

## Jefferies Virtual Software Conference 2020

### Company Participants

- Kirk Koenigsbauer, COO-CVP, Data Platform

### Other Participants

- Brent Thill, Analyst, Jefferies

### Presentation

#### **Brent Thill** {BIO 1556691 <GO>}

Welcome back to the Software Conference at Jefferies. I'm Brent Thill and we save one of the best for last, Microsoft. Kirk Koenigsbauer, the COO-CVP of the Data Platform. Kirk has been at the company for 24 years and prior to that time he actually was at Amazon, running the software and video game store. I didn't realize they had video game store way back then, but thank you so much Kirk, for joining us. And 24 years, that's -- it's quite the run, congrats on that.

#### **Kirk Koenigsbauer** {BIO 5905758 <GO>}

Yeah, thanks. Thanks a lot.

#### **Brent Thill** {BIO 1556691 <GO>}

Maybe just to kick off. We were kind of kidding around saying that you're the Chief Operating Officer of the work-from-home remote everything at Microsoft and maybe just to dig in on Microsoft 365, just to kind of put this into the frame, the larger vision of Microsoft, and how that fits in?

#### **Kirk Koenigsbauer** {BIO 5905758 <GO>}

Yeah, yeah, for sure. Why don't I just start by giving you a sort of a quick overview of it, the value proposition, so forth and talk a little bit about. I mean, we've -- it's been super gratifying the last three years to see the work really start to pay off. But the way we position Microsoft 365 is as the world's productivity cloud. And what we're trying to do is bring together best-in-class productivity, collaboration, communications, content creation and analytics capabilities on an integrated platform. And from a brand perspective, which might be more familiar with folks, that means Office, Microsoft Teams, OneDrive, SharePoint plus Windows and then the Enterprise Mobility and Security suite product that we have, bringing that together in a single offering for customers.

As I mentioned, it's about three-years old, and about three years in the market or so at this point and we've seen just phenomenal growth. Obviously accelerated over the course of the last six months, for sure, but it's been fantastic.

**Brent Thill** {BIO 1556691 <GO>}

Yeah. And talk maybe about the kind of big key areas of big investment right now. You can talk through Teams and Security. You've also been active in a lot of other kind of products that maybe aren't as well known. Can you talk through those areas?

**Kirk Koenigsbauer** {BIO 5905758 <GO>}

Yeah, so in the case of Microsoft 365, there are a bunch of core workloads. Obviously there is the -- there is the Teams workload. Well, I think there is the sort of end user oriented workloads, the workloads that people are using on a day-to-day basis. And again, that's the Office set of products, that's Microsoft Teams, that Outlook, that's OneDrive, all those products brought together, and that's a -- it's a core obviously part of the value proposition.

But when we talk to folks about it, the offering all up, one thing, I think it's important too is, if there are -- I refer to them as a several set of control plans essentially that are part of Microsoft 365. And so for example, one of those control plans would be a common management layer and that's supported by obviously Windows on the Windows operating side, but also in tune with the EMS suite, or we have an identity, I refer to our identity control plane as well powered by AD. We've got about 345 million active users on a monthly basis using Azure Active Directory. Then there is a notion of a security plane that underpins all this as well. And so we have a bunch of offerings there we could talk a little bit more about with the Defender line of products on the endpoint side, a series of threat protection products, series of products that are used for cloud app security, sort of securing applications with inside of a tenant and so forth. So, it's a pretty deep, pretty broad set of services that are part of this thing.

**Brent Thill** {BIO 1556691 <GO>}

Yeah, I know this market is pretty enormous, but I don't know how you break down kind of the TAM and opportunity set you're serving here, it's almost too big deep, to maybe even go through but how...

**Kirk Koenigsbauer** {BIO 5905758 <GO>}

Yeah, at a high level, when we think about the TAM, the total addressable market, depending on how you measure it or which analyst you are looking at, roughly the sort of core productivity and collaboration side of it, it's about \$200 billion to \$300 billion, so, it's quite large. That's not inclusive of the security and compliance space, which is yet another \$100 billion or so -- over \$100 million. And so together, \$300 billion to \$400 billion, an opportunity, it's a pretty big space.

The other way we think about it is from an audience lens too and so, for example, historically, we focused on and folks think of us, focusing on knowledge workers or what we sometimes refer to as information workers. Gartner classifies about 1 billion of those workers on the planet today. But a really interesting new segment of the market that we've been sort of working at hard with Microsoft 365 and then also Microsoft Teams in particular, is this notion of personal workers, so folks that work in hospitality, retail, manufacturing, the frontlines of the healthcare space. There are a bunch of different industries there are that people that are not your sort of traditional knowledge worker per se, but there are I believe there is 2 billion of them and that represents a pretty important part of the segment when companies are thinking about trying to connect their whole -- their whole organization or do digital transformation across our whole organization. So, that's a pretty, that's a pretty, a different way to think about it from that audience side as well. And then of course, we're an enterprise, we're an SMB in the consumer side of the market and education is a big part of market too. So, it's big.

**Brent Thill** {BIO 1556691 <GO>}

Yeah, on the Office 365 commercial side, the revenue growth continues to outpace seats and you've talked about the upgrades from E3 to E5 and getting more capabilities. Maybe if you can just talk to you know you don't give a lot of specific details but how you think about how much room is left and how much ARPU left is in the tank here?

**Kirk Koenigsbauer** {BIO 5905758 <GO>}

Yeah, yeah, no, it's a totally fair question. We -- I'll break it down by seats and then ARPU kind of the way you're outlining it. And there's a couple different ways that we think about what sort of room is left or gas left in the tank as you referred to it. One stat that we did offer last quarter, which is a pretty good one I think directionally, when you think about the shift from on-prem to cloud, we've got about 65% -- over 65% of the Office 365 commercial base is now on our cloud service, which is -- it's pretty, it's a pretty sizable piece, but it also means that there is room yet to grow. And that represents a series socket opportunity for us.

And then also I referenced a few moments ago, the notion of these firstline workers. These are folks that we've not been able to target typically, but now with everything moving into the cloud and digital transformation support, there is a big opportunity that we see in attracting firstline workers as a way to grow our seats. I'd also say small and mid size business is another big area for us. Certainly, we've done historically quite well in the core part of the SMB space. But that lower part of the SMB business is pretty right tuned for productivity and collaboration. Let alone, I would say our emerging markets or developing markets is another opportunity for us to penetrate more deeply on the seat side. And all those, we feel like are really good opportunities for us. COVID has had some impact on things like SMB and support, but generally speaking, structurally, we feel like there's a lot of room left there to go.

On the ARPU side, again shift to cloud, certainly, we think of it really as an ARPU driver overall and there is certainly room to grow there, but one thing that's been

great to see again, speaking of the beginning part of our chat which is Microsoft 365. We're now generating over a third of the Office 365 seats are moving straight to Microsoft 365 all up and so it's really gaining momentum for us and that is a great LTV and ARPU play for us all up. And then the third one I think I would mention, which I often get a lot of questions about is this thing that we have called E5. We have a number of different ways that we talk about our SKUs, different tiers almost think of them as cell phone plans. E3 is the core and E5 is the one that's sort of the advanced premium set of SKUs and that represents a big opportunity for us as well. And that E5 suite has typically been something that has been a big driver for us leading with security and compliance-oriented workloads. But it's really interesting just the last six months alone, we seen quite a bit of uptake in our phone system in calling set of services, so that workload is also now dragging the E5. So generally speaking, both on the seat side and the ARPU side, we feel like there is lots of room left to go for sure.

**Brent Thill** {BIO 1556691 <GO>}

That's great. Just on Windows commercial, inside the suite and 365 suite, what does this offer beyond the core OS?

**Kirk Koenigsbauer** {BIO 5905758 <GO>}

Yeah, yeah. So, for folks that may not be familiar with all the branding around and SKUs around Windows, the baseline in the commercial space is sort of the Pro business, that's the royalty model that is acquired by customers through the OEMs and so forth. With Microsoft 365, when customers buy Microsoft 365 they're buying one of essentially the cloud additions of Windows, what we refer to as that -- those E3 and E5 SKUs. And those SKUs really represent that notion of Windows being a cloud connected OS. And that means essentially things like enhanced management, security capabilities, it brings in advance identity workloads into that core and that's been a pretty big driver for -- of growth for us over the last, over the last year or so in particular. We think it's going to remain a pretty big growth driver for us in the coming -- in the coming quarters as well. Again, really driven by the notion of this advanced management, advanced security part of the value prop.

**Brent Thill** {BIO 1556691 <GO>}

Great. Just wanted to shift over to Teams. And if you can kind of share the next chapter. Our firm went through enterprise-wide adoption during COVID, it's really help transform how we collaborate with each other, 4,000 people across our firm globally. So, thanks for that.

**Kirk Koenigsbauer** {BIO 5905758 <GO>}

Thank you.

**Brent Thill** {BIO 1556691 <GO>}

Maybe talk to, to kind of the next leg of this. I certainly have a lot of things that I could see where I can envision this going a lot further in a lot of different ways and yeah, just at the stage and where we're at with Teams and kind of what's the next chapter?

**Kirk Koenigsbauer** {BIO 5905758 <GO>}

Yeah, yeah. Well, it's interesting, the last six months, we've been pretty humbled by everything we've seen with Teams in terms of the mass, the mass adoption. And I have to of course acknowledge that, yeah, the pandemic and COVID and work-from-home as horrible as it's been on so many dimensions in terms of loss of life and personal tragedy and the economic impact, Teams has absolutely been a beneficiary in terms of that digital transformation and Microsoft 365 is a part of that. And so we say that with a lot of humility, but also we're happy that we were able to deliver the service. Video conferencing, what we're doing right now is something that has been the workload that's been out front the most, but Teams offers a whole lot more than just video conferencing and that's, that's been the value proposition of the product often why it's driven so much growth is because it does offer a bunch of workloads on a single platform. It really is truly as we talk about our help for teamwork. So, yes, it's got meetings, it's got chat, it's got phone system, it's got all these communications capabilities and we'll continue to build out over time for sure. But it's also got the core integration of collaboration and productivity stuff, so it's got Office built in, really nicely integrated into it. It's got OneDrive and SharePoint for sort of document oriented and workspace kind of collaboration.

One that's been I would say building over the last 18 months in particular and we've seen some acceleration to COVID and we'll certainly be doubling down on this piece too is the notion of business processes and workflow being built into Teams as well. And so we're seeing this really interesting phenomenon where customers are appreciating the notion of our high engagement service that Teams is providing and they want to build their line of business applications into that service, doesn't mean that it's an exclusive oriented thing. Of course, they'll have their own experience as well, but they want to sort of hit that sweet spot of integrating their line of business out with Microsoft Teams to try and drive that engagement and that usage all up. And Teams provides a really a wonderful scaffolding for that along with power apps and workflow and our workflow automation stuff that we've got on top of it, so that's, that's a biggie too and we're going to continue to push hard in that area as well.

And then another key innovation area I would say that's been very important particularly given again just a massive increase in usage that we've seen is customers saying, hey, this is all great. But I want to make sure that it's secure and compliant. And so whether it's DLP type of capability, whether it's threat protection kinds of capability, whether it's compliance features, whether it's things like well in financial services, things like Ethical Walls, these have all been very, very important parts of the value proposition that's built inside of Teams as well and it's been, it's been really, really strong what we've seen and we're going to just kind of continue to, to work on these areas.

I don't hear you Brent. I think you are muted.

**Brent Thill** {BIO 1556691 <GO>}

Sorry about that.

**Kirk Koenigsbauer** {BIO 5905758 <GO>}

That's all right. You wouldn't have noticed it. If it was on Teams, we would have noticed it.

**Brent Thill** {BIO 1556691 <GO>}

Just talking through the voice and telephony feature, we think about what you can do there. It seems like a tremendous opportunity, where directionally on that side, where do you want to be in?

**Kirk Koenigsbauer** {BIO 5905758 <GO>}

Yeah, no, we think that's a very important part of the value proposition for Teams and as I mentioned a few minutes ago. As we think about Microsoft 365 all up and what's been driving E5, it's been security and compliance, but increasingly, we're seeing telephony and I think it's kind of one of these natural outcroppings that's happening from a lot of the push or the rethink on what is really the digital, what is a digital workplace.

And lots of companies are rethinking their physical space, how they're going to manage work-from-home and so forth, and you see lots of different, different opinions from CEOs in terms of how it's going to play out. But I think at the end of the day, people are feeling like you're going to need a phone number no matter where you are working. And the whole telephony space is something that we've been working on for the last, pretty hard the last 18 to 24 months within Teams and we've got a very, very strong value proposition here. We've got a legacy of working in the space before in the on-prem world with Skype for Business, but inside of Teams, we now offer phone system capabilities, routing analytics, of course, you can call within your tenant, but there is PSTN services, so you can reach outside your tenant, reach your customers and all the vendors and so forth that you're working with.

The other thing that's important as we've added calling plans and so you don't have to work with the telco, if you don't want to, but we've also over the last 12 months really worked on a strategy within the ecosystem where if a company has already got an existing relationship, we have a big telco and they want to maintain that, fantastic. They can bring their own trunk, as we call it and have a direct routing solution inside of Microsoft Teams. So, we're sort of providing a first-party experience, but also really embracing those third-party relationships too, which are super, super important for many big multinationals that exists. So, this for us is a good example of how Teams is not only one where we're sort of bringing sort of new users to the platform, but one that's going to allow us to have some ARPU opportunity as well because again these are the kinds of capabilities that are in that E5 tier of service.

**Brent Thill** {BIO 1556691 <GO>}

And just on the video side when you think about, there is a lot of awesome things you can integrate in but Zoom kind of came out of nowhere and kind of became the easy choice. How do you dislodge what's going on there?

**Kirk Koenigsbauer** {BIO 5905758 <GO>}

Well, I think we're focused on our value proposition and again as I mentioned earlier, the broad notion of Teams having everything that companies are looking for in a single platform is a very, very strong value proposition. And I talked to lots of CIOs and leaders in IT and technology and sometimes there is this oh, best-of-breed versus integration and our view is it's kind of looney. At the end of the day, we're going to do a great job of both. We aspire to have the best as we are just talking about calling and telephony solutions on the planet. We want to have the best chat and meetings infrastructure that's there. We've got the office integration already built into Microsoft Teams, which is again when you think about these high systems of engagement and so forth. Having everything as a real true hub for teamwork is a pretty valuable. It's pretty valuable differentiator for us.

And then as we talked about before, again this notion of business process, I can't emphasize enough how sticky that ends up being when companies decide, hey it's not sufficient just to have a video solution. I need to have a video solution that's connected into my line of business set of processes and that's where this platform that we've got with Teams is just so unique from that perspective, because it's not just chat, it's not just video, it's really bringing all these components together and pulling through the rest of the Microsoft 365 platform. So that's our strategy. We've been pretty clear on it. We're pretty maniacally focused on it and that's how we're going to ultimately win we believe customer mindshare in the market.

**Brent Thill** {BIO 1556691 <GO>}

Just shifting to security, it feels you've been there. But it feels like it's a much louder voice and you're having better traction than you may have had in the past, maybe I'm wrong, but I think you had said at RSA, I think you had this, putting \$1 billion into this with over 3,500 full-time employees, it's a big, big commitment.

**Kirk Koenigsbauer** {BIO 5905758 <GO>}

Yeah. No. And that's an old stat and I think those numbers are actually bigger at this point. But you're right, the last, I would say the last three years, we've been working pretty hard on the security space, really to finding what -- what's the breadth of the portfolio that we want to be into, what are the right markets for us to enter, what are our differentiator is going to be and the team is really I think done a nice job of executing and we are in a unique position. It's in some ways, similar to Teams. There are hundreds of security vendors that are on the planet today. Many of them are -- come from the legacy of building on-premises-oriented solutions, so very singularly vertically oriented. And that's been on okay sort of historical approach, but with the

sophistication of threats today and the intensity of them, there is no question that security is moving to the cloud and a vendor like us that is sort of with all the strengths that we have with Microsoft 365 and with Azure, there is quite an advantage, we think there in terms of the scale.

And so we've entered into markets like Identity and Access Management, I think I mentioned the 345 million people we have on Azure Active Directory, that is a very, very key asset for us. When you think about Zero Trust security models, identity is at the core of that and we are very, very strong part of that offering. That in many ways is the umbrella for all the other solutions that we have around threat protection, whether that's at the endpoint, whether that's in services like email or across Teams or across the application layer itself. As you know, obviously this world of bring your own SAS app, you know CIOs, they need to under -- CSOs, they need to understand what end-users are using inside of their organization. We've made a very intentional push and we've had strength here for years and information protection and compliance and that's been a very nice way to round up the value proposition.

And again the CASB space and cloud app security, these have all been workloads that we've been in and we have real strength in the market and have built a leadership position in. It's really fantastic and as I mentioned earlier, it's been a big, big driver of growth for us. Being able to attach this to Microsoft 365, but then also have solutions that are independent of Microsoft 365. I'm not sure how familiar you are with Azure Sentinel, it's a new SIEM-based offering that we launched I guess, about a year ago and into general availability. It's done super, super well in the market. There's chief integration there with Microsoft 365. So, we feel pretty good about where we are in the market and what our outlook looks like here.

### **Brent Thill** {BIO 1556691 <GO>}

The last six months I think have surprised us all. There is -- there has been, I think a lot of people would never have thought we'd be as productive as we are sitting at home. What's been most surprising to you in how your customers have acted and approach they've adopted? Is there a couple of things you'd call out that were most surprising?

### **Kirk Koenigsbauer** {BIO 5905758 <GO>}

Yeah. Yeah, this is a year where I think many of us will want to forget 2020 for lot of good reasons. But I think it's also a year where people will look back and go, this was the time for all the sort of tragedy that's been associated with it that the real birth of digital transformation kicked off, and went into high motive, of course digital transformation has been happening for the last couple of years. But vendors like us and others I think have seen two or three years worth of growth in a period of four to six months in a pretty massive way and it's pretty incredible.

I think when it all started, I would say the first few months of it was frankly almost like crisis management. How do companies let people like you and me work-from-home, how do they enable that to happen. And there was a real scramble we saw across the breadth of customers for everything from getting their VPN and strategy



together to making sure their users had great, great desktops. And those desktops were securely connected into their networks. And there was a pretty massive shift, a pretty massive push to cloud, but also -- things like Teams and so forth, but also people upgrading PCs and wanting to layer in security and thinking about information protection and support. And so it was very, very much a mad dash, I guess I would say.

And the last few months I think the tenor has changed a bit. Of course, there is still some companies that are on that journey for sure and catching up and moving fast. But I also think that there are folks now that are looking for long-term. What's going to be really durable, how much is -- how much of what we're doing now is going to stick, how much it's going to really change. And so they are thinking I think a lot more long term as opposed to firefighting in terms of what is going to be the durable technology platforms that they're going to go by. And the stress test that many companies went through during this journey, I think has been pretty intense and the notion of having us a platform that is comprehensive, that is broad, that is going to be best-of-breed in these key workflows, it's going to enable further digital transformation of these business processes moving them online, making sure that their employees are engaged and so forth. This stuff is going to matter a lot and I think -- I think it really is going to be a catalyst for the next three, four, five years that we're going to see.

**Brent Thill** {BIO 1556691 <GO>}

I know you don't talk about specifics on the roadmap, but maybe, if you kind of share the vision of how you expect things to look in at a high level and we get the questions, is there going to be E7, is there going to be you know, so maybe if you can just talk to you at a high level, the roadmap?

**Kirk Koenigsbauer** {BIO 5905758 <GO>}

Yeah, I know you're right, it's hard to get too specific on this. I think we've talked a little bit about some of these things. We're super committed to creating great experience as brand users in the productivity and collaboration space and there is -- we didn't get a chance to talk much about all the work that ML and AI is able to enable in terms of creating really interesting scenarios for end-users and that's a big thing that we're going to focus on. I think we talked a little bit about security and compliance, that will continue to be a big thrust for us in terms of where we're pouring our engineers and our R&D and where we see market opportunity. I talked about this unique intersection between systems of record and systems of engagement and this notion of workflow and line of business, I think that's going to be a big area of investment for us.

And then you know I touched on it briefly but as we're going through all this digital transformation, there is a lot of culture change that organizations have to go through and thinking about what that employee experience is, there is a lot there. We, for example, just a month or a month or two ago announced a new corporate earning application that we're going to be building into Teams, we've got a lot of data and analytics that we're using to help businesses understand how their employees are

being productive, their well-being and so forth and we think that's going to be a big opportunity for us too.

**Brent Thill** {BIO 1556691 <GO>}

Great. Kirk, thanks for joining us. Really appreciate the insight and congrats on the ongoing success. Thank you very much.

**Kirk Koenigsbauer** {BIO 5905758 <GO>}

Great, thank you very much for having me here. I appreciate it. Thank you, everyone.

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