

Wells Fargo TMT Summit

Company Participants

- Bill Duff, Corporate VP & CFO

Other Participants

- Unidentified Participant, Analyst, Unknown

Presentation

Unidentified Participant

All right. Well. Good afternoon, everyone. I'm very excited to have Microsoft here. We have Bill. Thank you for coming down. I know, as I said, it's a busy time of year. So thanks for making the time for us, really.

Bill Duff {BIO 3966952 <GO>}

Absolutely.

Unidentified Participant

I know everybody in the audience appreciates it, too.

Questions And Answers

Q - Unidentified Participant

So I guess for the benefit of everyone in the room, why don't you give us your background, who you are, what you do, what you do at Microsoft?

A - Bill Duff {BIO 3966952 <GO>}

Yes. So I'm Bill Duff. I'm the CFO of our Enterprise -- Experiences and Devices Group. Experience and Devices at Microsoft consists of our productivity experiences and also our consumer experiences. So it's covering Office, Windows, Surface and all of our hardware products, Gaming and Search.

Q - Unidentified Participant

Yes. The -- let's all -- let's start with Microsoft 365 then. It's like -- perhaps you all have heard of it. But the -- we've obviously been hearing a lot about Microsoft 365. Can you help us understand how M365 fits into just the larger vision of Microsoft?

A - Bill Duff {BIO 3966952 <GO>}

Yes. M365 is our productivity cloud. And so it consists of Office 365. So our productivity cloud services; Windows, specifically Windows Commercial; and EMS, which is our management and identity solutions. And so we bundled these together under the Microsoft 365 name a couple of years ago. And really, it was a marketing bundle at that time. These products have been developed, they were integrated somewhat. But we really didn't have the deep integration that we felt like we needed. So over the last couple of years, what we've really done is taken these different products across Office, Windows and our identity management solutions and integrated them into a holistic solution. And so, one, it's really seamless across all of these different workloads. It's seamless from a customer experience standpoint. But one of the advantages of integrating them more deeply is we're able to translate these experiences across Windows, across our Office experiences and deeply integrate them with identity management as well.

It's a super important strategic initiative for us. When you think about our overall productivity business, our customers that have brought into Microsoft 365, they use more of our services. So they actually bought into our full stack. And they use much more of our services. And they're much more likely to upgrade to premium SKUs. And so it's been a big driver of growth for us on the productivity side at Microsoft over the last couple of years.

Q - Unidentified Participant

Interesting. Yes, I know -- I mean, to your point as sort of just the evolution to date of M365, I remember in the press release, there was a bundle (event). You start to see different announcements of deep technical integration here, deep (inaudible) integration here. If you use this plus this, they were added together. So as you think about sort of the go forward, how do you imagine M365 to continue to evolve?

A - Bill Duff {BIO 3966952 <GO>}

Yes. M365, we really got to have 4 investment areas for M365. Productivity and collaboration you can see. And we'll talk a little bit later, hopefully, about Teams. And Teams has really been an exciting product for us. We've seen very, very strong growth. It's really the new hub for teamwork for companies and for enterprises. And so we have a strong focus on productivity and collaboration.

We also have a strong focus on security, compliance and management. And so you can see us investing pretty heavily in the security space. We're making a ton of progress there. Compliance is also a big opportunity for us going forward.

Then there's 2 new areas that we're excited about from a growth perspective. One is around business processes and workflows. So whether you think about Teams as really a platform for business processes, we think there's a lot of opportunity in vertical spaces in that specific area.

Then the fourth one is really a more forward-looking one around knowledge. We announced a project we called Project Cortex. And this is really about how organizations organize and use the data that they have inherent in their organization to optimize business processes. But also provide new insights into how to run their organization better.

Q - Unidentified Participant

Interesting. Where are we just in terms of commercial penetration across M365?

A - Bill Duff {BIO 3966952 <GO>}

Yes. We still look at it by workload. So Office 365, we've crossed 200 million now. So we had a significant number of active users of our Office workloads. And so these are active users. On the EMS side. So on the management side, we've sold 120 million seats. And so our install base is over 120 million seats right now. And on the Windows side, Windows Commercial, we spent the last couple of years really migrating the enterprises to our most modern operating system, Windows 10. We're more than halfway through that journey. And so we've got -- Office 365 is very strongly penetrated in enterprises. EMS and Windows are less so. And so what we're seeing is Microsoft 365 pull through those products. That's been a big driver of growth of ours in the last couple of quarters, in the last couple of years. And we also see growth opportunities going forward, where how do we expand out to -- versus the information worker, which is the typical Office user. You can think about Teams going into first-line workers. We think we have big opportunities with SMBs. So we're pretty excited overall about the growth. We've made a ton of progress, it shows up in our financials. But we've got a lot of growth left.

Q - Unidentified Participant

Yes. So I mean, obviously, you just talked about sort of individual workloads. Maybe help us think about what sort of M365 unlocks that maybe sort of Office, EMS, Windows or a stand-alone couldn't before?

A - Bill Duff {BIO 3966952 <GO>}

Yes. I think the way to think about it, there's a bunch of different scenarios that we can talk about. A couple of them that are pretty interesting is around security and compliance. When you think about all of the different, let's say, threat protection services that we had at Microsoft, we had threat protection associated with Windows, threat protection associated with Office, threat protection associated with our cloud and identity management, really integrating those together. So if you're a Chief Security Officer, you have one console, one place to look at what's happening across your entire estate. And also from a product truth perspective, looking at all of the data and signals that are coming, right? So we have 900 million Windows 10 devices, active devices out there. We've got a huge install base on the Office side. And really, security is about picking up these signals, picking up these data, making connections and then being able to do something about it, right? The future of security is really about how do you automate these processes. So once you have these signals, how do you automate things like shutting down an endpoint or protecting the overall estate. We think we have world-class technology. We think it's

a huge opportunity. That's a specific area where we see big opportunity going forward where you need to think of it holistically as a product across M365.

Q - Unidentified Participant

Yes. Just to reinforce what he said, we've obviously had quite a number of security vendors here and another several companies, one of the things that actually several of them have said is the strides that Microsoft has made from a security perspective and Windows. I mean, people in the industry are taking note of it. So (inaudible)

A - Bill Duff {BIO 3966952 <GO>}

Yes. And if you look at all of the Gartner Magic Quadrants, everything, Microsoft, let's say, 3 to five years ago, just didn't even show up in that discussion. Now we not only see it as a way to protect our products and we see a real differentiated opportunity for us. But we're thinking more broadly than that. And so we're thinking about security as an independent market for us that we're really going after.

Q - Unidentified Participant

Yes. Now obviously, Windows Commercial is a key part of M365. And obviously, it opens up the door to monetize Windows in more of a recurring mechanism versus a traditional OEM model. Which is great, too. It's great revenue. (inaudible) But maybe walk us through sort of what is the value prop of Windows Commercial? And kind of going forward, how do you think about growth of this?

A - Bill Duff {BIO 3966952 <GO>}

Yes. Windows Commercial is sort of a less-known business for us at Microsoft. So we talk about it publicly when we report our quarterly results. We talk about it as Windows Commercial. And this is a version of Windows and associated services that we sell directly to commercial customers. So one of the things that's really important to us is we sell it as part of Microsoft 365. So it's part of our standard go-to-market motion that all of our account executives talk about when they sell M365. And so it's part of the M365 suite that we talked about the integration before. But it also -- that's a little bit of a different business model for us. So it gets us on a recurring business model. And so when you think about a recurring cash flow from Windows, not only do we have the onetime device sale when our hardware partners sell a Windows device. But we also have this ongoing Windows relationship with our customers.

It is a decent-sized business, let's say, 5 to 10 years ago. But it's an area that we've grown a lot. And really, what we focused on is what are the features around security, management and increasingly virtualization and security and compliance that we can add into a version of Windows that's really service based, focused on the corporation and part of the overall M365 value proposition. So you've seen significant growth in the Windows Commercial business over the last couple of years. As a matter of fact, if you looked at our Windows revenue, let's say, 7 to 10 years ago versus today, the most significant change in the way that we are capturing revenue on the Windows side has been the growth of Windows Commercial. It's been a pretty consistent double-digit grower from a build perspective. For financial analysts out there, there's some accounting.

Q - Unidentified Participant

I was wondering if you could give a soliloquy on ASC 606 and the impact on Windows Commercial. Is that totally cool?

A - Bill Duff {BIO 3966952 <GO>}

Windows Commercial...

Q - Unidentified Participant

We'll do that at the bar later.

A - Bill Duff {BIO 3966952 <GO>}

Yes. We'll do that at the bar later. But it does show up from a revenue recognition standpoint. You've seen really strong growth over the last couple of quarters in it. But that's more of a revenue recognition thing. If you think about sort of the underlying health of that business and the number of new users that we're getting on Windows and sort of the value prop that we're delivering, it's been a consistent double-digit grower. And so we're excited about it.

Q - Unidentified Participant

Got it. Now I'm sure you haven't gotten this question today. But with Windows 7 nearing end of life -- I'm sure this is brand new. So hopefully I'm not putting you on the spot, how should we think about the impact of that on the Windows OEM business and Windows Commercial, too?

A - Bill Duff {BIO 3966952 <GO>}

Yes, yes. If you look at our results over the last couple of quarters, we've had very, very strong OEM Pro. That's how to think about our commercial PC sales. So OEM Pro has significantly grown. There's a number of factors there. Economy has been good. Windows 10 is a great product. And so we're seeing continued demand for Windows 10. But certainly, the end of support in the Windows 7 end-of-support cycle has fed into that and really helped drive the growth of our OEM Pro.

As we look forward, we're seeing very, very strong demand currently and over the last couple of quarters. If anything, it's exceeded our expectations. As we go through these refresh cycles, if you're a student of history of Microsoft, you've seen refresh cycles in our OEM business in the past. And so we will see some -- the refresh cycle show up in our OEM revenue, in our OEM Pro revenue. But we expect with the demand we're seeing now and the number of devices that we still see on Windows 7 out there, particularly in small and medium business, we still think we have a ways to go.

Q - Unidentified Participant

Got it. Then this is a question I get asked a lot. Is there going to be a Windows 11 or are we sticking on perfect 10 forever?

A - Bill Duff {BIO 3966952 <GO>}

Perfect 10. I don't know. I'm not going to make any news on the naming front. When we launched Windows 10, we really talked about how we changed the overall model. It used to be, we invested three years in building a new operating system, we launched it and then the engineering team went back and worked on the next generation of the operating system. This is much more about continuous improvement. And it's much more about making sure that we're continuing to move the Windows OS forward.

You saw us -- recently, we talked about Surface and our new devices. As part of that launch, we talked about some of the investments we're making in Windows and Windows 10x to support some of these new form factors that are coming out. So you should expect us to continue to invest in Windows, modernize platform, modernize the OS, support new form factors and really invest where we think there is differentiation in the Windows ecosystem.

Q - Unidentified Participant

Got it. Let's switch gears a little bit to the Gaming because actually I think that's -- we're at a pretty unique time frame, sort of ahead of the next cycle, ahead of some -- and (got to admit), there's some pretty secular changes, too. So Gaming, how do you think about, I guess, one, just the evolution of your Gaming business from sort of a product cycle perspective; then two, from these secular trends that we're seeing? And I got a follow-up to that.

A - Bill Duff {BIO 3966952 <GO>}

Yes. Absolutely. Xbox has been a great business for us. It's incredible, the fan base of Xbox and the energy that they bring to that overall business. If you look at that business today, it's primarily a console business. And we're very strong on the console. And we've been in that business for a long time. We're at the end of that cycle. So you're seeing us come out with new consoles next year. We're committed to the console business. The console business is a significant part of the Gaming business and has some of the highest value gamers that are out there. But when you think about the broader opportunity for gaming, there are 2 billion gamers in the world. And they play across all sorts of different platforms. So they play across console. We have a very strong position and have a very, very engaged user base in console. They play across Windows. Actually, our Windows business is aided by this. Windows is really the best PC platform for gaming. But we don't really participate in the gaming engagement on Windows. We have a smaller business there. Then on mobile, obviously, has been the big growth story over the last couple of years. And so what we're seeing with these shifts of workloads to the cloud, we see a big opportunity for us to take this great starting position, this highly engaged user base and these high-value gaming scenarios and bring them to any endpoint. We service-based want people to be able to play anywhere. And so that's really our strategy in gaming. We're really sort of thinking about a much, much broader TAM and investing behind that. And really, our investments are in 3 areas. One is on the cloud side and investing in cloud infrastructure in order to deliver those experiences on those endpoints. Content, you've seen us be very aggressive on the content side.

Over the last 18 months, we've doubled our capacity for first-party games in terms of the acquisitions of studios that we've made. And on the community side, we have a very, very engaged base with Xbox Live, 65,000 -- or 65 million users. And we see a big opportunity to expand that.

Q - Unidentified Participant

Yes. Interesting. So how do you think about the business model changes, too? So I mean it's -- are they -- it's great background on sort of the industry change (going around). How does this impact just the Gaming business model for Microsoft?

A - Bill Duff {BIO 3966952 <GO>}

Yes. On the Gaming business model side, you've seen us make some changes as well. We've always had Xbox Live as a premium subscription business on the console. But the console is a relatively closed ecosystem. So you have to think differently when you think about the business models much more broadly in ways on the PC. And gaming has evolved differently on the PC. Gaming has evolved differently in mobile. And so we launched Game Pass a little while ago. And this is our opportunity to bring more people into our gaming platform. It's a great value proposition. You can play many, many different games. You can play where the other players are. We think community is a big part of that. One of the big differences between, let's say, video streaming and game streaming is gaming is a very social -- it's a very social product. And people will go where their friends are. And so that's a really important element to it. So as we build Game Pass, we're going to not only build great content, have relationships with both our first-party studios. But also third-party studios, to have great content in Game Pass. But make sure we're building a strong community there.

Q - Unidentified Participant

Got it. Interesting. The -- all right. Let's talk about xCloud. (inaudible) exciting project since it's been announced. I mean (can you assess), just at a high level, just your vision for video game streaming, obviously part of Project xCloud? Then how do you think about the next-generation Xbox console you just talked about play into this vision?

A - Bill Duff {BIO 3966952 <GO>}

Right. We -- at its simplest, xCloud is about playing the games you want with who you want anywhere you want. And so it's really about extending the Xbox value proposition to any endpoint. And so we are very early in the stages. You've seen other companies invest in this space. We think it's exciting. We think that the cloud opens up new opportunities and new ways of delivering those experiences to endpoints that didn't -- couldn't necessarily support them in the past. We love our starting position because we have great content library that works well. We have a great, as we talked about, highly engaged user base that's already engaging with our products. So initial users might be already Xbox users that say, "Hi. look, I have this great Halo experience at home. And I want to experience that when I'm on a mobile device outside the home," something like that. There's all sorts of scenarios you can think about. And so from a end point perspective, it's really about

expanding our overall endpoint strategy. Azure is the underlying fabric for that. We've invested heavily in data centers. You can think of this as a really interesting, differentiated workload on top of Azure. That's a big opportunity for us.

Q - Unidentified Participant

Yes. So what does video game streaming mean in the context of the console? This is a question I get a lot. So I'd love to hear your perspective.

A - Bill Duff {BIO 3966952 <GO>}

I think on the console, I think things will evolve over time. I mean, we clearly believe that the console is going to be an important place where people play games. There's a lot of advantages to having that processing power local. And certainly, if you think about xCloud and the investments in the cloud, it's not only about the investments in the cloud infrastructure, let's say Azure data centers. But it's investments in the network. You can think about 5G as being a significant enabler of these types of scenarios. We're building our solution to work on 4G. But 5G is going to open up entirely new opportunities. And so you see different parts of whether it be the processing in the cloud or the network, all of those have to evolve. And the console is going to be a very, very important part of that through that journey. And so we invested in the next-generation console. We're really excited about our launch next holiday. We're bringing a lot of new technology with our partners, a lot of new content that will leverage that technology. It's an important part of our business. And you'll see us continue to invest there.

Q - Unidentified Participant

Yes. I feel like the past couple of years have been like the age of the unforeseen partnerships. (inaudible) Microsoft and Oracle, Microsoft (inaudible) AWS, it's like cats and dogs sleeping together, (inaudible) sound like Bill Murray up there. But PlayStation, didn't see that coming. Let's just talk about it. Let's talk about that partnership with Sony PlayStation. Just go. (inaudible)

A - Bill Duff {BIO 3966952 <GO>}

Yes. I mean you're right. Partnerships, I think one of the things that Satya's done culturally at Microsoft has really opened us up and sort of recentered us on our path of being a platform company. And so what does it mean to be a platform company? Certainly, we'll have our first-party experiences. And we've talked about some of those, whether it be on the productivity side or whether it be on the gaming side. But that doesn't preclude us from -- particularly from a cloud infrastructure side of being able to work with -- and work with companies that we compete in other areas. And Sony is a perfect example of that. It's a really interesting partnership.

And I think what it also says is it says something about Microsoft and the trust that the ecosystem has in Microsoft and how we're going to work both in a first-party perspective and we're going to be aggressive in going after opportunities. We talked about it with xCloud. We've talked about it with M365. But we're also going to be very, very strong partners to everybody in the ecosystem. And we deeply believe we're a platform company. We deeply believe that we have a big opportunity with

Azure and our other infrastructure -- our other infrastructure investments to work across all levels of partnerships.

Q - Unidentified Participant

Got it. Interesting. And so let's switch gears a little bit to Surface and Edge. All right. So Surface, obviously, we've seen continued (upgrade) popularity above -- it's actually like a family now. As Head of Devices, I used to think of Surface as that thing, it's like a family now device. But how do you think about this opportunity going forward? And also provide me with some of the answer to this in the context of some of the announcements that we saw in the fall.

A - Bill Duff {BIO 3966952 <GO>}

Yes, yes. In October, we had our last Surface event. And we talked about a couple of things. So we talked about the products that were up for holiday lineup. So we launched the new Surface Pro 7, which is our next-generation of Surface Pro. That really started the -- our Surface investment overall. Surface Laptop 3. And we introduced a new product called Surface Pro X, which is our first Surface that is based on ARM. We had a co-development relationship with Qualcomm to develop it and tune it for a PC type of environment. And so it sort of talks to how Surface has evolved within Microsoft. It's a big business. It's over a \$5 billion business for us. I mean this is a significant business. It's important to us. We run it. We want to operate it. We want to grow it. The -- one of the interesting things about Surface is we have very, very high Net Promoter Score. That's how we think about customer satisfaction. And so it's really important for us to have our experiences being delivered on experience -- or being delivered on Surface. We think these are the best Microsoft 365 devices that we have out there. But it's also a very important way for us to innovate.

And so when you think about the original Surface 2-in-1, Surface Pro, that is an innovation that eventually got extended out through the ecosystem. I mean you saw many other companies pick it up and really extend Windows in that way. You're seeing that with Surface Pro X. Surface Pro X on Qualcomm, we think there's something very interesting here. We're willing to put our capital behind it. It's expensive to develop devices. And it's something that we think is important for the future. So we're willing to invest. We're willing to partner with Qualcomm on this and really push that forward. You see it with Surface Hub, which is our meeting collaboration device. And so we're -- the Surface business is great. We're excited about it. And it's a big, strategic focus of ours in Microsoft 365.

Q - Unidentified Participant

Another part of the family, (a mini part of the family, back to the future), Neo and Duo. So I guess how -- what was the decision or thought process of sort of getting back into the smartphone business but also the twist is on the Android platform?

A - Bill Duff {BIO 3966952 <GO>}

Yes. I think it blew a lot (of peoples' minds). We're not the best at -- I shouldn't say it this way. But everything leaked before the Surface event, except for Duo, which was

kind of amazing. And I think it was a little bit of a head-scratcher. And people were saying, "Well what's going on here?" And really, it comes back to our focus on the user. And so we feel like there's some really interesting innovation that's going on in dual-screen devices. So if people missed the announcement, we announced 2 new devices that are not being shipped until next holiday. And both of these devices -- Neo is a little bit of a bigger device. It's a Windows-based device. And you can think about it as a 2-screen device that folds up. You can think of it like a tablet. Duo is the same device, smaller form factor, you can carry it in your pocket and we built it on Android. But really, our thought process across both of them was the same. We think there's some very interesting things happening in dual-screen devices. If you look at dual screens and how people use dual screens. And we did a lot of analysis around this, people are significantly more productive when you have 2 screens. And that's because you can think about you have a work pane and then you have a reference pane. There's all sorts of interesting scenarios. And you just work differently when you have 2 monitors for the desktop or 2 screens when you have a device. Then simply, you just -- to get to the Android question on Duo, we make a pragmatic decision. If we're going to build a mobile phone, mobile phones, the expectations are that the apps are going to be there. And so we needed to make sure that we were able to support the Android app ecosystem. It was something we worked with Google on. And we're continuing to work with Google on. And so to get back to your partnership point on the strange bedfellows and everything else, this is an example of the new Microsoft.

Q - Unidentified Participant

It is amazing. So last question. We got 2 minutes. So when you think about emerging opportunities here in personal computing, what excites you? What does Microsoft really think about addressing in the -- how to address these in the future?

A - Bill Duff {BIO 3966952 <GO>}

Yes. It's interesting. We talked about a lot of them. I would say the one thing that I didn't really mention up-front on the M365 thing is the power of data and the power of AI that will bring the productivity scenarios. You're starting to see AI get infused in our productivity scenarios just a little bit. We're doing it in terms of PowerPoint Designer, Presentation Coach. You're seeing AI show up in our security elements. But when you think about a company adopting Microsoft 365, you have an incredible amount of important data that the company needs to use in order to optimize our operations. And they have an incredible number of signals that are coming in. And so using that data to bring new employees up to speed quicker, to find information more quickly, to automate workflows, to connect dots, to automate processes. We have this offering called Workplace Analytics, which looks at how the -- how data is used in your company and communication is used in your company. So you can think about how can you have more effective meetings? How do you break down silos in your organization? How do you increase the effectiveness of your sales force? There's all of these things that, once you have this data. And this data is -- can be reasoned against in a central location, you can think about all sorts of new scenarios around AI that are really productive for organizations. And that's one of the most exciting areas that we see.

Q - Unidentified Participant

Awesome. All right. Time is up. You nailed it within 10 seconds. So good job.

A - Bill Duff {BIO 3966952 <GO>}

Thank you. So much.

Q - Unidentified Participant

Thank you for coming out. I know it's a busy time, like I said. Thank you for coming to Vegas.

A - Bill Duff {BIO 3966952 <GO>}

Thanks a lot.

Q - Unidentified Participant

Appreciate it, Bill.

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