

## Barclays Global Technology, Media and Telecommunications Conference

### Company Participants

- Catherine Gluckstein, Product & Strategy
- Raimo Lenschow, Analyst
- Tim Stuart, CFO

### Presentation

#### Raimo Lenschow {BIO 4664646 <GO>}

Hi. Welcome to our next session. We're here with Microsoft. We're talking gaming. Before we start, Tim, Catherine, maybe you can briefly introduce yourself, and then I go straight into the gaming part.

#### Tim Stuart {BIO 20382118 <GO>}

Great. Catherine, why don't you go first?

#### Catherine Gluckstein

Thank you, Tim. So I'm Catherine Gluckstein. I run product and strategy for Project xCloud, which is our cloud gaming efforts at Microsoft.

#### Tim Stuart {BIO 20382118 <GO>}

I'm Tim Stuart, Xbox CFO. I've been at Microsoft and Xbox almost 20 years now. So we can talk a little bit about the history of gaming throughout that if we need to.

### Questions And Answers

#### A - Raimo Lenschow {BIO 4664646 <GO>}

Yes. Okay. So yes. We're both getting gray. Yes. Hi. Just to set the scene a little bit, like we've seen quite a few changes over the last couple of years, couple of quarters as well in terms of like gaming at Microsoft. Can you give us a little bit of a background from when we started Xbox five years ago to kind of what gaming is at Microsoft today that's kind of very different?

#### A - Tim Stuart {BIO 20382118 <GO>}

Oh, yes. Yes. Well said. Especially over those 20 years, a lot has changed in the console space and in the gaming space writ large around the world. Over the last 20

years, we've really seen a growth and we talk about a lot of content services, think subscriptions, think games, think digital distribution. A lot have changed over the last cycle.

And even really, over the last 4 or five years, a lot had changed. It wasn't too long ago when we were thinking a lot about discs and how you walk into a store and buy games and you play a game for a few hours, you're done and move on to the next one. Game creation has changed, how you experience games have changed, the services like Game Pass, Xbox Live, things like Fortnite, how subscription models have changed. So it's an extremely exciting time to be in the industry.

I'd say at Microsoft, we're -- Xbox here, we're over \$11 billion a year now. Our goal is, as we think about just how do you reach the billions of players around the world? And we'll talk about that later, but that's kind of the evolution of where we take this business next into the future. So a lot had changed in the industry, a lot had changed here at Xbox over the past few years and really, really excited about where it's going.

### **A - Catherine Gluckstein**

Absolutely, Tim. I mean I think what's really interesting as well as you track what's gone on at Microsoft, but you also need to track what's gone on in the wider market. Streaming has become mainstream. We estimate there are 3 billion gamers in the world. It's a huge number. It's one of the fastest-growing areas of entertainment all up. Obviously that's just an area we want to embrace as Microsoft.

### **A - Raimo Lenschow {BIO 4664646 <GO>}**

Yes. Okay. I mean like there -- let's stay on the recent news now. I guess the next evolution would for me be like streaming. There, we saw the, what you call, like -- do you actually call it xCloud? Or is this, as you call it, xCloud, xCloud game streaming? So maybe like to get everyone on the same page now, how do you like -- set the scene a little bit what it is, and then I have a couple of questions there.

### **A - Catherine Gluckstein**

Totally, totally. So just to set a scene on name, Project xCloud is our internal working name for cloud gaming. And cloud gaming right now is pairing Xbox Game Pass Ultimate, but that's just lots of terminology. Essentially, what it is, is this.

So if you think about gaming and the compute that it takes to render games on different devices, you've seen that silicon in devices support different types of games. So on consoles where you can have pretty high CPU, GPU, you can get these very high-fidelity games and much lower res games perhaps on mobile phones.

What cloud gaming does is it takes all of that and it renders the games literally in the cloud. So you have any amount of compute. Then you take the games from the cloud and you literally stream them to any device, which allows us as Xbox to stream our high-fidelity games from our consoles in the cloud right to Android phones as we're doing today with Xbox Game Pass Ultimate.

Essentially, it's just a video stream. The way that everybody should think about it is if you're able to stream Netflix or YouTube on your phone, then you're able to stream any game from the cloud. So what that means is we can take any game made and distribute it to any device, which as you can imagine, just opens up the opportunity. In a world where there are 200 million consoles, we can now reach any device with these games and our TAM opportunity just opened right up. In terms --

**A - Raimo Lenschow** {BIO 4664646 <GO>}

Yes. Sorry. No, go ahead, sorry. Go ahead, sorry.

**A - Catherine Gluckstein**

I'm sorry. In terms of what we are doing, we know this is going to be a journey to perfection. There's a lot to get right with latency and the streaming efforts. If you see what's happened in video over the years and how it's improved, we know we're on that journey with gaming. But we started about a year ago in what we called Preview, which is where we just opened it up to everybody. So come and test them with us, and an amazing hundreds of thousands of people did that.

Then in September of this year, we launched in 22 markets into Xbox Game Pass Ultimate, which is our flagship subscription product with more than 100 games to stream and play right then and there on Android phones. Then since then, we've opened up a number of other markets, and we'll enter with -- into 4 new markets next year with Game Pass Ultimate, Japan, Mexico, Brazil and Australia. And just this morning, we announced that we're also going to bring streaming to PCs, both as part of the native app and on browser and to iOS phones through a browser. So you can see that we're on this steady march to increase countries, to increase devices and to reach this TAM.

**A - Raimo Lenschow** {BIO 4664646 <GO>}

And so there's 2 questions I had on that, Catherine. One is like you're trying this, I think -- but there are other guys as well like Google, Amazon, PlayStation, et cetera. Like what's the differentiator? How do you try to differentiate here?

**A - Catherine Gluckstein**

Yes. It's an awesome question. So the way we think about it is this, and I think Tim sort of launched it at the beginning. We are a gaming company. We've actually been in games even longer than Tim's been at the company because it's 40 years since we first entered gaming on PC. Over the last 20 years, we've been building the Xbox brand. So we're a gaming company through and through.

We have a broad first-party studio. These are studios that are part of Microsoft. We have 15 of them, and with the ZeniMax acquisition, we'll add a further 8 studios. This allows us to innovate in really interesting ways because, obviously with first parties, we can look to do things that we wouldn't look to do with other types of content. We went day-and-date with first party in Game Pass, which was an inflection point for Game Pass. And even as we learn in the cloud, we've been working with the team of Minecraft Dungeons to build native touch controls.

We also -- because we've been in gaming a long time, we've built a community. We think a community is absolutely key for gaming. You play games together, you play with your friends. We have more than 100 million people on Xbox Live. Then, of course there's the cloud. Sorry, that's my dog, there's nothing like being at home. Then, of course there's the cloud, and we have Azure. 66 regions, 140 countries. That means we can get within streaming distance of more than 80% of the sort of 3 billion gamers on the planet today and we're only expanding that.

So a ton of things that we really think that it plays to our strengths. The other thing that we've done that's maybe a little bit different to some others in the market is we've actually taken our consoles and we built cloud play. So we've put it in the cloud. So we actually have the technology to stream any of the games ever built for Xbox. That is thousands and thousands of games. So really interesting.

Perhaps the final thing that I'd add here just because I think it's a way when we look at TAM to think about things is we obviously have a very large Xbox consumer base today. What we're seeing, again early data because we're early into market, there's a couple of things. One is that for people who have -- we call them console-first game -- from console-first gamers. They're people who've joined us on console or PC and they stream as an additional part.

What we're seeing with those gamers is as they stream, they're actually playing longer on their native devices as well. So you kind of see this enhancement for the current user. Then really excitingly and obviously part of our expansion to empower every gamer on the planet is this idea of a stream-first user. In specific markets, you know that we went and tested with SKT in South Korea, we're seeing gamers we've never seen before. Those are some of the most highly engaged gamers that we're seeing on our streaming platform.

### **A - Raimo Lenschow {BIO 4664646 <GO>}**

Yes. The other question around cloud is like this kind of works or doesn't work based on latency, I would think. Like so -- and that's -- going back to your points, like if I have Netflix, I can play games, but can I? And where are we on that latency journey? Because you need to have that feedback loop back to be able to play.

### **A - Catherine Gluckstein**

Yes. It's such a smart question, and it's always the one that we think about most. This is why we took this journey with Preview because it wasn't just about learning what the market would be like, it's learning how the technology works.

The way to think about it is that we've optimized our stack to basically run at sort of 10 megabits per second. So it's actually a very reasonable size, which is in line with how Netflix runs. So if you can -- as I said before, if you can run Netflix, if you can run video, you can run these games.

Then what we did as part of Preview is we took a whole selection of different types of games. Some of the most demanding sort of Twitch-type games, from Killer Instinct

to Destiny, and we tested them. Interestingly, what we found is they worked really well. I think the way we can tell that they worked really well is, yes, we did tests and we benchmarked it. But more than that, Destiny, during Preview, was our most engaged game.

So obviously if it's going to be our most engaged game, people are getting a very satisfactory experience or more than satisfactory experience. The scores and the NPS scores that we got back were incredibly solid. So we have confidence.

And what we've learned from that is it's not latency alone that matters. It's consistency of stream. So where our human brains get upset is if things jump around and change. But if you've got this consistency, so along with our partners in Microsoft Research, we've been working on enhancing that. So it's something that we're pretty confident about, and I'm really proud of the advances the team has made there.

**A - Raimo Lenschow** {BIO 4664646 <GO>}

Yes. So it's funny, that kind of brings me then slightly different subject, but then the question is do I need to chase you because Tim, I was trying to kind of find out what's the situation on the new Xbox X and S because I do hear about supply constraints and a little bit -- and Christmas is coming up and the kids are asking. Well I'll be for that, but then maybe I go straight to the cloud there, but maybe that's the only Xbox perks, yes?

**A - Tim Stuart** {BIO 20382118 <GO>}

Yes. On the Xbox side, first is we've seen unprecedented demand for what we have in the market, which is a great sign out of the gates. I really, really love the SKU profile we picked, the power profile of these consoles and ultimately, the price profile as well. We talk about the world's most powerful console at \$499 and the best value in gaming at \$299 with Xbox Series S. I really think Raimo, the combination of both of those combined with what we've seen is really unprecedented engagement in gaming as of late is really driving demand for these consoles.

We're at max capacity on supply. We will be for as long as we can see and really catch up to that demand profile. But as you say exactly right, we are supply constrained right now, and we're doing our best to get consoles onto the hands of consumers.

The consumers, at this point in the stage, are some of your best Xbox fans, your highest lifetime value when you think of -- these are the -- we call them high-value gamers because they play a lot, they buy a lot, they spend a lot. They have the most friends online. They're really your most actively engaged consumers. So having consoles in their hands out of the gates to really jump-start the generation is really, really key.

And I may add on that one. We've seen in the past something like 50% of console generation units come at \$299 and below. So what we do with Xbox Series S is really

find a price point that resonates with that consumer group, which resonates with the broadening of the audience to bring forward that console demand. What it turns into is high demand in holidays and a supply portfolio that we're working to fulfill as quickly as we can.

**A - Raimo Lenschow** {BIO 4664646 <GO>}

Yes. And how do you think about consoles going forward in a way? Like I mean if -- will we have another Xbox X after this? Or is it going to be all cloud? Is this kind of the last generation, and hence, I need to buy it even more?

**A - Tim Stuart** {BIO 20382118 <GO>}

Yes. That's a great question. I think over the 20 years that I've been here, we've sort of said this is the last console generation for a while. But really, what it turns into is the console becomes the cornerstone and the foundation of our strategy. The console has a world where 3,000 games work on the console.

And to Catherine's point, you can lift and shift those games into xCloud. You can stream them out of the gate. You can put them in our Azure data centers, reach 90% of the world's gamers with the geo footprint we have because of that strength in console. Having that content pipeline, which I know we'll talk about in a second, having games built, having the community of players there, that console piece of the business is so important to have out of the gate, which we're very, very excited about. But yes, it's a very different cycle.

One of the things I'd highlight here, too -- but some of the differences is when -- this time around, we think about console as a piece of the puzzle as opposed to the puzzle. We're not doing things like making Halo Infinite exclusive to the next-gen consoles. We're not doing things like making our controllers exclusive to these generational consoles, which really puts the user at the center.

We think about an ecosystem, not unlike Netflix talks about subscribers or Facebook talks about monthly active users. We think about that ecosystem and that community of users, of which console is important, but growth at Microsoft and growth in this category is all about PC. It's all about mobile. It's all about geo expansion. How do you get into Africa and India? How do you create new business models? Console helps us establish that and console is so important for us to win in. But that really creates that foundation of where we're going.

**A - Raimo Lenschow** {BIO 4664646 <GO>}

Yes. Okay okay. That makes sense. Okay. Then from a -- now I'm the Wall Street guy who cares about numbers. Let's -- and numbers were -- the thinking has changed in our industry as like, "Oh, I want subscriptions." So talk a little bit about Game Pass as the way to have a different monetization model.

**A - Tim Stuart** {BIO 20382118 <GO>}

Yes. That's great. Yes. So for the audience, what Game Pass is, is it's a monthly subscription to access to hundreds of great games. Depending on the region you're in or SKU, it's \$14.99 with Game Pass Ultimate, which gives you streaming, which Catherine talked about earlier; or \$9.99, which is you get it for Xbox on the console or on the PC. So that's kind of Game Pass in a nutshell.

One of the things that we really, really like about Game Pass is how it drives engagement. I talk a lot about how engagement equals currency. You want to have users on your platform. You want to have players playing the games. And Game Pass has really changed the game for us.

When you think about a user coming in, they have access to more games. They have access to more of their friends playing those games. On the first-party side, when we think about first-party content pipeline, we put those games in day-and-date in the Game Pass.

So I think not unlike Netflix will launch Orange is the New Black then Stranger Things then House of Cards. We want that exact high-quality first-party content going into Game Pass, drive top-of-funnel excitement so users come in and really decrease churn out of the bottom. They always know something new is coming every single month or every single quarter, and they can play those games and go forward.

So from a business model standpoint, I love it. It's sort of a classic new recurring revenue. I get the -- you get the revenue and annuity over time. But more importantly is you engage with that customer on a recurring basis. We don't have to have that customer acquisition cost to go find a new customer.

We don't have to go have that, will they buy a game in the spring and maybe they'll buy a game in the fall. It's that recurring revenue stream that is critically important. That -- which leads us into the content pipeline discussion, which is also going to be key to that Game Pass bet. But out of the gate, I love it.

One of the things I would say about Game Pass too is from a third-party standpoint or when you think about content pipeline, third parties can come into Game Pass. Grand Theft Auto from Take-Two is a great example. Grand Theft Auto, one of the most successful games ever you would think that almost everybody has purchased Grand Theft Auto for \$60 and then played it over time. It turns out there's a lot of users that haven't bought the game. So Grand Theft Auto goes into Game Pass, they can acquire new users in the Game Pass subscriber pool.

And as we talked about earlier a little bit, the evolution of gaming, these games as a service are all about monetization from there. They can sell maps and skins and missions as downloadable content. So they reach a new content or new customer pool and then they find the ability to go engage and monetize that pool as well. So they're seeing revenue growth as well from a third-party side. Then the Microsoft heritage as a platform when our partners do well, we do well. So it's all about driving that ecosystem.

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**A - Raimo Lenschow** {BIO 4664646 <GO>}

And how do you think about like exclusivity because like that's -- and I like -- if I think about Sony and their games, there's still kind of a big element of that. Like how do you feel? Like do you need some exclusive titles? Would it be helpful or --

**A - Tim Stuart** {BIO 20382118 <GO>}

Yes, yes. I mean you think about one of the cornerstones of first party is driving that, we'll call it, exclusive content. When you think about Halo or Forza, what we've done with Gears of War over time. Any strong platform, any strong subscription service has to have that cornerstone platform, the cornerstone, the flagship content to come in. That's really something we're focusing on as well. How do you bolster first-party content pipeline? How do you think about content from our studios coming in and driving our platforms?

Now as Catherine mentioned, as we put the customer at the center, it's going to be less about, call it, exclusivity to a specific device and more about we want Game Pass on every device, whether it's a console or a PC or a mobile phone. So that content pipeline that we have to drive a Game Pass service to get that Game Pass service onto any device in the world, that's the goal. That's really why we want a strong content piece of the puzzle in there to drive propensity to the subscription. Then you can play the subscription in whatever device you happen to be on.

**A - Catherine Gluckstein**

Yes. That's a really interesting point that layers on top of what Tim -- which is just said, which is when you start thinking about the true network effects of gaming. So if you think engagement equals monetization, you want to up the engagement through the network effects. You can do that with Game Pass because everybody shares the same library.

So if I want to play Destiny with you, Raimo, we can because we both are subscribers and we both have that. When there's very little friction to getting into the service because it's available on multiple devices, you can just jump in and play. So you start thinking of all of that virtual cycle that can start to exist together. And community takes up a new way of thinking about it, if you think.

**A - Raimo Lenschow** {BIO 4664646 <GO>}

Yes, yes, yes. And like talk a little bit about content. I remember when you were last at our conference, I think that was two years ago, I asked a question about the acquisition. You were like, no, no, no, we kind of feel really comfortable about our content. And now we saw like -- I mean it looks like a very interesting deal coming in, in the last couple of months. How do you think about more broader terms? How much content do you need? How much -- like how do you solve that puzzle?

**A - Tim Stuart** {BIO 20382118 <GO>}



Yes, yes. Well said. Yes, so we -- you're referencing the ZeniMax acquisition, which is one of the bigger ones Microsoft has ever done. It really hits on a key strategic point. We think Game Pass -- or we know Game Pass is one of our core bets. We have announced 15 million subscribers in Game Pass.

And as you think about the path from 15 million to 20 million to 50 million to 100 million Game Pass subscribers, you have to have a content pipeline that supports that because you're talking about a much broader set of customers, a much broader geographic base and much broader elements of play style, whether it's first-person shooters or RPGs or strategy games or whatever it is. You're going to have that content pipeline that supports hundreds of millions of people playing these games.

And our acquisitions really reflect that. We're now to 23 studios on the first-party side. We did, I think at the time of the last conference in 2018, we're just on our way to sort of 7 or 8 acquisitions back then.

And really, what we see is content being that key differentiator, content being the driver of Game Pass subscription, content being the reason we play which is why you watch Netflix or Hulu or listen to Spotify, it's the content.

As we thought about an acquisition like Bethesda, it gives us access to a great set of IP. Some of the best content creators in the world are in Bethesda or in ZeniMax. And really what it allows us to do is when that content is in our first-party portfolio, we can take that, make it day-and-date, meaning we can launch it into Game Pass the day that we launched the game publicly.

And that's really one of the cornerstones of Game Pass value prop is I can play those games right when it come out. Not unlike what HBO Max is going to be doing with some of the titles you see launching now, which is day-and-date into the service to drive propensity to the subscription.

So that's really the cornerstone of why we think about Bethesda being an awesome piece of that puzzle. It really creates that pipeline, the demand of what it means to be a Game Pass subscriber.

Then I'd say maybe lastly on this one. As Catherine noted, going to different devices like PC, different devices like mobile, they're not going to be all console gamers. We talk about the market size of console being 200 million or 300 million consoles, PC is 200 million or 300 million and then mobile audience is billions plus.

That's Microsoft scale that we're thinking about. How do you go reach the 3 billion gamers in the world? How do you leverage Azure to go reach those gamers? And to get to scale that big, again you have to have that content differentiation. ZeniMax has a great piece of portfolio. They have some awesome mobile IP. That's really -- as you think about that kind of expansion into new users and the new audiences where acquisitions like that are going to be so critical. So when we think about, again that

console space going to billions of gamers for Microsoft growth, Microsoft scale, Bethesda and ZeniMax fits right into that strategy.

**A - Raimo Lenschow** {BIO 4664646 <GO>}

Yes. Okay. Now that's really interesting. It's funny, I'm just getting the warnings here on time. The -- I could talk for hours here on this one. Like maybe like last question then for me is like there's a lot of kind of amazing stuff coming together with the new Xbox, streaming, expansion of the content, et cetera. Like what's next for you guys? Like what's the stuff that keeps you awake at night that we don't know yet without you launching it here, yes?

**A - Tim Stuart** {BIO 20382118 <GO>}

Yes. No, it's a great question. First and foremost, it's growth, it's Microsoft scale. How do you expand beyond where we're going today? And we're -- I look at the date here. We're a month or so into the new console generation. So the next 3 or four years are going to be all about, how do you just go -- how do you go expand? How do you go win share? How do you go get as many consoles as we can into the market as a piece of the puzzle?

When we think about our next steps of growth, when we think about a decade from now, getting Game Pass to hundreds of millions of subscribers, it's really the goal. That's going to drive such a demand to our service. It's going to drive such a network effect.

Then Catherine, on her side with -- when we think about Project xCloud, a lot of good, yes, not yet announced products we have coming to really go reach those gamers. There's going to be amazing experiences where people can pick up a mobile device, play a game they want when they want and really have that sort of seamless devices go away in the future. So that's going to be key. And Catherine, you can hit on that one too.

**A - Catherine Gluckstein**

Yes, yes. No. Sorry, Tim, I didn't mean to interrupt you there, but that's absolutely right. So Raimo, when you think about this, think about innovation in business model, continued innovation there as we target different markets and different segments. Think about continued innovation in product. Tim talked about the seamless, frictionless. When I can literally jump into a game with one click, it changes everything, right?

And think about innovation in the technology with our partners in Azure and our telco partners as we look to continue to refine that experience when you have the rollout of 5G. It's really -- this is so exciting when you bring the content together with the technology, with the business models and the product, we create a Microsoft scale future.

**A - Raimo Lenschow** {BIO 4664646 <GO>}

Yes,. Yes. Yes. I mean yes. We haven't even talked 5G. That's another whole session. That comes off -- yes. It's for next time. Yes. Hi. Tim, Catherine, thank you. Thank you, so much for joining us. That was really -- this was really informative, really helpful. It's nice to see the progress as well. Thank you.

**A - Tim Stuart** {BIO 20382118 <GO>}

Yes. Thanks very much.

**A - Catherine Gluckstein**

Great to see you. Thank you.

**A - Raimo Lenschow** {BIO 4664646 <GO>}

Thank you.

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