- we're -- we remain excited about that and you'll hear more about that. The other one is Microsoft 365. Microsoft 365 is a big deal, not just for Microsoft but more importantly, for our customers. Microsoft 365, if I could just take a minute and expand on what it is. And will it just (inaudible) Microsoft 365 is. It's about pivoting on the user's complete needs. So not just the product ready services that come with Office. But how do you manage these on different devices. When you are on your desktop, how does Windows 10 Enterprise light up? How do we innovate all the way from the Silicon, into the operating systems, into the cloud to run AI and ML models. And bring it back into office and experience this. How do these experiences, how you interact with Office? How does that roam for you from device to device? Three out of 4 IT prof -- SISOs, they expect to get hacked in the next year. This is a sobering statistic. It just blew me away. I think about ransomware, the ever-sophisticated cyber threats and Office -- with M365 or Microsoft 365, how do we bring the end-to-end protection on a user basis network directory application, how do we bring that all together? So enabling the end user to be creative, to be able to collaborate on any device, while keeping IT and the organization secure. So you'll see a lot of our M365 there, too.

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

I'm excited for that.

A - Rajesh Jha {BIO 6218647 <GO>}

So am I.

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

So thank you. And I don't think anybody would have anticipated, let's say five years ago, that Office would be the kind of growth engine it is for Microsoft. So it's a fantastic success story and congratulations on that. And thank you very much, Microsoft, everybody for coming to our event this year.

A - Rajesh Jha {BIO 6218647 <GO>}

Well thank you, Karl. And thank you, everyone. Thanks for having me here.

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

Thank you.

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