UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended December 31, 2023

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition Period From to

Commission File Number 001-37845

MICROSOFT CORPORATION

WASHINGTON	**91-1144442**
(STATE OF INCORPORATION)	**(I.R.S. ID)**

ONE MICROSOFT WAY, REDMOND, WASHINGTON 98052-6399
(425) 882-8080
www.microsoft.com/investor

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of exchange on which registered
Common stock, $0.00000625 par value per share	**MSFT**	**NASDAQ**
3.125% Notes due 2028	**MSFT**	**NASDAQ**
2.625% Notes due 2033	**MSFT**	**NASDAQ**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ☒	Accelerated Filer ☐
Non-accelerated Filer ☐	Smaller Reporting Company ☐
	Emerging Growth Company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	**Outstanding as of January 25, 2024**
Common Stock, $0.00000625 par value per share	7,430,436,229 shares

MICROSOFT CORPORATION

FORM 10-Q

For the Quarter Ended December 31, 2023

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INCOME STATEMENTS

(In millions, except per share amounts) (Unaudited)	Three Months Ended December 31, 2023	Three Months Ended December 31, 2022	Six Months Ended December 31, 2023	Six Months Ended December 31, 2022
Revenue:				
Product	**$ 18,941**	$ 16,517	**$ 34,476**	$ 32,258
Service and other	**43,079**	36,230	**84,061**	70,611
Total revenue	**62,020**	52,747	**118,537**	102,869
Cost of revenue:				
Product	**5,964**	5,690	**9,495**	9,992
Service and other	**13,659**	11,798	**26,430**	22,948
Total cost of revenue	**19,623**	17,488	**35,925**	32,940
Gross margin	**42,397**	35,259	**82,612**	69,929
Research and development	**7,142**	6,844	**13,801**	13,472
Sales and marketing	**6,246**	5,679	**11,433**	10,805
General and administrative	**1,977**	2,337	**3,451**	3,735
Operating income	**27,032**	20,399	**53,927**	41,917
Other expense, net	**(506)**	(60)	**(117)**	(6)
Income before income taxes	**26,526**	20,339	**53,810**	41,911
Provision for income taxes	**4,656**	3,914	**9,649**	7,930
Net income	**$ 21,870**	$ 16,425	**$ 44,161**	$ 33,981
Earnings per share:				
Basic	**$ 2.94**	$ 2.20	**$ 5.94**	$ 4.56
Diluted	**$ 2.93**	$ 2.20	**$ 5.92**	$ 4.54
Weighted average shares outstanding:				
Basic	**7,432**	7,451	**7,431**	7,454
Diluted	**7,468**	7,473	**7,465**	7,479

Refer to accompanying notes.

COMPREHENSIVE INCOME STATEMENTS

(In millions) (Unaudited)	Three Months Ended December 31,		Six Months Ended December 31,	
	2023	2022	2023	2022
Net income	**$ 21,870**	$ 16,425	**$ 44,161**	$ 33,981
Other comprehensive income (loss), net of tax:				
Net change related to derivatives	**(3)**	(32)	**18**	(25)
Net change related to investments	**1,331**	348	**1,071**	(1,549)
Translation adjustments and other	**660**	570	**305**	(205)
Other comprehensive income (loss)	**1,988**	886	**1,394**	(1,779)
Comprehensive income	**$ 23,858**	$ 17,311	**$ 45,555**	$ 32,202

Refer to accompanying notes.

BALANCE SHEETS

(In millions) (Unaudited)

		December 31, 2023		June 30, 2023
Assets				
Current assets:				
Cash and cash equivalents	**$**	**17,305**	$	34,704
Short-term investments		**63,712**		76,558
Total cash, cash equivalents, and short-term investments		**81,017**		111,262
Accounts receivable, net of allowance for doubtful accounts of **$591** and $650		**42,831**		48,688
Inventories		**1,615**		2,500
Other current assets		**21,930**		21,807
Total current assets		**147,393**		184,257
Property and equipment, net of accumulated depreciation of **$72,949** and $68,251		**112,308**		95,641
Operating lease right-of-use assets		**16,398**		14,346
Equity investments		**13,367**		9,879
Goodwill		**118,931**		67,886
Intangible assets, net		**29,896**		9,366
Other long-term assets		**32,265**		30,601
Total assets	**$**	**470,558**	$	411,976
Liabilities and stockholders' equity				
Current liabilities:				
Accounts payable	**$**	**17,695**	$	18,095
Short-term debt		**27,041**		0
Current portion of long-term debt		**2,250**		5,247
Accrued compensation		**8,813**		11,009
Short-term income taxes		**5,787**		4,152
Short-term unearned revenue		**43,068**		50,901
Other current liabilities		**16,362**		14,745
Total current liabilities		**121,016**		104,149
Long-term debt		**44,928**		41,990
Long-term income taxes		**25,890**		25,560
Long-term unearned revenue		**2,966**		2,912
Deferred income taxes		**2,548**		433
Operating lease liabilities		**14,155**		12,728
Other long-term liabilities		**20,787**		17,981
Total liabilities		**232,290**		205,753
Commitments and contingencies				
Stockholders' equity:				
Common stock and paid-in capital – shares authorized 24,000; outstanding **7,432** and 7,432		**97,480**		93,718
Retained earnings		**145,737**		118,848
Accumulated other comprehensive loss		**(4,949)**		(6,343)
Total stockholders' equity		**238,268**		206,223
Total liabilities and stockholders' equity	**$**	**470,558**	$	411,976

Refer to accompanying notes.

CASH FLOWS STATEMENTS

(In millions) (Unaudited)	Three Months Ended December 31, 2023	Three Months Ended December 31, 2022	Six Months Ended December 31, 2023	Six Months Ended December 31, 2022
Operations				
Net income	**$ 21,870**	$ 16,425	**$ 44,161**	$ 33,981
Adjustments to reconcile net income to net cash from operations:				
Depreciation, amortization, and other	**5,959**	3,648	**9,880**	6,438
Stock-based compensation expense	**2,828**	2,538	**5,335**	4,730
Net recognized losses on investments and derivatives	**198**	214	**212**	192
Deferred income taxes	**(1,702)**	(1,305)	**(2,270)**	(2,496)
Changes in operating assets and liabilities:				
Accounts receivable	**(2,951)**	(3,164)	**8,083**	8,565
Inventories	**1,474**	1,305	**969**	762
Other current assets	**725**	(392)	**(71)**	(724)
Other long-term assets	**(1,427)**	(65)	**(3,440)**	(731)
Accounts payable	**(2,521)**	(2,058)	**(1,307)**	(3,625)
Unearned revenue	**(5,538)**	(5,186)	**(9,664)**	(8,508)
Income taxes	**(1,554)**	(2,863)	**(129)**	(2,453)
Other current liabilities	**1,518**	1,819	**(2,588)**	(2,205)
Other long-term liabilities	**(26)**	257	**265**	445
Net cash from operations	**18,853**	11,173	**49,436**	34,371
Financing				
Proceeds from issuance (repayments) of debt, maturities of 90 days or less, net	**(8,490)**	0	**10,202**	0
Proceeds from issuance of debt	**10,773**	0	**17,846**	0
Repayments of debt	**(2,916)**	(750)	**(4,416)**	(1,750)
Common stock issued	**261**	243	**946**	818
Common stock repurchased	**(4,000)**	(5,459)	**(8,831)**	(11,032)
Common stock cash dividends paid	**(5,574)**	(5,066)	**(10,625)**	(9,687)
Other, net	**(201)**	(317)	**(508)**	(581)
Net cash from (used in) financing	**(10,147)**	(11,349)	**4,614**	(22,232)
Investing				
Additions to property and equipment	**(9,735)**	(6,274)	**(19,652)**	(12,557)
Acquisition of companies, net of cash acquired, and purchases of intangible and other assets	**(65,029)**	(679)	**(66,215)**	(1,028)
Purchases of investments	**(4,258)**	(11,599)	**(12,718)**	(16,612)
Maturities of investments	**4,150**	6,928	**19,868**	13,590
Sales of investments	**1,600**	4,775	**6,930**	7,486
Other, net	**1,347**	(301)	**365**	(1,161)
Net cash used in investing	**(71,925)**	(7,150)	**(71,422)**	(10,282)
Effect of foreign exchange rates on cash and cash equivalents	**72**	88	**(27)**	(142)
Net change in cash and cash equivalents	**(63,147)**	(7,238)	**(17,399)**	1,715
Cash and cash equivalents, beginning of period	**80,452**	22,884	**34,704**	13,931
Cash and cash equivalents, end of period	**$ 17,305**	$ 15,646	**$ 17,305**	$ 15,646

Refer to accompanying notes.

STOCKHOLDERS' EQUITY STATEMENTS

(In millions, except per share amounts) (Unaudited)	Three Months Ended December 31, 2023	Three Months Ended December 31, 2022	Six Months Ended December 31, 2023	Six Months Ended December 31, 2022
Common stock and paid-in capital				
Balance, beginning of period	**$ 95,508**	$ 88,535	**$ 93,718**	$ 86,939
Common stock issued	**261**	243	**946**	818
Common stock repurchased	**(1,300)**	(1,090)	**(2,701)**	(2,261)
Stock-based compensation expense	**2,828**	2,538	**5,335**	4,730
Other, net	**183**	(1)	**182**	(1)
Balance, end of period	**97,480**	90,225	**97,480**	90,225
Retained earnings				
Balance, beginning of period	**132,143**	92,374	**118,848**	84,281
Net income	**21,870**	16,425	**44,161**	33,981
Common stock cash dividends	**(5,574)**	(5,059)	**(11,145)**	(10,123)
Common stock repurchased	**(2,702)**	(4,372)	**(6,127)**	(8,771)
Balance, end of period	**145,737**	99,368	**145,737**	99,368
Accumulated other comprehensive loss				
Balance, beginning of period	**(6,937)**	(7,343)	**(6,343)**	(4,678)
Other comprehensive income (loss)	**1,988**	886	**1,394**	(1,779)
Balance, end of period	**(4,949)**	(6,457)	**(4,949)**	(6,457)
Total stockholders' equity	**$ 238,268**	$ 183,136	**$ 238,268**	$ 183,136
Cash dividends declared per common share	**$ 0.75**	$ 0.68	**$ 1.50**	$ 1.36

Refer to accompanying notes.

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 — ACCOUNTING POLICIES

Accounting Principles

Our unaudited interim consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). In the opinion of management, the unaudited interim consolidated financial statements reflect all adjustments of a normal recurring nature that are necessary for a fair presentation of the results for the interim periods presented. Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with information included in the Microsoft Corporation fiscal year 2023 Form 10-K filed with the U.S. Securities and Exchange Commission on July 27, 2023.

We have recast certain prior period amounts to conform to the current period presentation. The recast of these prior period amounts had no impact on our consolidated balance sheets, consolidated income statements, or consolidated cash flows statements.

Principles of Consolidation

The consolidated financial statements include the accounts of Microsoft Corporation and its subsidiaries. Intercompany transactions and balances have been eliminated.

Estimates and Assumptions

Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples of estimates and assumptions include: for revenue recognition, determining the nature and timing of satisfaction of performance obligations, and determining the standalone selling price of performance obligations, variable consideration, and other obligations such as product returns and refunds; loss contingencies; product warranties; the fair value of and/or potential impairment of goodwill and intangible assets for our reporting units; product life cycles; useful lives of our tangible and intangible assets; allowances for doubtful accounts; the market value of, and demand for, our inventory; stock-based compensation forfeiture rates; when technological feasibility is achieved for our products; the potential outcome of uncertain tax positions that have been recognized in our consolidated financial statements or tax returns; and determining the timing and amount of impairments for investments. Actual results and outcomes may differ from management's estimates and assumptions due to risks and uncertainties.

Financial Instruments

Investments

We consider all highly liquid interest-earning investments with a maturity of three months or less at the date of purchase to be cash equivalents. The fair values of these investments approximate their carrying values. In general, investments with original maturities of greater than three months and remaining maturities of less than one year are classified as short-term investments. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations.

Debt investments are classified as available-for-sale and realized gains and losses are recorded using the specific identification method. Changes in fair value, excluding credit losses and impairments, are recorded in other comprehensive income. Fair value is calculated based on publicly available market information or other estimates determined by management. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, credit quality of debt instrument issuers, and the extent to which the fair value is less than cost. To determine credit losses, we employ a systematic methodology that considers available quantitative and qualitative evidence. In addition, we consider specific adverse conditions related to the financial health of, and business outlook for, the investee. If we have plans to sell the security or it is more likely than not that we will be required to sell the security before recovery, then a decline in fair value below cost is recorded as an impairment charge in other income (expense), net and a new cost basis in the investment is established. If market, industry, and/or investee conditions deteriorate, we may incur future impairments.

Equity investments with readily determinable fair values are measured at fair value. Equity investments without readily determinable fair values are measured using the equity method or measured at cost with adjustments for observable changes in price or impairments (referred to as the measurement alternative). We perform a qualitative assessment on a periodic basis and recognize an impairment if there are sufficient indicators that the fair value of the investment is less than carrying value. Changes in value are recorded in other income (expense), net.

Derivatives

Derivative instruments are recognized as either assets or liabilities and measured at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

For derivative instruments designated as fair value hedges, gains and losses are recognized in other income (expense), net with offsetting gains and losses on the hedged items. Gains and losses representing hedge components excluded from the assessment of effectiveness are recognized in other income (expense), net.

For derivative instruments designated as cash flow hedges, gains and losses are initially reported as a component of other comprehensive income and subsequently recognized in other income (expense), net with the corresponding hedged item. Gains and losses representing hedge components excluded from the assessment of effectiveness are recognized in other income (expense), net.

For derivative instruments that are not designated as hedges, gains and losses from changes in fair values are primarily recognized in other income (expense), net.

Fair Value Measurements

We account for certain assets and liabilities at fair value. The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. We categorize each of our fair value measurements in one of these three levels based on the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

- *Level 1* – inputs are based upon unadjusted quoted prices for identical instruments in active markets. Our Level 1 investments include U.S. government securities, common and preferred stock, and mutual funds. Our Level 1 derivative assets and liabilities include those actively traded on exchanges.
- *Level 2* – inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques (e.g. the Black-Scholes model) for which all significant inputs are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, credit spreads, foreign exchange rates, and forward and spot prices for currencies. Our Level 2 investments include commercial paper, certificates of deposit, U.S. agency securities, foreign government bonds, mortgage- and asset-backed securities, corporate notes and bonds, and municipal securities. Our Level 2 derivative assets and liabilities include certain cleared swap contracts and over-the-counter forward, option, and swap contracts.
- *Level 3* – inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques, including option pricing models and discounted cash flow models. Our Level 3 assets and liabilities include investments in corporate notes and bonds, municipal securities, and goodwill and intangible assets, when they are recorded at fair value due to an impairment charge. Unobservable inputs used in the models are significant to the fair values of the assets and liabilities.

We measure equity investments without readily determinable fair values on a nonrecurring basis. The fair values of these investments are determined based on valuation techniques using the best information available, and may include quoted market prices, market comparables, and discounted cash flow projections.

Our other current financial assets and current financial liabilities have fair values that approximate their carrying values.

Contract Balances and Other Receivables

As of December 31, 2023 and June 30, 2023, long-term accounts receivable, net of allowance for doubtful accounts, was $4.8 billion and $4.5 billion, respectively, and is included in other long-term assets in our consolidated balance sheets.

As of December 31, 2023 and June 30, 2023, other receivables related to activities to facilitate the purchase of server components were $8.8 billion and $9.2 billion, respectively, and are included in other current assets in our consolidated balance sheets.

We record financing receivables when we offer certain of our customers the option to acquire our software products and services offerings through a financing program in a limited number of countries. As of December 31, 2023 and June 30, 2023, our financing receivables, net were $3.6 billion and $5.3 billion, respectively, for short-term and long-term financing receivables, which are included in other current assets and other long-term assets in our consolidated balance sheets. We record an allowance to cover expected losses based on troubled accounts, historical experience, and other currently available evidence.

Recent Accounting Guidance

Segment Reporting – Improvements to Reportable Segment Disclosures

In November 2023, the Financial Accounting Standards Board ("FASB") issued a new standard to improve reportable segment disclosures. The guidance expands the disclosures required for reportable segments in our annual and interim consolidated financial statements, primarily through enhanced disclosures about significant segment expenses. The standard will be effective for us beginning with our annual reporting for fiscal year 2025 and interim periods thereafter, with early adoption permitted. We are currently evaluating the impact of this standard on our segment disclosures.

Income Taxes – Improvements to Income Tax Disclosures

In December 2023, the FASB issued a new standard to improve income tax disclosures. The guidance requires disclosure of disaggregated income taxes paid, prescribes standardized categories for the components of the effective tax rate reconciliation, and modifies other income tax-related disclosures. The standard will be effective for us beginning with our annual reporting for fiscal year 2026, with early adoption permitted. We are currently evaluating the impact of this standard on our income tax disclosures.

NOTE 2 — EARNINGS PER SHARE

Basic earnings per share ("EPS") is computed based on the weighted average number of shares of common stock outstanding during the period. Diluted EPS is computed based on the weighted average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include outstanding stock options and stock awards.

The components of basic and diluted EPS were as follows:

(In millions, except per share amounts)	**Three Months Ended December 31,**		**Six Months Ended December 31,**	
	2023	**2022**	**2023**	**2022**
Net income available for common shareholders (A)	**$ 21,870**	$ 16,425	**$ 44,161**	$ 33,981
Weighted average outstanding shares of common stock (B)	**7,432**	7,451	**7,431**	7,454
Dilutive effect of stock-based awards	**36**	22	**34**	25
Common stock and common stock equivalents (C)	**7,468**	7,473	**7,465**	7,479
Earnings Per Share				
Basic (A/B)	**$ 2.94**	$ 2.20	**$ 5.94**	$ 4.56
Diluted (A/C)	**$ 2.93**	$ 2.20	**$ 5.92**	$ 4.54

Anti-dilutive stock-based awards excluded from the calculations of diluted EPS were immaterial during the periods presented.

NOTE 3 — OTHER INCOME (EXPENSE), NET

The components of other income (expense), net were as follows:

(In millions)	Three Months Ended December 31, 2023	Three Months Ended December 31, 2022	Six Months Ended December 31, 2023	Six Months Ended December 31, 2022
Interest and dividends income	**$ 734**	$ 700	**$ 1,900**	$ 1,341
Interest expense	**(909)**	(490)	**(1,434)**	(990)
Net recognized gains (losses) on investments	**69**	(15)	**(38)**	(2)
Net losses on derivatives	**(267)**	(199)	**(174)**	(190)
Net gains (losses) on foreign currency remeasurements	**36**	(18)	**(65)**	(96)
Other, net	**(169)**	(38)	**(306)**	(69)
Total	**$ (506)**	$ (60)	**$ (117)**	$ (6)

Net Recognized Gains (Losses) on Investments

Net recognized gains (losses) on debt investments were as follows:

(In millions)	Three Months Ended December 31, 2023	Three Months Ended December 31, 2022	Six Months Ended December 31, 2023	Six Months Ended December 31, 2022
Realized gains from sales of available-for-sale securities	**$ 4**	$ 27	**$ 6**	$ 30
Realized losses from sales of available-for-sale securities	**(29)**	(23)	**(54)**	(43)
Impairments and allowance for credit losses	**18**	5	**12**	(13)
Total	**$ (7)**	$ 9	**$ (36)**	$ (26)

Net recognized gains (losses) on equity investments were as follows:

(In millions)	Three Months Ended December 31, 2023	Three Months Ended December 31, 2022	Six Months Ended December 31, 2023	Six Months Ended December 31, 2022
Net realized gains (losses) on investments sold	**$ (31)**	$ (8)	**$ 14**	$ 75
Net unrealized gains (losses) on investments still held	**286**	(7)	**163**	(35)
Impairments of investments	**(179)**	(9)	**(179)**	(16)
Total	**$ 76**	$ (24)	**$ (2)**	$ 24

NOTE 4 — INVESTMENTS

Investment Components

The components of investments were as follows:

(In millions)	Fair Value Level	Adjusted Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity Investments
December 31, 2023								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 4,577	$ 0	$ 0	$ 4,577	$ 4,574	$ 3	$ 0
Certificates of deposit	Level 2	2,973	0	0	2,973	2,931	42	0
U.S. government securities	Level 1	54,775	11	(2,848)	51,938	0	51,938	0
U.S. agency securities	Level 2	24	0	0	24	0	24	0
Foreign government bonds	Level 2	420	4	(12)	412	7	405	0
Mortgage- and asset-backed securities	Level 2	926	5	(31)	900	0	900	0
Corporate notes and bonds	Level 2	10,164	63	(349)	9,878	0	9,878	0
Corporate notes and bonds	Level 3	129	0	0	129	0	129	0
Municipal securities	Level 2	282	1	(13)	270	0	270	0
Municipal securities	Level 3	104	0	(16)	88	0	88	0
Total debt investments		$ 74,374	$ 84	$ (3,269)	$ 71,189	$ 7,512	$ 63,677	$ 0
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				$ 3,276	$ 257	$ 0	$ 3,019
Equity investments	Other				10,348	0	0	10,348
Total equity investments					$ 13,624	$ 257	$ 0	$ 13,367
Cash					$ 9,536	$ 9,536	$ 0	$ 0
Derivatives, net [(a)]					35	0	35	0
Total					$ 94,384	$ 17,305	$ 63,712	$ 13,367

(In millions)	Fair Value Level	Adjusted Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity Investments
June 30, 2023								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 16,589	$ 0	$ 0	$ 16,589	$ 12,231	$ 4,358	$ 0
Certificates of deposit	Level 2	2,701	0	0	2,701	2,657	44	0
U.S. government securities	Level 1	65,237	2	(3,870)	61,369	2,991	58,378	0
U.S. agency securities	Level 2	2,703	0	0	2,703	894	1,809	0
Foreign government bonds	Level 2	498	1	(24)	475	0	475	0
Mortgage- and asset-backed securities	Level 2	824	1	(39)	786	0	786	0
Corporate notes and bonds	Level 2	10,809	8	(583)	10,234	0	10,234	0
Corporate notes and bonds	Level 3	120	0	0	120	0	120	0
Municipal securities	Level 2	285	1	(18)	268	7	261	0
Municipal securities	Level 3	103	0	(16)	87	0	87	0
Total debt investments		$ 99,869	$ 13	$ (4,550)	$ 95,332	$ 18,780	$ 76,552	$ 0
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				$ 10,138	$ 7,446	$ 0	$ 2,692
Equity investments	Other				7,187	0	0	7,187
Total equity investments					$ 17,325	$ 7,446	$ 0	$ 9,879
Cash					$ 8,478	$ 8,478	$ 0	$ 0
Derivatives, net [(a)]					6	0	6	0
Total					$ 121,141	$ 34,704	$ 76,558	$ 9,879

(a)*Refer to Note 5 – Derivatives for further information on the fair value of our derivative instruments.*

Equity investments presented as “Other” in the tables above include investments without readily determinable fair values measured using the equity method or measured at cost with adjustments for observable changes in price or impairments, and investments measured at fair value using net asset value as a practical expedient which are not categorized in the fair value hierarchy. As of December 31, 2023 and June 30, 2023, equity investments without readily determinable fair values measured at cost with adjustments for observable changes in price or impairments were $4.0 billion and $4.2 billion, respectively.

Unrealized Losses on Debt Investments

Debt investments with continuous unrealized losses for less than 12 months and 12 months or greater and their related fair values were as follows:

	Less than 12 Months		12 Months or Greater			
(In millions)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Total Fair Value**	**Total Unrealized Losses**
December 31, 2023						
U.S. government and agency securities	$ 292	$ (8)	$ 51,092	$ (2,840)	$ 51,384	$ (2,848)
Foreign government bonds	26	(1)	312	(11)	338	(12)
Mortgage- and asset-backed securities	185	(1)	403	(30)	588	(31)
Corporate notes and bonds	396	(6)	7,208	(343)	7,604	(349)
Municipal securities	46	0	240	(29)	286	(29)
Total	$ 945	$ (16)	$ 59,255	$ (3,253)	$ 60,200	$ (3,269)

	Less than 12 Months		12 Months or Greater			
(In millions)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Total Fair Value**	**Total Unrealized Losses**
June 30, 2023						
U.S. government and agency securities	$ 7,950	$ (336)	$ 45,273	$ (3,534)	$ 53,223	$ (3,870)
Foreign government bonds	77	(5)	391	(19)	468	(24)
Mortgage- and asset-backed securities	257	(5)	412	(34)	669	(39)
Corporate notes and bonds	2,326	(49)	7,336	(534)	9,662	(583)
Municipal securities	111	(3)	186	(31)	297	(34)
Total	$ 10,721	$ (398)	$ 53,598	$ (4,152)	$ 64,319	$ (4,550)

Unrealized losses from fixed-income securities are primarily attributable to changes in interest rates. Management does not believe any remaining unrealized losses represent impairments based on our evaluation of available evidence.

Debt Investment Maturities

The following table outlines maturities of our debt investments as of December 31, 2023:

(In millions)	**Adjusted Cost Basis**	**Estimated Fair Value**
December 31, 2023		
Due in one year or less	$ 17,257	$ 17,145
Due after one year through five years	46,857	44,848
Due after five years through 10 years	8,932	7,976
Due after 10 years	1,328	1,220
Total	$ 74,374	$ 71,189

NOTE 5 — DERIVATIVES

We use derivative instruments to manage risks related to foreign currencies, interest rates, equity prices, and credit; to enhance investment returns; and to facilitate portfolio diversification. Our objectives for holding derivatives include reducing, eliminating, and efficiently managing the economic impact of these exposures as effectively as possible. Our derivative programs include strategies that both qualify and do not qualify for hedge accounting treatment.

Foreign Currencies

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily to maximize the economic effectiveness of our foreign currency hedge positions.

Foreign currency risks related to certain non-U.S. dollar-denominated investments are hedged using foreign exchange forward contracts that are designated as fair value hedging instruments. Foreign currency risks related to certain Euro-denominated debt are hedged using foreign exchange forward contracts that are designated as cash flow hedging instruments.

Certain options and forwards not designated as hedging instruments are also used to manage the variability in foreign exchange rates on certain balance sheet amounts and to manage other foreign currency exposures.

Interest Rate

Interest rate risks related to certain fixed-rate debt are hedged using interest rate swaps that are designated as fair value hedging instruments to effectively convert the fixed interest rates to floating interest rates.

Securities held in our fixed-income portfolio are subject to different interest rate risks based on their maturities. We manage the average maturity of our fixed-income portfolio to achieve economic returns that correlate to certain broad-based fixed-income indices using option, futures, and swap contracts. These contracts are not designated as hedging instruments and are included in "Other contracts" in the tables below.

Equity

Securities held in our equity investments portfolio are subject to market price risk. At times, we may hold options, futures, and swap contracts. These contracts are not designated as hedging instruments.

Credit

Our fixed-income portfolio is diversified and consists primarily of investment-grade securities. We use credit default swap contracts to manage credit exposures relative to broad-based indices and to facilitate portfolio diversification. These contracts are not designated as hedging instruments and are included in "Other contracts" in the tables below.

Credit-Risk-Related Contingent Features

Certain counterparty agreements for derivative instruments contain provisions that require our issued and outstanding long-term unsecured debt to maintain an investment grade credit rating and require us to maintain minimum liquidity of $1.0 billion. To the extent we fail to meet these requirements, we will be required to post collateral, similar to the standard convention related to over-the-counter derivatives. As of December 31, 2023, our long-term unsecured debt rating was AAA, and cash investments were in excess of $1.0 billion. As a result, no collateral was required to be posted.

The following table presents the notional amounts of our outstanding derivative instruments measured in U.S. dollar equivalents:

(In millions)	December 31, 2023	June 30, 2023
Designated as Hedging Instruments		
Foreign exchange contracts purchased	**$ 1,492**	$ 1,492
Interest rate contracts purchased	**1,106**	1,078
Not Designated as Hedging Instruments		
Foreign exchange contracts purchased	**8,113**	7,874
Foreign exchange contracts sold	**20,772**	25,159
Equity contracts purchased	**3,731**	3,867
Equity contracts sold	**2,154**	2,154
Other contracts purchased	**1,643**	1,224
Other contracts sold	**739**	581

Fair Values of Derivative Instruments

The following table presents our derivative instruments:

(In millions)	Derivative Assets	Derivative Liabilities	Derivative Assets	Derivative Liabilities
		December 31, 2023		June 30, 2023
Designated as Hedging Instruments				
Foreign exchange contracts	**$ 53**	**$ (59)**	$ 34	$ (67)
Interest rate contracts	**21**	**0**	16	0
Not Designated as Hedging Instruments				
Foreign exchange contracts	**300**	**(702)**	249	(332)
Equity contracts	**104**	**(513)**	165	(400)
Other contracts	**42**	**0**	5	(6)
Gross amounts of derivatives	**520**	**(1,274)**	469	(805)
Gross amounts of derivatives offset in the balance sheet	**(227)**	**229**	(202)	206
Cash collateral received	**0**	**(190)**	0	(125)
Net amounts of derivatives	**$ 293**	**$ (1,235)**	$ 267	$ (724)
Reported as				
Short-term investments	**$ 35**	**$ 0**	$ 6	$ 0
Other current assets	**237**	**0**	245	0
Other long-term assets	**21**	**0**	16	0
Other current liabilities	**0**	**(786)**	0	(341)
Other long-term liabilities	**0**	**(449)**	0	(383)
Total	**$ 293**	**$ (1,235)**	$ 267	$ (724)

Gross derivative assets and liabilities subject to legally enforceable master netting agreements for which we have elected to offset were $459 million and $1.3 billion, respectively, as of December 31, 2023, and $442 million and $804 million, respectively, as of June 30, 2023.

The following table presents the fair value of our derivatives instruments on a gross basis:

(In millions)	Level 1	Level 2	Level 3	Total
December 31, 2023				
Derivative assets	**$ 0**	**$ 511**	**$ 9**	**$ 520**
Derivative liabilities	**0**	**(1,274)**	**0**	**(1,274)**
June 30, 2023				
Derivative assets	0	462	7	469
Derivative liabilities	0	(805)	0	(805)

Gains (losses) on derivative instruments recognized in other income (expense), net were as follows:

(In millions)	Three Months Ended December 31, 2023	2022	Six Months Ended December 31, 2023	2022
Designated as Fair Value Hedging Instruments				
Interest rate contracts				
Derivatives	**$ 22**	$ 5	**$ 6**	$ (38)
Hedged items	**(34)**	(8)	**(31)**	35
Designated as Cash Flow Hedging Instruments				
Foreign exchange contracts				
Amount reclassified from accumulated other comprehensive loss	**51**	103	**5**	44
Not Designated as Hedging Instruments				
Foreign exchange contracts	**(334)**	(250)	**(128)**	(10)
Equity contracts	**(287)**	(181)	**(174)**	(169)
Other contracts	**36**	(25)	**3**	(35)

Gains, net of tax, on derivative instruments recognized in our consolidated comprehensive income statements were as follows:

(In millions)	Three Months Ended December 31, 2023	2022	Six Months Ended December 31, 2023	2022
Designated as Cash Flow Hedging Instruments				
Foreign exchange contracts				
Included in effectiveness assessment	**$ 37**	$ 49	**$ 22**	$ 9

NOTE 6 — INVENTORIES

The components of inventories were as follows:

(In millions)	December 31, 2023	June 30, 2023
Raw materials	**$ 382**	$ 709
Work in process	**12**	23
Finished goods	**1,221**	1,768
Total	**$ 1,615**	$ 2,500

NOTE 7 — BUSINESS COMBINATIONS

Activision Blizzard, Inc.

On October 13, 2023, we completed our acquisition of Activision Blizzard, Inc. (“Activision Blizzard”) for a total purchase price of $75.4 billion, consisting primarily of cash. Activision Blizzard is a leader in game development and an interactive entertainment content publisher. The acquisition will accelerate the growth in our gaming business across mobile, PC, console, and cloud gaming. The financial results of Activision Blizzard have been included in our consolidated financial statements since the date of the acquisition. Activision Blizzard is reported as part of our More Personal Computing segment.

The purchase price allocation as of the date of acquisition was based on a preliminary valuation and is subject to revision as more detailed analyses are completed and additional information about the fair value of assets acquired and liabilities assumed becomes available. The primary areas that remain preliminary relate to the fair values of goodwill, intangible assets, and income taxes.

The major classes of assets and liabilities to which we have preliminarily allocated the purchase price were as follows:

(In millions)		
Cash and cash equivalents	$	12,976
Goodwill		50,945
Intangible assets		22,046
Other assets		2,420
Long-term debt		(2,800)
Long-term income taxes		(1,853)
Deferred income taxes		(4,644)
Other liabilities		(3,684)
Total purchase price	$	75,406

Goodwill was assigned to our More Personal Computing segment. The goodwill was primarily attributed to increased synergies that are expected to be achieved from the integration of Activision Blizzard. Substantially all of the goodwill is expected to be non-deductible for income tax purposes.

Following are the details of the purchase price allocated to the intangible assets acquired:

(In millions, except average life)		Amount	Weighted Average Life
Marketing-related	$	11,619	24 years
Technology-based		9,767	4 years
Customer-related		660	4 years
Fair value of intangible assets acquired	$	22,046	15 years

Since the date of acquisition, the net impact of the Activision Blizzard acquisition on our consolidated income statements was revenue and operating loss of $2.1 billion and $437 million, respectively, for both the three and six months ended December 31, 2023. The change of Activision Blizzard content from third-party to first-party is reflected in the net impact.

Following are the supplemental consolidated financial results of Microsoft Corporation on an unaudited pro forma basis, as if the acquisition had been consummated on July 1, 2022:

(In millions, except per share amounts)		Three Months Ended December 31,				Six Months Ended December 31,		
		2023		2022		**2023**		2022
Revenue	**$**	**62,297**	$	55,002	**$**	**120,857**	$	106,799
Net income		**22,025**		16,364		**44,334**		33,266
Diluted earnings per share		**2.95**		2.19		**5.94**		4.45

These pro forma results were based on estimates and assumptions, which we believe are reasonable. They are not the results that would have been realized had we been a combined company during the periods presented and are not necessarily indicative of our consolidated results of operations in future periods. The pro forma results include adjustments related to purchase accounting, primarily amortization of intangible assets. Acquisition costs and other nonrecurring charges were immaterial and are included in the earliest period presented.

NOTE 8 — GOODWILL

Changes in the carrying amount of goodwill were as follows:

(In millions)	June 30, 2023	Acquisitions	Other	December 31, 2023
Productivity and Business Processes	$ 24,775	$ 0	$ 42	$ 24,817
Intelligent Cloud	30,469	0	(6)	30,463
More Personal Computing	12,642	50,945 [(a)]	64	63,651
Total	$ 67,886	$ 50,945	$ 100	$ 118,931

(a)*Includes goodwill of $50.9 billion related to Activision Blizzard. See Note 7 – Business Combinations for further information.*

The measurement periods for the valuation of assets acquired and liabilities assumed end as soon as information on the facts and circumstances that existed as of the acquisition dates becomes available, but do not exceed 12 months. Adjustments in purchase price allocations may require a change in the amounts allocated to goodwill during the periods in which the adjustments are determined.

Any change in the goodwill amounts resulting from foreign currency translations and purchase accounting adjustments are presented as “Other” in the table above. Also included in “Other” are business dispositions and transfers between segments due to reorganizations, as applicable.

NOTE 9 — INTANGIBLE ASSETS

The components of intangible assets, all of which are finite-lived, were as follows:

(In millions)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
			December 31, 2023			June 30, 2023
Marketing-related	$ 16,555	$ (2,745)	$ 13,810	$ 4,935	$ (2,473)	$ 2,462
Technology-based	21,426	(8,758)	12,668	11,245	(7,589)	3,656
Customer-related	7,939	(4,533)	3,406	7,281	(4,047)	3,234
Contract-based	31	(19)	12	29	(15)	14
Total	$ 45,951 [(a)]	$ (16,055)	$ 29,896	$ 23,490	$ (14,124)	$ 9,366

(a)*Includes intangible assets of $22.0 billion related to Activision Blizzard. See Note 7 – Business Combinations for further information.*

Intangible assets amortization expense was $1.3 billion and $2.0 billion for the three and six months ended December 31, 2023, respectively, and $632 million and $1.3 billion for the three and six months ended December 31, 2022, respectively.

The following table outlines the estimated future amortization expense related to intangible assets held as of December 31, 2023:

(In millions)	
Year Ending June 30,	
2024 (excluding the six months ended December 31, 2023)	$ 2,870
2025	5,746
2026	4,315
2027	2,681
2028	1,864
Thereafter	12,420
Total	$ 29,896

NOTE 10 — DEBT

Short-term Debt

As of December 31, 2023, we had $27.0 billion of commercial paper issued and outstanding, with a weighted average interest rate of 5.5% and maturities ranging from 33 days to 216 days. The estimated fair value of this commercial paper approximates its carrying value. As of June 30, 2023, we had no commercial paper issued or outstanding.

Long-term Debt

The components of long-term debt were as follows:

(In millions, issuance by calendar year)	Maturities (calendar year)	Stated Interest Rate	Effective Interest Rate	December 31, 2023	June 30, 2023
2009 issuance of $3.8 billion	**2039**	**5.20%**	**5.24%**	**$ 520**	$ 520
2010 issuance of $4.8 billion	**2040**	**4.50%**	**4.57%**	**486**	486
2011 issuance of $2.3 billion	**2041**	**5.30%**	**5.36%**	**718**	718
2012 issuance of $2.3 billion	**2042**	**3.50%**	**3.57%**	**454**	454
2013 issuance of $5.2 billion	**2043**	**3.75%–4.88%**	**3.83%–4.92%**	**314**	1,814
2013 issuance of €4.1 billion	**2028–2033**	**2.63%–3.13%**	**2.69%–3.22%**	**2,541**	2,509
2015 issuance of $23.8 billion	**2025–2055**	**2.70%–4.75%**	**2.77%–4.78%**	**9,805**	9,805
2016 issuance of $19.8 billion	**2026–2056**	**2.40%–3.95%**	**2.46%–4.03%**	**7,930**	9,430
2017 issuance of $17.1 billion [(a)]	**2024–2057**	**2.88%–4.50%**	**3.04%–5.49%**	**9,083**	8,945
2020 issuance of $10.1 billion [(a)]	**2030–2060**	**1.35%_2.68%**	**2.53%_5.43%**	**10,111**	10,000
2021 issuance of $8.2 billion	**2052–2062**	**2.92%–3.04%**	**2.92%–3.04%**	**8,185**	8,185
2023 issuance of $3.4 billion [(a)]	**2026–2050**	**1.35%–4.50%**	**5.16%–5.49%**	**3,401**	0
Total face value				**53,548**	52,866
Unamortized discount and issuance costs				**(1,264)**	(438)
Hedge fair value adjustments [(b)]				**(75)**	(106)
Premium on debt exchange				**(5,031)**	(5,085)
Total debt				**47,178**	47,237
Current portion of long-term debt				**(2,250)**	(5,247)
Long-term debt				**$ 44,928**	$ 41,990

(a)*Includes $3.6 billion of debt at face value related to the Activision Blizzard acquisition. See Note 7 – Business Combinations for further information.*
(b)*Refer to Note 5 – Derivatives for further information on the interest rate swaps related to fixed-rate debt.*

As of December 31, 2023 and June 30, 2023, the estimated fair value of long-term debt, including the current portion, was $46.6 billion and $46.2 billion, respectively. The estimated fair values are based on Level 2 inputs.

Debt in the table above is comprised of senior unsecured obligations and ranks equally with our other outstanding obligations. Interest is paid semi-annually, except for the Euro-denominated debt, which is paid annually.

The following table outlines maturities of our long-term debt, including the current portion, as of December 31, 2023:

(In millions) Year Ending June 30,	
2024 (excluding the six months ended December 31, 2023)	**$ 2,250**
2025	**2,250**
2026	**3,000**
2027	**9,250**
2028	**0**
Thereafter	**36,798**
Total	**$ 53,548**

NOTE 11 — INCOME TAXES

Effective Tax Rate

Our effective tax rate was 18% and 19% for the three months ended December 31, 2023 and 2022, respectively, and 18% and 19% for the six months ended December 31, 2023 and 2022, respectively. The decrease in our effective tax rate for the three and six months ended December 31, 2023 compared to the prior year was primarily due to tax benefits from tax law changes, including the impact from the issuance of Notice 2023-55 and Notice 2023-80 by the Internal Revenue Service ("IRS") and U.S. Treasury Department. Notice 2023-55, issued in the first quarter of fiscal year 2024, delayed the effective date of final foreign tax credit regulations to fiscal year 2024 for Microsoft. Notice 2023-80, issued in the second quarter of fiscal year 2024, further delayed the effective date of final foreign tax credit regulations indefinitely.

Our effective tax rate was lower than the U.S. federal statutory rate for the three and six months ended December 31, 2023, primarily due to earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations center in Ireland.

Uncertain Tax Positions

As of December 31, 2023 and June 30, 2023, unrecognized tax benefits and other income tax liabilities were $22.9 billion and $18.7 billion, respectively, and are included in long-term income taxes in our consolidated balance sheets. The balance as of December 31, 2023 includes $1.9 billion of acquired unrecognized tax benefits and other income tax liabilities due to the acquisition of Activision Blizzard. See Note 7 – Business Combinations for further information.

We remain under audit by the IRS for tax years 2014 to 2017. With respect to the audit for tax years 2004 to 2013, on September 26, 2023, we received Notices of Proposed Adjustment ("NOPAs") from the IRS. The primary issues in the NOPAs relate to intercompany transfer pricing. In the NOPAs, the IRS is seeking an additional tax payment of $28.9 billion plus penalties and interest. As of December 31, 2023, we believe our allowances for income tax contingencies are adequate. We disagree with the proposed adjustments and will vigorously contest the NOPAs through the IRS's administrative appeals office and, if necessary, judicial proceedings. We do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our income tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2023, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NOTE 12 — UNEARNED REVENUE

Unearned revenue by segment was as follows:

(In millions)

	December 31, 2023	June 30, 2023
Productivity and Business Processes	**$ 22,591**	$ 27,572
Intelligent Cloud	**17,696**	21,563
More Personal Computing	**5,747**	4,678
Total	**$ 46,034**	$ 53,813

Changes in unearned revenue were as follows:

(In millions)		
Six Months Ended December 31, 2023		
Balance, beginning of period	**$**	**53,813**
Deferral of revenue		**59,828**
Recognition of unearned revenue		**(67,607)**
Balance, end of period	**$**	**46,034**

Revenue allocated to remaining performance obligations, which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods, was $229 billion as of December 31, 2023, of which $222 billion is related to the commercial portion of revenue. We expect to recognize approximately 45% of this revenue over the next 12 months and the remainder thereafter.

NOTE 13 — LEASES

We have operating and finance leases for datacenters, corporate offices, research and development facilities, Microsoft Experience Centers, and certain equipment. Our leases have remaining lease terms of less than 1 year to 18 years, some of which include options to extend the leases for up to 5 years, and some of which include options to terminate the leases within 1 year.

The components of lease expense were as follows:

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2023	**2022**	**2023**	**2022**
Operating lease cost	**$ 817**	$ 684	**$ 1,591**	$ 1,346
Finance lease cost:				
Amortization of right-of-use assets	**$ 408**	$ 457	**$ 788**	$ 646
Interest on lease liabilities	**168**	119	**317**	232
Total finance lease cost	**$ 576**	$ 576	**$ 1,105**	$ 878

Supplemental cash flow information related to leases was as follows:

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2023	**2022**	**2023**	**2022**
Cash paid for amounts included in the measurement of lease liabilities:				
Operating cash flows from operating leases	**$ 803**	$ 645	**$ 1,597**	$ 1,299
Operating cash flows from finance leases	**168**	119	**317**	232
Financing cash flows from finance leases	**288**	262	**573**	518
Right-of-use assets obtained in exchange for lease obligations:				
Operating leases	**847**	525	**2,651**	1,714
Finance leases	**1,796**	598	**3,500**	1,209

Supplemental balance sheet information related to leases was as follows:

(In millions, except lease term and discount rate)

	December 31, 2023	June 30, 2023
Operating Leases		
Operating lease right-of-use assets	**$ 16,398**	$ 14,346
Other current liabilities	**$ 2,787**	$ 2,409
Operating lease liabilities	**14,155**	12,728
Total operating lease liabilities	**$ 16,942**	$ 15,137
Finance Leases		
Property and equipment, at cost	**$ 24,245**	$ 20,538
Accumulated depreciation	**(5,484)**	(4,647)
Property and equipment, net	**$ 18,761**	$ 15,891
Other current liabilities	**$ 1,691**	$ 1,197
Other long-term liabilities	**18,506**	15,870
Total finance lease liabilities	**$ 20,197**	$ 17,067
Weighted Average Remaining Lease Term		
Operating leases	**8 years**	8 years
Finance leases	**12 years**	11 years
Weighted Average Discount Rate		
Operating leases	**3.3%**	2.9%
Finance leases	**3.7%**	3.4%

The following table outlines maturities of our lease liabilities as of December 31, 2023:

(In millions)

Year Ending June 30,	**Operating Leases**	**Finance Leases**
2024 (excluding the six months ended December 31, 2023)	**$ 1,614**	**$ 1,021**
2025	**3,091**	**2,411**
2026	**2,633**	**2,101**
2027	**2,179**	**2,109**
2028	**1,933**	**2,121**
Thereafter	**7,615**	**15,326**
Total lease payments	**19,065**	**25,089**
Less imputed interest	**(2,123)**	**(4,892)**
Total	**$ 16,942**	**$ 20,197**

As of December 31, 2023, we had additional operating and finance leases, primarily for datacenters, that had not yet commenced of $7.5 billion and $85.1 billion, respectively. These operating and finance leases will commence between fiscal year 2024 and fiscal year 2030 with lease terms of 1 year to 20 years.

NOTE 14 — CONTINGENCIES

U.S. Cell Phone Litigation

Microsoft Mobile Oy, a subsidiary of Microsoft, along with other handset manufacturers and network operators, is a defendant in 45 lawsuits filed in the Superior Court for the District of Columbia by individual plaintiffs who allege that radio emissions from cellular handsets caused their brain tumors and other adverse health effects. We assumed responsibility for these claims in our agreement to acquire Nokia's Devices and Services business and have been substituted for the Nokia defendants. Twelve of these cases were consolidated for certain pre-trial proceedings; the remaining cases are stayed. In a separate 2009 decision, the Court of Appeals for the District of Columbia held that adverse health effect claims arising from the use of cellular handsets that operate within the U.S. Federal Communications Commission radio frequency emission guidelines ("FCC Guidelines") are pre-empted by federal law. The plaintiffs allege that their handsets either operated outside the FCC Guidelines or were manufactured before the FCC Guidelines went into effect. The lawsuits also allege an industry-wide conspiracy to manipulate the science and testing around emission guidelines.

In 2013, the defendants in the consolidated cases moved to exclude the plaintiffs' expert evidence of general causation on the basis of flawed scientific methodologies. In 2014, the trial court granted in part and denied in part the defendants' motion to exclude the plaintiffs' general causation experts. The defendants filed an interlocutory appeal to the District of Columbia Court of Appeals challenging the standard for evaluating expert scientific evidence. In October 2016, the Court of Appeals issued its decision adopting the standard advocated by the defendants and remanding the cases to the trial court for further proceedings under that standard. The plaintiffs have filed supplemental expert evidence, portions of which were stricken by the court. A hearing on general causation took place in September of 2022. In April of 2023, the court granted defendants' motion to strike the testimony of plaintiffs' experts that cell phones cause brain cancer and entered an order excluding all of plaintiffs' experts from testifying. The parties agreed to a stipulated dismissal of the consolidated cases to allow plaintiffs to appeal the expert testimony order. Plaintiffs appealed the court's order in August of 2023. A hearing on the status of the stayed cases occurred in December of 2023.

Irish Data Protection Commission Matter

In 2018, the Irish Data Protection Commission ("IDPC") began investigating a complaint against LinkedIn as to whether LinkedIn's targeted advertising practices violated the recently implemented European Union General Data Protection Regulation ("GDPR"). Microsoft cooperated throughout the period of inquiry. In April 2023, the IDPC provided LinkedIn with a non-public preliminary draft decision alleging GDPR violations and proposing a fine. Microsoft intends to challenge the preliminary draft decision. There is no set timeline for the IDPC to issue a final decision.

Other Contingencies

We also are subject to a variety of other claims and suits that arise from time to time in the ordinary course of our business. Although management currently believes that resolving claims against us, individually or in aggregate, will not have a material adverse impact in our consolidated financial statements, these matters are subject to inherent uncertainties and management's view of these matters may change in the future.

As of December 31, 2023, we accrued aggregate legal liabilities of $703 million. While we intend to defend these matters vigorously, adverse outcomes that we estimate could reach approximately $600 million in aggregate beyond recorded amounts are reasonably possible. Were unfavorable final outcomes to occur, there exists the possibility of a material adverse impact in our consolidated financial statements for the period in which the effects become reasonably estimable.

NOTE 15 — STOCKHOLDERS' EQUITY

Share Repurchases

On September 14, 2021, our Board of Directors approved a share repurchase program authorizing up to $60.0 billion in share repurchases. This share repurchase program commenced in November 2021, has no expiration date, and may be terminated at any time. As of December 31, 2023, $15.9 billion remained of this $60.0 billion share repurchase program.

We repurchased the following shares of common stock under the share repurchase program:

(In millions)	Shares	Amount	Shares	Amount
Fiscal Year		2024		2023
First Quarter	**11**	**$ 3,560**	17	$ 4,600
Second Quarter	**7**	**2,800**	20	4,600
Total	**18**	**$ 6,360**	37	$ 9,200

All repurchases were made using cash resources. All shares repurchased were under the share repurchase program approved on September 14, 2021. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards of $1.2 billion and $2.5 billion for the three and six months ended December 31, 2023, respectively, and $859 million and $1.8 billion for the three and six months ended December 31, 2022, respectively.

Dividends

Our Board of Directors declared the following dividends:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
Fiscal Year 2024				(In millions)
September 19, 2023	**November 16, 2023**	**December 14, 2023**	**$ 0.75**	**$ 5,574**
November 28, 2023	**February 15, 2024**	**March 14, 2024**	**0.75**	**5,574**
Total			**$ 1.50**	**$ 11,148**
Fiscal Year 2023				
September 20, 2022	November 17, 2022	December 8, 2022	$ 0.68	$ 5,066
November 29, 2022	February 16, 2023	March 9, 2023	0.68	5,059
Total			$ 1.36	$ 10,125

The dividend declared on November 28, 2023 was included in other current liabilities as of December 31, 2023.

NOTE 16 — ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table summarizes the changes in accumulated other comprehensive income (loss) by component:

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2023	2022	**2023**	2022
Derivatives				
Balance, beginning of period	**$ (6)**	$ (6)	**$ (27)**	$ (13)
Unrealized gains, net of tax of **$10,** $13**, $6,** and $2	**37**	49	**22**	9
Reclassification adjustments for gains included in other income (expense), net	**(51)**	(103)	**(5)**	(44)
Tax expense included in provision for income taxes	**11**	22	**1**	10
Amounts reclassified from accumulated other comprehensive loss	**(40)**	(81)	**(4)**	(34)
Net change related to derivatives, net of tax of **$(1),** $(9)**, $5,** and $(8)	**(3)**	(32)	**18**	(25)
Balance, end of period	**$ (9)**	$ (38)	**$ (9)**	$ (38)
Investments				
Balance, beginning of period	**$ (3,842)**	$ (4,035)	**$ (3,582)**	$ (2,138)
Unrealized gains (losses), net of tax of **$352**, $89, **$277,** and $(421)	**1,325**	340	**1,042**	(1,585)
Reclassification adjustments for losses included in other income (expense), net	**7**	10	**36**	45
Tax benefit included in provision for income taxes	**(1)**	(2)	**(7)**	(9)
Amounts reclassified from accumulated other comprehensive loss	**6**	8	**29**	36
Net change related to investments, net of tax of **$353**, $91, **$284**, and $(412)	**1,331**	348	**1,071**	(1,549)
Balance, end of period	**$ (2,511)**	$ (3,687)	**$ (2,511)**	$ (3,687)
Translation Adjustments and Other				
Balance, beginning of period	**$ (3,089)**	$ (3,302)	**$ (2,734)**	$ (2,527)
Translation adjustments and other, net of tax of **$0**, $0, **$0**, and $0	**660**	570	**305**	(205)
Balance, end of period	**$ (2,429)**	$ (2,732)	**$ (2,429)**	$ (2,732)
Accumulated other comprehensive loss, end of period	**$ (4,949)**	$ (6,457)	**$ (4,949)**	$ (6,457)

NOTE 17 — SEGMENT INFORMATION AND GEOGRAPHIC DATA

In its operation of the business, management, including our chief operating decision maker, who is also our Chief Executive Officer, reviews certain financial information, including segmented internal profit and loss statements prepared on a basis not consistent with GAAP. During the periods presented, we reported our financial performance based on the following segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing.

Our reportable segments are described below.

Productivity and Business Processes

Our Productivity and Business Processes segment consists of products and services in our portfolio of productivity, communication, and information services, spanning a variety of devices and platforms. This segment primarily comprises:

- Office Commercial (Office 365 subscriptions, the Office 365 portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises), comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, Microsoft Viva, and Copilot for Microsoft 365.
- Office Consumer, including Microsoft 365 Consumer subscriptions, Office licensed on-premises, and other Office services.
- LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions.
- Dynamics business solutions, including Dynamics 365, comprising a set of intelligent, cloud-based applications across ERP, CRM (including Customer Insights), Power Apps, and Power Automate; and on-premises ERP and CRM applications.

Intelligent Cloud

Our Intelligent Cloud segment consists of our public, private, and hybrid server products and cloud services that can power modern business and developers. This segment primarily comprises:

- Server products and cloud services, including Azure and other cloud services; SQL Server, Windows Server, Visual Studio, System Center, and related Client Access Licenses ("CALs"); and Nuance and GitHub.
- Enterprise and partner services, including Enterprise Support Services, Industry Solutions, Nuance professional services, Microsoft Partner Network, and Learning Experience.

More Personal Computing

Our More Personal Computing segment consists of products and services that put customers at the center of the experience with our technology. This segment primarily comprises:

- Windows, including Windows original equipment manufacturer ("OEM") licensing and other non-volume licensing of the Windows operating system; Windows Commercial, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings; patent licensing; and Windows Internet of Things.
- Devices, including Surface, HoloLens, and PC accessories.
- Gaming, including Xbox hardware and Xbox content and services, comprising first-party content (such as Activision Blizzard) and third-party content, including games and in-game content; Xbox Game Pass and other subscriptions; Xbox Cloud Gaming; advertising; third-party disc royalties; and other cloud services.
- Search and news advertising, comprising Bing (including Copilot), Microsoft News, Microsoft Edge, and third-party affiliates.

Revenue and costs are generally directly attributed to our segments. However, due to the integrated structure of our business, certain revenue recognized and costs incurred by one segment may benefit other segments. Revenue from certain contracts is allocated among the segments based on the relative value of the underlying products and services, which can include allocation based on actual prices charged, prices when sold separately, or estimated costs plus a profit margin. Cost of revenue is allocated in certain cases based on a relative revenue methodology. Operating expenses that are allocated primarily include those relating to marketing of products and services from which multiple segments benefit and are generally allocated based on relative gross margin.

In addition, certain costs are incurred at a corporate level and allocated to our segments. These allocated costs generally include legal, including settlements and fines, information technology, human resources, finance, excise taxes, field selling, shared facilities services, customer service and support, and severance incurred as part of a corporate program. Each allocation is measured differently based on the specific facts and circumstances of the costs being allocated and is generally based on relative gross margin or relative headcount.

Segment revenue and operating income were as follows during the periods presented:

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2023	2022	2023	2022
Revenue				
Productivity and Business Processes	**$ 19,249**	$ 17,002	**$ 37,841**	$ 33,467
Intelligent Cloud	**25,880**	21,508	**50,139**	41,833
More Personal Computing	**16,891**	14,237	**30,557**	27,569
Total	**$ 62,020**	$ 52,747	**$ 118,537**	$ 102,869
Operating Income				
Productivity and Business Processes	**$ 10,284**	$ 8,175	**$ 20,254**	$ 16,498
Intelligent Cloud	**12,461**	8,904	**24,212**	17,882
More Personal Computing	**4,287**	3,320	**9,461**	7,537
Total	**$ 27,032**	$ 20,399	**$ 53,927**	$ 41,917

No sales to an individual customer or country other than the United States accounted for more than 10% of revenue for the three or six months ended December 31, 2023 or 2022. Revenue, classified by the major geographic areas in which our customers were located, was as follows:

(In millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2023	2022	2023	2022
United States [(a)]	**$ 32,295**	$ 26,976	**$ 61,107**	$ 52,843
Other countries	**29,725**	25,771	**57,430**	50,026
Total	**$ 62,020**	$ 52,747	**$ 118,537**	$ 102,869

(a)*Includes billings to OEMs and certain multinational organizations because of the nature of these businesses and the impracticability of determining the geographic source of the revenue.*

Revenue, classified by significant product and service offerings, was as follows:

(In millions)	Three Months Ended December 31, 2023	Three Months Ended December 31, 2022	Six Months Ended December 31, 2023	Six Months Ended December 31, 2022
Server products and cloud services	**$ 23,953**	$ 19,594	**$ 46,261**	$ 37,982
Office products and cloud services	**13,477**	11,867	**26,617**	23,444
Gaming	**7,111**	4,758	**11,030**	8,368
Windows	**5,262**	4,808	**10,829**	10,121
LinkedIn	**4,195**	3,833	**8,108**	7,461
Search and news advertising	**3,220**	3,209	**6,273**	6,122
Enterprise and partner services	**1,917**	1,907	**3,861**	3,836
Dynamics products and cloud services	**1,576**	1,302	**3,116**	2,562
Devices	**1,298**	1,430	**2,423**	2,878
Other	**11**	39	**19**	95
Total	**$ 62,020**	$ 52,747	**$ 118,537**	$ 102,869

We have recast certain prior period amounts to conform to the way we internally manage and monitor our business.

Our Microsoft Cloud revenue, which includes Azure and other cloud services, Office 365 Commercial, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties, was $33.7 billion and $65.5 billion for the three and six months ended December 31, 2023, respectively, and $27.1 billion and $52.8 billion for the three and six months ended December 31, 2022, respectively. These amounts are primarily included in Server products and cloud services, Office products and cloud services, LinkedIn, and Dynamics products and cloud services in the table above.

Assets are not allocated to segments for internal reporting presentations. A portion of amortization and depreciation is included with various other costs in an overhead allocation to each segment. It is impracticable for us to separately identify the amount of amortization and depreciation by segment that is included in the measure of segment profit or loss.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Microsoft Corporation

Results of Review of Interim Financial Information

We have reviewed the accompanying consolidated balance sheet of Microsoft Corporation and subsidiaries (the “Company”) as of December 31, 2023, the related consolidated statements of income, comprehensive income, cash flows, and stockholders’ equity for the three-month and six-month periods ended December 31, 2023 and 2022, and the related notes (collectively referred to as the “interim financial information”). Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheet of the Company as of June 30, 2023, and the related consolidated statements of income, comprehensive income, cash flows, and stockholders’ equity for the year then ended (not presented herein); and in our report dated July 27, 2023, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of June 30, 2023, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Basis for Review Results

This interim financial information is the responsibility of the Company’s management. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our reviews in accordance with standards of the PCAOB. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the PCAOB, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

/S/ DELOITTE & TOUCHE LLP

Seattle, Washington
January 30, 2024

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Note About Forward-Looking Statements

This report includes estimates, projections, statements relating to our business plans, objectives, and expected operating results that are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may appear throughout this report, including the following sections: "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors" (Part II, Item 1A of this Form 10-Q). These forward-looking statements generally are identified by the words "believe," "project," "expect," "anticipate," "estimate," "intend," "strategy," "future," "opportunity," "plan," "may," "should," "will," "would," "will be," "will continue," "will likely result," and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties that may cause actual results to differ materially. We describe risks and uncertainties that could cause actual results and events to differ materially in "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Quantitative and Qualitative Disclosures about Market Risk" (Part I, Item 3 of this Form 10-Q), and "Risk Factors". We undertake no obligation to update or revise publicly any forward-looking statements, whether because of new information, future events, or otherwise.

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to help the reader understand the results of operations and financial condition of Microsoft Corporation. MD&A is provided as a supplement to, and should be read in conjunction with, our Annual Report on Form 10-K for the year ended June 30, 2023, and our financial statements and the accompanying Notes to Financial Statements (Part I, Item 1 of this Form 10-Q).

OVERVIEW

Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. We are creating the platforms and tools, powered by artificial intelligence ("AI"), that deliver better, faster, and more effective solutions to support small and large business competitiveness, improve educational and health outcomes, grow public-sector efficiency, and empower human ingenuity.

We generate revenue by offering a wide range of cloud-based solutions, content, and other services to people and businesses; licensing and supporting an array of software products; delivering relevant online advertising to a global audience; and designing and selling devices. Our most significant expenses are related to compensating employees; supporting and investing in our cloud-based services, including datacenter operations; designing, manufacturing, marketing, and selling our other products and services; and income taxes.

Highlights from the second quarter of fiscal year 2024 compared with the second quarter of fiscal year 2023 included:

- Microsoft Cloud revenue increased 24% to $33.7 billion.
- Office Commercial products and cloud services revenue increased 15% driven by Office 365 Commercial growth of 17%.
- Office Consumer products and cloud services revenue increased 5% and Microsoft 365 Consumer subscribers grew to 78.4 million.
- LinkedIn revenue increased 9%.
- Dynamics products and cloud services revenue increased 21% driven by Dynamics 365 growth of 27%.
- Server products and cloud services revenue increased 22% driven by Azure and other cloud services growth of 30%.
- Windows revenue increased 9% with Windows original equipment manufacturer licensing ("Windows OEM") revenue growth of 11% and Windows Commercial products and cloud services revenue growth of 9%.
- Devices revenue decreased 9%.

- Xbox content and services revenue increased 61% driven by 55 points of net impact from the Activision Blizzard Inc. ("Activision Blizzard") acquisition. The net impact reflects the change of Activision Blizzard content from third-party to first-party.
- Search and news advertising revenue excluding traffic acquisition costs increased 8%.

On October 13, 2023, we completed our acquisition of Activision Blizzard for a total purchase price of $75.4 billion, consisting primarily of cash. The financial results of Activision Blizzard have been included in our consolidated financial statements since the date of the acquisition. Activision Blizzard is reported as part of our More Personal Computing segment. Refer to Note 7 – Business Combinations of the Notes to the Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

Industry Trends

Our industry is dynamic and highly competitive, with frequent changes in both technologies and business models. Each industry shift is an opportunity to conceive new products, new technologies, or new ideas that can further transform the industry and our business. At Microsoft, we push the boundaries of what is possible through a broad range of research and development activities that seek to identify and address the changing demands of customers and users, industry trends, and competitive forces.

Economic Conditions, Challenges, and Risks

The markets for software, devices, and cloud-based services are dynamic and highly competitive. Our competitors are developing new software and devices, while also deploying competing cloud-based services for consumers and businesses. The devices and form factors customers prefer evolve rapidly, influencing how users access services in the cloud and, in some cases, the user's choice of which suite of cloud-based services to use. Aggregate demand for our software, services, and devices is also correlated to global macroeconomic and geopolitical factors, which remain dynamic. We must continue to evolve and adapt over an extended time in pace with this changing environment.

The investments we are making in cloud and AI infrastructure and devices will continue to increase our operating costs and may decrease our operating margins. We continue to identify and evaluate opportunities to expand our datacenter locations and increase our server capacity to meet the evolving needs of our customers, particularly given the growing demand for AI services. Our datacenters depend on the availability of permitted and buildable land, predictable energy, networking supplies, and servers, including graphics processing units ("GPUs") and other components. Our devices are primarily manufactured by third-party contract manufacturers. For the majority of our products, we have the ability to use other manufacturers if a current vendor becomes unavailable or unable to meet our requirements. However, some of our products contain certain components for which there are very few qualified suppliers. Extended disruptions at these suppliers could impact our ability to manufacture devices on time to meet consumer demand.

Our success is highly dependent on our ability to attract and retain qualified employees. We hire a mix of university and industry talent worldwide. We compete for talented individuals globally by offering an exceptional working environment, broad customer reach, scale in resources, the ability to grow one's career across many different products and businesses, and competitive compensation and benefits.

Our international operations provide a significant portion of our total revenue and expenses. Many of these revenue and expenses are denominated in currencies other than the U.S. dollar. As a result, changes in foreign exchange rates may significantly affect revenue and expenses. Fluctuations in the U.S. dollar relative to certain foreign currencies increased reported revenue and did not have a material impact on reported expenses from our international operations for the three months ended December 31, 2023, and did not have a material impact on reported revenue and expenses from our international operations for the six months ended December 31, 2023.

Refer to Risk Factors (Part II, Item 1A of this Form 10-Q) for a discussion of these factors and other risks.

Seasonality

Our revenue fluctuates quarterly and is generally higher in the second and fourth quarters of our fiscal year. Second quarter revenue is driven by corporate year-end spending trends in our major markets and holiday season spending by consumers, and fourth quarter revenue is driven by the volume of multi-year on-premises contracts executed during the period.

Reportable Segments

We report our financial performance based on the following segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing. The segment amounts included in MD&A are presented on a basis consistent with our internal management reporting.

Additional information on our reportable segments is contained in Note 17 – Segment Information and Geographic Data of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q).

Metrics

We use metrics in assessing the performance of our business and to make informed decisions regarding the allocation of resources. We disclose metrics to enable investors to evaluate progress against our ambitions, provide transparency into performance trends, and reflect the continued evolution of our products and services. Our commercial and other business metrics are fundamentally connected based on how customers use our products and services. The metrics are disclosed in the MD&A or the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q). Financial metrics are calculated based on financial results prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"), and growth comparisons relate to the corresponding period of last fiscal year.

In the first quarter of fiscal year 2024, we made updates to the presentation and method of calculation for certain metrics, revising our Microsoft Cloud revenue metric to include revenue growth and expanding our Microsoft 365 Consumer subscribers metric to include Microsoft 365 Basic subscribers, aligning with how we manage our business.

Commercial

Our commercial business primarily consists of Server products and cloud services, Office Commercial, Windows Commercial, the commercial portion of LinkedIn, Enterprise and partner services, and Dynamics. Our commercial metrics allow management and investors to assess the overall health of our commercial business and include leading indicators of future performance.

Commercial remaining performance obligation	Commercial portion of revenue allocated to remaining performance obligations, which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods
Microsoft Cloud revenue and revenue growth	Revenue from Azure and other cloud services, Office 365 Commercial, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties
Microsoft Cloud gross margin percentage	Gross margin percentage for our Microsoft Cloud business

Productivity and Business Processes and Intelligent Cloud

Metrics related to our Productivity and Business Processes and Intelligent Cloud segments assess the health of our core businesses within these segments. The metrics reflect our cloud and on-premises product strategies and trends.

Office Commercial products and cloud services revenue growth	Revenue from Office Commercial products and cloud services (Office 365 subscriptions, the Office 365 portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises), comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, Microsoft Viva, and Copilot for Microsoft 365
Office Consumer products and cloud services revenue growth	Revenue from Office Consumer products and cloud services, including Microsoft 365 Consumer subscriptions, Office licensed on-premises, and other Office services
Office 365 Commercial seat growth	The number of Office 365 Commercial seats at end of period where seats are paid users covered by an Office 365 Commercial subscription
Microsoft 365 Consumer subscribers	The number of Microsoft 365 Consumer subscribers at end of period
Dynamics products and cloud services revenue growth	Revenue from Dynamics products and cloud services, including Dynamics 365, comprising a set of intelligent, cloud-based applications across ERP, CRM (including Customer Insights), Power Apps, and Power Automate; and on-premises ERP and CRM applications

LinkedIn revenue growth	Revenue from LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions
Server products and cloud services revenue growth	Revenue from Server products and cloud services, including Azure and other cloud services; SQL Server, Windows Server, Visual Studio, System Center, and related Client Access Licenses ("CALs"); and Nuance and GitHub

More Personal Computing

Metrics related to our More Personal Computing segment assess the performance of key lines of business within this segment. These metrics provide strategic product insights which allow us to assess the performance across our commercial and consumer businesses. As we have diversity of target audiences and sales motions within the Windows business, we monitor metrics that are reflective of those varying motions.

Windows OEM revenue growth	Revenue from sales of Windows Pro and non-Pro licenses sold through the OEM channel
Windows Commercial products and cloud services revenue growth	Revenue from Windows Commercial products and cloud services, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings
Devices revenue growth	Revenue from Devices, including Surface, HoloLens, and PC accessories
Xbox content and services revenue growth	Revenue from Xbox content and services, comprising first-party content (such as Activision Blizzard) and third-party content, including games and in-game content; Xbox Game Pass and other subscriptions; Xbox Cloud Gaming; advertising; third-party disc royalties; and other cloud services
Search and news advertising revenue (ex TAC) growth	Revenue from search and news advertising excluding traffic acquisition costs ("TAC") paid to Bing Ads network publishers and news partners

SUMMARY RESULTS OF OPERATIONS

(In millions, except percentages and per share amounts)	**Three Months Ended December 31,**		**Percentage Change**	**Six Months Ended December 31,**		**Percentage Change**
	2023	**2022**		**2023**	**2022**	
Revenue	**$ 62,020**	$ 52,747	18%	**$ 118,537**	$ 102,869	15%
Gross margin	**42,397**	35,259	20%	**82,612**	69,929	18%
Operating income	**27,032**	20,399	33%	**53,927**	41,917	29%
Net income	**21,870**	16,425	33%	**44,161**	33,981	30%
Diluted earnings per share	**2.93**	2.20	33%	**5.92**	4.54	30%
Adjusted gross margin (non-GAAP)	**42,397**	35,411	20%	**82,612**	70,081	18%
Adjusted operating income (non-GAAP)	**27,032**	21,570	25%	**53,927**	43,088	25%
Adjusted net income (non-GAAP)	**21,870**	17,371	26%	**44,161**	34,927	26%
Adjusted diluted earnings per share (non-GAAP)	**2.93**	2.32	26%	**5.92**	4.67	27%

Adjusted gross margin, operating income, net income, and diluted earnings per share ("EPS") are non-GAAP financial measures. Prior year non-GAAP financial measures exclude the impact of a $1.2 billion charge in the second quarter of fiscal year 2023 ("Q2 charge"), which included employee severance expenses, impairment charges resulting from changes to our hardware portfolio, and costs related to lease consolidation activities. Refer to the Non-GAAP Financial Measures section below for a reconciliation of our financial results reported in accordance with GAAP to non-GAAP financial results.

Three Months Ended December 31, 2023 Compared with Three Months Ended December 31, 2022

Revenue increased $9.3 billion or 18% driven by growth across each of our segments. Intelligent Cloud revenue increased driven by Azure. More Personal Computing revenue increased driven by Gaming. Productivity and Business Processes revenue increased driven by Office 365 Commercial.

Cost of revenue increased $2.1 billion or 12% driven by growth in Microsoft Cloud and Gaming, offset in part by a decline in Devices.

Gross margin increased $7.1 billion or 20% driven by growth across each of our segments.

- Gross margin percentage increased. Excluding the impact of the prior year change in accounting estimate for the useful lives of our server and network equipment, gross margin percentage increased 2 points driven by improvement in More Personal Computing.
- Microsoft Cloud gross margin percentage of 72% was relatively unchanged. Excluding the impact of the change in accounting estimate, Microsoft Cloud gross margin percentage increased 1 point driven by improvements in Azure and Office 365 Commercial, offset in part by the impact of scaling our AI infrastructure.

Operating expenses increased $505 million or 3% driven by Gaming, with 11 points of growth from the Activision Blizzard acquisition, offset in part by 7 points of favorable impact from the prior year Q2 charge.

Operating income increased $6.6 billion or 33% driven by growth across each of our segments.

Revenue, gross margin, and operating income included a favorable foreign currency impact of 2%, 2%, and 3%, respectively.

Prior year gross margin, operating income, net income, and diluted EPS were negatively impacted by the Q2 charge, which resulted in decreases of $152 million, $1.2 billion, $946 million, and $0.12, respectively.

Six Months Ended December 31, 2023 Compared with Six Months Ended December 31, 2022

Revenue increased $15.7 billion or 15% driven by growth across each of our segments. Intelligent Cloud revenue increased driven by Azure. Productivity and Business Processes revenue increased driven by Office 365 Commercial. More Personal Computing revenue increased driven by Gaming.

Cost of revenue increased $3.0 billion or 9% driven by growth in Microsoft Cloud and Gaming, offset in part by a decline in Devices.

Gross margin increased $12.7 billion or 18% driven by growth across each of our segments.

- Gross margin percentage increased. Excluding the impact of the change in accounting estimate, gross margin percentage increased 2 points driven by improvement in More Personal Computing.
- Microsoft Cloud gross margin percentage increased slightly to 73%. Excluding the impact of the change in accounting estimate, Microsoft Cloud gross margin percentage increased 2 points driven by improvements in Azure and Office 365 Commercial, offset in part by the impact of scaling our AI infrastructure.

Operating expenses increased $673 million or 2% driven by Gaming, with 6 points of growth from the Activision Blizzard acquisition, offset in part by 4 points of favorable impact from the prior year Q2 charge.

Operating income increased $12.0 billion or 29%, including a favorable foreign currency impact of 2%, driven by growth across each of our segments.

Prior year gross margin, operating income, net income, and diluted EPS were negatively impacted by the Q2 charge, which resulted in decreases of $152 million, $1.2 billion, $946 million, and $0.13, respectively.

SEGMENT RESULTS OF OPERATIONS

(In millions, except percentages)	Three Months Ended December 31, 2023	2022	Percentage Change	Six Months Ended December 31, 2023	2022	Percentage Change
Revenue						
Productivity and Business Processes	**$ 19,249**	$ 17,002	13%	**$ 37,841**	$ 33,467	13%
Intelligent Cloud	**25,880**	21,508	20%	**50,139**	41,833	20%
More Personal Computing	**16,891**	14,237	19%	**30,557**	27,569	11%
Total	**$ 62,020**	$ 52,747	18%	**$ 118,537**	$ 102,869	15%
Operating Income						
Productivity and Business Processes	**$ 10,284**	$ 8,175	26%	**$ 20,254**	$ 16,498	23%
Intelligent Cloud	**12,461**	8,904	40%	**24,212**	17,882	35%
More Personal Computing	**4,287**	3,320	29%	**9,461**	7,537	26%
Total	**$ 27,032**	$ 20,399	33%	**$ 53,927**	$ 41,917	29%

Reportable Segments

Three Months Ended December 31, 2023 Compared with Three Months Ended December 31, 2022

Productivity and Business Processes

Revenue increased $2.2 billion or 13%.

- Office Commercial products and cloud services revenue increased $1.5 billion or 15%. Office 365 Commercial revenue grew 17% with seat growth of 9%, driven by small and medium business and frontline worker offerings, as well as growth in revenue per user. Office Commercial products revenue declined 17% driven by continued customer shift to cloud offerings.
- Office Consumer products and cloud services revenue increased $74 million or 5%. Microsoft 365 Consumer subscribers grew 16% to 78.4 million.
- LinkedIn revenue increased $362 million or 9% driven by growth across all lines of business – Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions.
- Dynamics products and cloud services revenue increased $274 million or 21% driven by Dynamics 365 growth of 27%.

Operating income increased $2.1 billion or 26%.

- Gross margin increased $1.8 billion or 14% driven by growth in Office 365 Commercial. Gross margin percentage increased slightly. Excluding the impact of the change in accounting estimate, gross margin percentage increased 1 point driven by improvement in Office 365 Commercial.
- Operating expenses decreased $273 million or 5% driven by 5 points of favorable impact from the prior year Q2 charge.

Gross margin and operating income both included a favorable foreign currency impact of 2%.

Intelligent Cloud

Revenue increased $4.4 billion or 20%.

- Server products and cloud services revenue increased $4.4 billion or 22% driven by Azure and other cloud services. Azure and other cloud services revenue grew 30% driven by growth in our consumption-based services. Server products revenue increased 3% driven by demand for Windows Server and SQL Server running in multi-cloud environments.
- Enterprise and partner services revenue increased $10 million or 1% driven by Enterprise Support Services.

Operating income increased $3.6 billion or 40%.

- Gross margin increased $3.1 billion or 20% driven by growth in Azure. Gross margin percentage was relatively unchanged. Excluding the impact of the change in accounting estimate, gross margin percentage increased 1 point driven by improvement in Azure, offset in part by the impact of scaling our AI infrastructure.
- Operating expenses decreased $504 million or 8% driven by 9 points of favorable impact from the prior year Q2 charge.

Gross margin and operating income included a favorable foreign currency impact of 2% and 3%, respectively.

More Personal Computing

Revenue increased $2.7 billion or 19%.

- Windows revenue increased $454 million or 9% driven by growth in Windows OEM and Windows Commercial. Windows OEM revenue increased 11%. Windows Commercial products and cloud services revenue increased 9% driven by demand for Microsoft 365.
- Gaming revenue increased $2.4 billion or 49% driven by growth in Xbox content and services. Xbox content and services revenue increased 61% driven by 55 points of net impact from the Activision Blizzard acquisition. Xbox hardware revenue increased 3% driven by sales mix shift to higher-priced consoles.
- Search and news advertising revenue increased slightly. Search and news advertising revenue excluding traffic acquisition costs increased 8% driven by higher search volume.
- Devices revenue decreased $132 million or 9%.

Operating income increased $967 million or 29%.

- Gross margin increased $2.2 billion or 34% driven by growth in Gaming, with 17 points of net impact from the Activision Blizzard acquisition, as well as growth in Devices and Windows. Gross margin percentage increased driven by improvement in Devices, including the impact from prior year impairment charges resulting from changes to our hardware portfolio, and sales mix shift to higher margin businesses.
- Operating expenses increased $1.3 billion or 38% driven by Gaming, with 48 points of growth from the Activision Blizzard acquisition, offset in part by 6 points of favorable impact from the prior year Q2 charge.

Gross margin and operating income included a favorable foreign currency impact of 2% and 3%, respectively.

Six Months Ended December 31, 2023 Compared with Six Months Ended December 31, 2022

Productivity and Business Processes

Revenue increased $4.4 billion or 13%.

- Office Commercial products and cloud services revenue increased $3.1 billion or 15%. Office 365 Commercial revenue grew 18% with seat growth of 9%, driven by small and medium business and frontline worker offerings, as well as growth in revenue per user. Office Commercial products revenue declined 17% driven by continued customer shift to cloud offerings.
- Office Consumer products and cloud services revenue increased $118 million or 4% with continued growth in Microsoft 365 Consumer subscribers.
- LinkedIn revenue increased $647 million or 9% driven by growth across all lines of business – Talent Solutions, Premium Subscriptions, Marketing Solutions, and Sales Solutions.
- Dynamics products and cloud services revenue increased $554 million or 22% driven by Dynamics 365 growth of 27%.

Operating income increased $3.8 billion or 23%.

- Gross margin increased $3.6 billion or 14% driven by growth in Office 365 Commercial. Gross margin percentage increased slightly. Excluding the impact of the change in accounting estimate, gross margin percentage increased 1 point driven by improvement in Office 365 Commercial.

- Operating expenses decreased $154 million or 2% driven by 2 points of favorable impact from the prior year Q2 charge.

Gross margin and operating income both included a favorable foreign currency impact of 2%.

Intelligent Cloud

Revenue increased $8.3 billion or 20%.

- Server products and cloud services revenue increased $8.3 billion or 22% driven by Azure and other cloud services. Azure and other cloud services revenue grew 30% driven by growth in our consumption-based services. Server products revenue increased 3% driven by demand for Windows Server and SQL Server running in multi-cloud environments.
- Enterprise and partner services revenue increased $25 million or 1% driven by growth in Enterprise Support Services, offset in part by a decline in Industry Solutions.

Operating income increased $6.3 billion or 35%, including a favorable foreign currency impact of 2%.

- Gross margin increased $5.9 billion or 20% driven by growth in Azure. Gross margin percentage was relatively unchanged. Excluding the impact of the change in accounting estimate, gross margin percentage increased 1 point driven by improvement in Azure, offset in part by the impact of scaling our AI infrastructure.
- Operating expenses decreased $418 million or 4% driven by 5 points of favorable impact from the prior year Q2 charge.

More Personal Computing

Revenue increased $3.0 billion or 11%.

- Windows revenue increased $708 million or 7% driven by growth in Windows OEM and Windows Commercial. Windows OEM revenue increased 7%. Windows Commercial products and cloud services revenue increased 9% driven by demand for Microsoft 365.
- Gaming revenue increased $2.7 billion or 32% driven by growth in Xbox content and services. Xbox content and services revenue increased 40% driven by 30 points of net impact from the Activision Blizzard acquisition. Xbox hardware revenue decreased 1%.
- Search and news advertising revenue increased $151 million or 2%. Search and news advertising revenue excluding traffic acquisition costs increased 9% driven by higher search volume.
- Devices revenue decreased $455 million or 16%.

Operating income increased $1.9 billion or 26%, including a favorable foreign currency impact of 3%.

- Gross margin increased $3.2 billion or 23% driven by growth in Gaming, with 8 points of net impact from the Activision Blizzard acquisition, as well as growth in Windows and Devices. Gross margin percentage increased driven by sales mix shift to higher margin businesses and improvement in Devices, including the impact from prior year impairment charges resulting from changes to our hardware portfolio.
- Operating expenses increased $1.2 billion or 20% driven by Gaming, with 25 points of growth from the Activision Blizzard acquisition, offset in part by a decline in Devices and 3 points of favorable impact from the prior year Q2 charge.

OPERATING EXPENSES

Research and Development

(In millions, except percentages)	Three Months Ended December 31,		Percentage Change	Six Months Ended December 31,		Percentage Change
	2023	**2022**		**2023**	**2022**	
Research and development	**$ 7,142**	$ 6,844	4%	**$ 13,801**	$ 13,472	2%
As a percent of revenue	**12%**	13%	(1)ppt	**12%**	13%	(1)ppt

Research and development expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with product development. Research and development expenses also include third-party development and programming costs and the amortization of purchased software code and services content.

Three Months Ended December 31, 2023 Compared with Three Months Ended December 31, 2022

Research and development expenses increased $298 million or 4% driven by Gaming, with 9 points of growth from the Activision Blizzard acquisition, offset in part by prior year impairment charges resulting from changes to our hardware portfolio and a decline in Devices.

Six Months Ended December 31, 2023 Compared with Six Months Ended December 31, 2022

Research and development expenses increased $329 million or 2% driven by Gaming, with 5 points of growth from the Activision Blizzard acquisition, offset in part by a decline in Devices and prior year impairment charges resulting from changes to our hardware portfolio.

Sales and Marketing

(In millions, except percentages)	Three Months Ended December 31,		Percentage Change	Six Months Ended December 31,		Percentage Change
	2023	**2022**		**2023**	**2022**	
Sales and marketing	**$ 6,246**	$ 5,679	10%	**$ 11,433**	$ 10,805	6%
As a percent of revenue	**10%**	11%	(1)ppt	**10%**	11%	(1)ppt

Sales and marketing expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with sales and marketing personnel, and the costs of advertising, promotions, trade shows, seminars, and other programs.

Three Months Ended December 31, 2023 Compared with Three Months Ended December 31, 2022

Sales and marketing expenses increased $567 million or 10% driven by Gaming, with 9 points of growth from the Activision Blizzard acquisition.

Six Months Ended December 31, 2023 Compared with Six Months Ended December 31, 2022

Sales and marketing expenses increased $628 million or 6% driven by Gaming, with 5 points of growth from the Activision Blizzard acquisition.

General and Administrative

(In millions, except percentages)	Three Months Ended December 31,		Percentage Change	Six Months Ended December 31,		Percentage Change
	2023	**2022**		**2023**	**2022**	
General and administrative	**$ 1,977**	$ 2,337	(15)%	**$ 3,451**	$ 3,735	(8)%
As a percent of revenue	**3%**	4%	(1)ppt	**3%**	4%	(1)ppt

General and administrative expenses include payroll, employee benefits, stock-based compensation expense, employee severance expense incurred as part of a corporate program, and other headcount-related expenses associated with finance, legal, facilities, certain human resources and other administrative personnel, certain taxes, and legal and other administrative fees.

Three Months Ended December 31, 2023 Compared with Three Months Ended December 31, 2022

General and administrative expenses decreased $360 million or 15% driven by prior year employee severance expenses, offset in part by Gaming, with 20 points of growth from the Activision Blizzard acquisition.

Six Months Ended December 31, 2023 Compared with Six Months Ended December 31, 2022

General and administrative expenses decreased $284 million or 8% driven by prior year employee severance expenses, offset in part by Gaming, with 12 points of growth from the Activision Blizzard acquisition.

OTHER INCOME (EXPENSE), NET

The components of other income (expense), net were as follows:

(In millions)	**Three Months Ended December 31,**		**Six Months Ended December 31,**	
	2023	**2022**	**2023**	**2022**
Interest and dividends income	**$ 734**	$ 700	**$ 1,900**	$ 1,341
Interest expense	**(909)**	(490)	**(1,434)**	(990)
Net recognized gains (losses) on investments	**69**	(15)	**(38)**	(2)
Net losses on derivatives	**(267)**	(199)	**(174)**	(190)
Net gains (losses) on foreign currency remeasurements	**36**	(18)	**(65)**	(96)
Other, net	**(169)**	(38)	**(306)**	(69)
Total	**$ (506)**	$ (60)	**$ (117)**	$ (6)

We use derivative instruments to manage risks related to foreign currencies, equity prices, interest rates, and credit; enhance investment returns; and facilitate portfolio diversification. Gains and losses from changes in fair values of derivatives that are not designated as hedging instruments are primarily recognized in other income (expense), net.

Three Months Ended December 31, 2023 Compared with Three Months Ended December 31, 2022

Interest and dividends income increased due to higher portfolio balances. Interest expense increased due to the issuance of commercial paper. Net recognized gains on investments increased due to gains on equity securities in the current period as opposed to losses in the prior period, offset in part by higher equity impairments. Net losses on derivatives increased primarily due to higher losses on equity derivatives.

Six Months Ended December 31, 2023 Compared with Six Months Ended December 31, 2022

Interest and dividends income increased due to higher yields and higher portfolio balances. Interest expense increased due to the issuance of commercial paper. Net recognized losses on investments increased due to higher equity impairments and higher losses on fixed income securities, offset in part by higher gains on equity securities. Net losses on derivatives decreased primarily due to gains on interest rate derivatives as opposed to losses in the prior period.

INCOME TAXES

Effective Tax Rate

Our effective tax rate was 18% and 19% for the three months ended December 31, 2023 and 2022, respectively, and 18% and 19% for the six months ended December 31, 2023 and 2022, respectively. The decrease in our effective tax rate for the three and six months ended December 31, 2023 compared to the prior year was primarily due to tax benefits from tax law changes, including the impact from the issuance of Notice 2023-55 and Notice 2023-80 by the Internal Revenue Service ("IRS") and U.S. Treasury Department. Notice 2023-55, issued in the first quarter of fiscal year 2024, delayed the effective date of final foreign tax credit regulations to fiscal year 2024 for Microsoft. Notice 2023-80, issued in the second quarter of fiscal year 2024, further delayed the effective date of final foreign tax credit regulations indefinitely.

Our effective tax rate was lower than the U.S. federal statutory rate for the three and six months ended December 31, 2023, primarily due to earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations center in Ireland.

Uncertain Tax Positions

We remain under audit by the IRS for tax years 2014 to 2017. With respect to the audit for tax years 2004 to 2013, on September 26, 2023, we received Notices of Proposed Adjustment ("NOPAs") from the IRS. The primary issues in the NOPAs relate to intercompany transfer pricing. In the NOPAs, the IRS is seeking an additional tax payment of $28.9 billion plus penalties and interest. As of December 31, 2023, we believe our allowances for income tax contingencies are adequate. We disagree with the proposed adjustments and will vigorously contest the NOPAs through the IRS's administrative appeals office and, if necessary, judicial proceedings. We do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our income tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2023, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NON-GAAP FINANCIAL MEASURES

Adjusted gross margin, operating income, net income, and diluted EPS are non-GAAP financial measures. Prior year non-GAAP financial measures exclude the impact of the Q2 charge, which includes employee severance expenses, impairment charges resulting from changes to our hardware portfolio, and costs related to lease consolidation activities. We believe these non-GAAP measures aid investors by providing additional insight into our operational performance and help clarify trends affecting our business. For comparability of reporting, management considers non-GAAP measures in conjunction with GAAP financial results in evaluating business performance. These non-GAAP financial measures presented should not be considered a substitute for, or superior to, the measures of financial performance prepared in accordance with GAAP.

The following table reconciles our financial results reported in accordance with GAAP to non-GAAP financial results:

(In millions, except percentages and per share amounts)	Three Months Ended December 31, 2023	2022	Percentage Change	Six Months Ended December 31, 2023	2022	Percentage Change
Gross margin	**$ 42,397**	$ 35,259	20%	**$ 82,612**	$ 69,929	18%
Severance, hardware-related impairment, and lease consolidation costs	**0**	152	*	**0**	152	*
Adjusted gross margin (non-GAAP)	**$ 42,397**	$ 35,411	20%	**$ 82,612**	$ 70,081	18%
Operating income	**$ 27,032**	$ 20,399	33%	**$ 53,927**	$ 41,917	29%
Severance, hardware-related impairment, and lease consolidation costs	**0**	1,171	*	**0**	1,171	*
Adjusted operating income (non-GAAP)	**$ 27,032**	$ 21,570	25%	**$ 53,927**	$ 43,088	25%
Net income	**$ 21,870**	$ 16,425	33%	**$ 44,161**	$ 33,981	30%
Severance, hardware-related impairment, and lease consolidation costs	**0**	946	*	**0**	946	*
Adjusted net income (non-GAAP)	**$ 21,870**	$ 17,371	26%	**$ 44,161**	$ 34,927	26%
Diluted earnings per share	**$ 2.93**	$ 2.20	33%	**$ 5.92**	$ 4.54	30%
Severance, hardware-related impairment, and lease consolidation costs	**0**	0.12	*	**0**	0.13	*
Adjusted diluted earnings per share (non-GAAP)	**$ 2.93**	$ 2.32	26%	**$ 5.92**	$ 4.67	27%

* *Not meaningful.*

LIQUIDITY AND CAPITAL RESOURCES

We expect existing cash, cash equivalents, short-term investments, cash flows from operations, and access to capital markets to continue to be sufficient to fund our operating activities and cash commitments for investing and financing activities, such as dividends, share repurchases, debt maturities, material capital expenditures, and the transition tax related to the Tax Cuts and Jobs Act (“TCJA”), for at least the next 12 months and thereafter for the foreseeable future.

Cash, Cash Equivalents, and Investments

Cash, cash equivalents, and short-term investments totaled $81.0 billion and $111.3 billion as of December 31, 2023 and June 30, 2023, respectively. Equity investments were $13.4 billion and $9.9 billion as of December 31, 2023 and June 30, 2023, respectively. Our short-term investments are primarily intended to facilitate liquidity and capital preservation. They consist predominantly of highly liquid investment-grade fixed-income securities, diversified among industries and individual issuers. The investments are predominantly U.S. dollar-denominated securities, but also include foreign currency-denominated securities to diversify risk. Our fixed-income investments are exposed to interest rate risk and credit risk. The credit risk and average maturity of our fixed-income portfolio are managed to achieve economic returns that correlate to certain fixed-income indices. The settlement risk related to these investments is insignificant given that the short-term investments held are primarily highly liquid investment-grade fixed-income securities.

Valuation

In general, and where applicable, we use quoted prices in active markets for identical assets or liabilities to determine the fair value of our financial instruments. This pricing methodology applies to our Level 1 investments, such as U.S. government securities, common and preferred stock, and mutual funds. If quoted prices in active markets for identical assets or liabilities are not available to determine fair value, then we use quoted prices for similar assets and liabilities or inputs other than the quoted prices that are observable either directly or indirectly. This pricing methodology applies to our Level 2 investments, such as commercial paper, certificates of deposit, U.S. agency securities, foreign government bonds, mortgage- and asset-backed securities, corporate notes and bonds, and municipal securities. Level 3 investments are valued using internally-developed models with unobservable inputs. Assets and liabilities measured at fair value on a recurring basis using unobservable inputs are an immaterial portion of our portfolio.

A majority of our investments are priced by pricing vendors and are generally Level 1 or Level 2 investments as these vendors either provide a quoted market price in an active market or use observable inputs for their pricing without applying significant adjustments. Broker pricing is used mainly when a quoted price is not available, the investment is not priced by our pricing vendors, or when a broker price is more reflective of fair values in the market in which the investment trades. Our broker-priced investments are generally classified as Level 2 investments because the broker prices these investments based on similar assets without applying significant adjustments. In addition, all our broker-priced investments have a sufficient level of trading volume to demonstrate that the fair values used are appropriate for these investments. Our fair value processes include controls that are designed to ensure appropriate fair values are recorded. These controls include model validation, review of key model inputs, analysis of period-over-period fluctuations, and independent recalculation of prices where appropriate.

Cash Flows

Cash from operations increased $15.1 billion to $49.4 billion for the six months ended December 31, 2023, mainly due to an increase in cash received from customers and a decrease in cash paid to suppliers. Cash from financing increased $26.8 billion to $4.6 billion for the six months ended December 31, 2023, mainly due to a $25.4 billion increase in proceeds from issuance of debt, net of repayments. Cash used in investing increased $61.1 billion to $71.4 billion for the six months ended December 31, 2023, mainly due to a $65.2 billion increase in cash used for acquisitions of companies, net of cash acquired, and purchases of intangible and other assets.

Debt Proceeds

We issue debt to take advantage of favorable pricing and liquidity in the debt markets, reflecting our credit rating. The proceeds of these issuances were or will be used for general corporate purposes, which may include, among other things, funding for working capital, capital expenditures, repurchases of capital stock, acquisitions, and repayment of existing debt. Refer to Note 10 – Debt of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

Unearned Revenue

Unearned revenue comprises mainly unearned revenue related to volume licensing programs, which may include Software Assurance ("SA") and cloud services. Unearned revenue is generally invoiced annually at the beginning of each contract period for multi-year agreements and recognized ratably over the coverage period. Unearned revenue also includes payments for other offerings for which we have been paid in advance and earn the revenue when we transfer control of the product or service.

The following table outlines the expected future recognition of unearned revenue as of December 31, 2023:

(In millions)		
Three Months Ending		
March 31, 2024	$	**21,623**
June 30, 2024		**13,127**
September 30, 2024		**5,615**
December 31, 2024		**2,703**
Thereafter		**2,966**
Total	$	**46,034**

If our customers choose to license cloud-based versions of our products and services rather than licensing transaction-based products and services, the associated revenue will shift from being recognized at the time of the transaction to being recognized over the subscription period or upon consumption, as applicable. Refer to Note 12 – Unearned Revenue of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

Material Cash Requirements and Other Obligations

Income Taxes

As a result of the TCJA, we are required to pay a one-time transition tax on deferred foreign income not previously subject to U.S. income tax. Under the TCJA, the transition tax is payable in interest-free installments over eight years, with 8% due in each of the first five years, 15% in year six, 20% in year seven, and 25% in year eight. As of December 31, 2023, we had a remaining transition tax liability of $7.6 billion, of which $3.8 billion is short-term and payable in the first quarter of fiscal year 2025.

Share Repurchases

For the six months ended December 31, 2023 and 2022, we repurchased 18 million shares and 37 million shares of our common stock for $6.4 billion and $9.2 billion, respectively, through our share repurchase program. All repurchases were made using cash resources. As of December 31, 2023, $15.9 billion remained of our $60 billion share repurchase program. Refer to Note 15 – Stockholders' Equity of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

Dividends

For the six months ended December 31, 2023 and 2022, our Board of Directors declared quarterly dividends of $0.75 per share and $0.68 per share, totaling $11.1 billion and $10.1 billion, respectively. We intend to continue returning capital to shareholders in the form of dividends, subject to declaration by our Board of Directors. Refer to Note 15 – Stockholders' Equity of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

Other Planned Uses of Capital

We will continue to invest in sales, marketing, product support infrastructure, and existing and advanced areas of technology, as well as acquisitions that align with our business strategy. Additions to property and equipment will continue, including new facilities, datacenters, and computer systems for research and development, sales and marketing, support, and administrative staff. We expect capital expenditures to increase in coming years to support growth in our cloud offerings and our investments in AI infrastructure. We have operating and finance leases for datacenters, corporate offices, research and development facilities, Microsoft Experience Centers, and certain equipment. We have not engaged in any related party transactions or arrangements with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of capital resources.

RECENT ACCOUNTING GUIDANCE

Refer to Note 1 – Accounting Policies of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion.

CRITICAL ACCOUNTING ESTIMATES

Our consolidated financial statements and accompanying notes are prepared in accordance with GAAP. Preparing consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Critical accounting estimates are those estimates that involve a significant level of estimation uncertainty and could have a material impact on our financial condition or results of operations. We have critical accounting estimates in the areas of revenue recognition, impairment of investment securities, goodwill, research and development costs, legal and other contingencies, income taxes, inventories, and business combinations – valuation of intangible assets.

Revenue Recognition

Our contracts with customers often include promises to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. When a cloud-based service includes both on-premises software licenses and cloud services, judgment is required to determine whether the software license is considered distinct and accounted for separately, or not distinct and accounted for together with the cloud service and recognized over time. Certain cloud services, primarily Office 365, depend on a significant level of integration, interdependency, and interrelation between the desktop applications and cloud services, and are accounted for together as one performance obligation. Revenue from Office 365 is recognized ratably over the period in which the cloud services are provided.

Judgment is required to determine the standalone selling price ("SSP") for each distinct performance obligation. We use a single amount to estimate SSP for items that are not sold separately, including on-premises licenses sold with SA or software updates provided at no additional charge. We use a range of amounts to estimate SSP when we sell each of the products and services separately and need to determine whether there is a discount to be allocated based on the relative SSP of the various products and services.

In instances where SSP is not directly observable, such as when we do not sell the product or service separately, we determine the SSP using information that may include market conditions and other observable inputs. We typically have more than one SSP for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, we may use information such as the size of the customer and geographic region in determining the SSP.

Due to the various benefits from and the nature of our SA program, judgment is required to assess the pattern of delivery, including the exercise pattern of certain benefits across our portfolio of customers.

Our products are generally sold with a right of return, we may provide other credits or incentives, and in certain instances we estimate customer usage of our products and services, which are accounted for as variable consideration when determining the amount of revenue to recognize. Returns and credits are estimated at contract inception and updated at the end of each reporting period if additional information becomes available. Changes to our estimated variable consideration were not material for the periods presented.

Impairment of Investment Securities

We review debt investments quarterly for credit losses and impairment. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, credit quality of debt instrument issuers, and the extent to which the fair value is less than cost. This determination requires significant judgment. In making this judgment, we employ a systematic methodology that considers available quantitative and qualitative evidence in evaluating potential impairment of our investments. In addition, we consider specific adverse conditions related to the financial health of, and business outlook for, the investee. If we have plans to sell the security or it is more likely than not that we will be required to sell the security before recovery, then a decline in fair value below cost is recorded as an impairment charge in other income (expense), net and a new cost basis in the investment is established. If market, industry, and/or investee conditions deteriorate, we may incur future impairments.

Equity investments without readily determinable fair values are written down to fair value if a qualitative assessment indicates that the investment is impaired and the fair value of the investment is less than carrying value. We perform a qualitative assessment on a periodic basis. We are required to estimate the fair value of the investment to determine the amount of the impairment loss. Once an investment is determined to be impaired, an impairment charge is recorded in other income (expense), net.

Goodwill

We allocate goodwill to reporting units based on the reporting unit expected to benefit from the business combination. We evaluate our reporting units on an annual basis and, if necessary, reassign goodwill using a relative fair value allocation approach. Goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis (May 1) and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. These events or circumstances could include a significant change in the business climate, legal factors, operating performance indicators, competition, or sale or disposition of a significant portion of a reporting unit.

Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. The fair value of each reporting unit is estimated primarily through the use of a discounted cash flow methodology. This analysis requires significant judgments, including estimation of future cash flows, which is dependent on internal forecasts, estimation of the long-term rate of growth for our business, estimation of the useful life over which cash flows will occur, and determination of our weighted average cost of capital.

The estimates used to calculate the fair value of a reporting unit change from year to year based on operating results, market conditions, and other factors. Changes in these estimates and assumptions could materially affect the determination of fair value and goodwill impairment for each reporting unit.

Research and Development Costs

Costs incurred internally in researching and developing a computer software product are charged to expense until technological feasibility has been established for the product. Once technological feasibility is established, software costs are capitalized until the product is available for general release to customers. Judgment is required in determining when technological feasibility of a product is established. We have determined that technological feasibility for our software products is reached after all high-risk development issues have been resolved through coding and testing. Generally, this occurs shortly before the products are released to production. The amortization of these costs is included in cost of revenue over the estimated life of the products.

Legal and Other Contingencies

The outcomes of legal proceedings and claims brought against us are subject to significant uncertainty. An estimated loss from a loss contingency such as a legal proceeding or claim is accrued by a charge to income if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. In determining whether a loss should be accrued we evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. Changes in these factors could materially impact our consolidated financial statements.

Income Taxes

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year, and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. We recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Accounting literature also provides guidance on derecognition of income tax assets and liabilities, classification of deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures. Judgment is required in assessing the future tax consequences of events that have been recognized in our consolidated financial statements or tax returns. Variations in the actual outcome of these future tax consequences could materially impact our consolidated financial statements.

Inventories

Inventories are stated at average cost, subject to the lower of cost or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. Net realizable value is the estimated selling price less estimated costs of completion, disposal, and transportation. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. These reviews include analysis of demand forecasts, product life cycle status, product development plans, current sales levels, pricing strategy, and component cost trends. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue.

Business Combinations – Valuation of Intangible Assets

Accounting for business combinations requires significant judgments when allocating the purchase price to the estimated fair values of assets acquired and liabilities assumed at the acquisition date. Determination of fair value involves estimates and assumptions which can be complex, most notably with respect to intangible assets. Critical estimates used in the valuation of intangible assets include, but are not limited to, the amount and timing of projected cash flows, useful lives, and discount rates. While management's estimates of fair value are based on assumptions that are believed to be reasonable, these assumptions are inherently uncertain as they pertain to forward-looking views of our business and market conditions. The judgments made in this valuation process could materially impact our consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

RISKS

We are exposed to economic risk from foreign exchange rates, interest rates, credit risk, and equity prices. We use derivatives instruments to manage these risks, however, they may still impact our consolidated financial statements.

Foreign Currencies

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily to maximize the economic effectiveness of our foreign currency positions, including hedges. Principal currency exposures include the Euro, Japanese yen, British pound, Canadian dollar, and Australian dollar.

Interest Rate

Securities held in our fixed-income portfolio are subject to different interest rate risks based on their maturities. We manage the average maturity of the fixed-income portfolio to achieve economic returns that correlate to certain global fixed-income indices.

Credit

Our fixed-income portfolio is diversified and consists primarily of investment-grade securities. We manage credit exposures relative to broad-based indices to facilitate portfolio diversification.

Equity

Securities held in our equity investments portfolio are subject to price risk.

SENSITIVITY ANALYSIS

The following table sets forth the potential loss in future earnings or fair values, including associated derivatives, resulting from hypothetical changes in relevant market rates or prices:

(In millions)

Risk Categories	Hypothetical Change	December 31, 2023	Impact
Foreign currency – Revenue	10% decrease in foreign exchange rates	$ (9,075)	Earnings
Foreign currency – Investments	10% decrease in foreign exchange rates	(33)	Fair Value
Interest rate	100 basis point increase in U.S. treasury interest rates	(1,597)	Fair Value
Credit	100 basis point increase in credit spreads	(336)	Fair Value
Equity	10% decrease in equity market prices	(1,047)	Earnings

ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective. There were no changes in our internal control over financial reporting during the quarter ended December 31, 2023 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Refer to Note 14 – Contingencies of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for information regarding legal proceedings in which we are involved.

ITEM 1A. RISK FACTORS

Our operations and financial results are subject to various risks and uncertainties, including those described below, that could adversely affect our business, financial condition, results of operations, cash flows, and the trading price of our common stock.

STRATEGIC AND COMPETITIVE RISKS

We face intense competition across all markets for our products and services, which may lead to lower revenue or operating margins.

Competition in the technology sector

Our competitors range in size from diversified global companies with significant research and development resources to small, specialized firms whose narrower product lines may let them be more effective in deploying technical, marketing, and financial resources. Barriers to entry in many of our businesses are low and many of the areas in which we compete evolve rapidly with changing and disruptive technologies, shifting user needs, and frequent introductions of new products and services. Our ability to remain competitive depends on our success in making innovative products, devices, and services that appeal to businesses and consumers.

Competition among platform-based ecosystems

An important element of our business model has been to create platform-based ecosystems on which many participants can build diverse solutions. A well-established ecosystem creates beneficial network effects among users, application developers, and the platform provider that can accelerate growth. Establishing significant scale in the marketplace is necessary to achieve and maintain attractive margins. We face significant competition from firms that provide competing platforms.

- A competing vertically-integrated model, in which a single firm controls the software and hardware elements of a product and related services, has succeeded with some consumer products such as personal computers, tablets, phones, gaming consoles, wearables, and other endpoint devices. Competitors pursuing this model also earn revenue from services integrated with the hardware and software platform, including applications and content sold through their integrated marketplaces. They may also be able to claim security and performance benefits from their vertically integrated offer. We also offer some vertically-integrated hardware and software products and services. To the extent we shift a portion of our business to a vertically integrated model we increase our cost of revenue and reduce our operating margins.
- We derive substantial revenue from licenses of Windows operating systems on PCs. We face significant competition from competing platforms developed for new devices and form factors such as smartphones and tablet computers. These devices compete on multiple bases including price and the perceived utility of the device and its platform. Users are increasingly turning to these devices to perform functions that in the past were performed by personal computers. Even if many users view these devices as complementary to a personal computer, the prevalence of these devices may make it more difficult to attract application developers to our PC operating system platforms. Competing with operating systems licensed at low or no cost may decrease our PC operating system margins. Popular products or services offered on competing platforms could increase their competitive strength. In addition, some of our devices compete with products made by our original equipment manufacturer ("OEM") partners, which may affect their commitment to our platform.

•Competing platforms have content and application marketplaces with scale and significant installed bases. The variety and utility of content and applications available on a platform are important to device purchasing decisions. Users may incur costs to move data and buy new content and applications when switching platforms. To compete, we must successfully enlist developers to write applications for our platform and ensure that these applications have high quality, security, customer appeal, and value. Efforts to compete with competitors' content and application marketplaces may increase our cost of revenue and lower our operating margins. Competitors' rules governing their content and applications marketplaces may restrict our ability to distribute products and services through them in accordance with our technical and business model objectives.

Business model competition

Companies compete with us based on a growing variety of business models.

•Even as we transition more of our business to infrastructure-, platform-, and software-as-a-service business model, the license-based proprietary software model generates a substantial portion of our software revenue. We bear the costs of converting original ideas into software products through investments in research and development, offsetting these costs with the revenue received from licensing our products. Many of our competitors also develop and sell software to businesses and consumers under this model.

•We are investing in artificial intelligence ("AI") across the entire company and infusing generative AI capabilities into our consumer and commercial offerings. We expect AI technology and services to be a highly competitive and rapidly evolving market. We will bear significant development and operational costs to build and support the AI capabilities, products, and services necessary to meet the needs of our customers. To compete effectively we must also be responsive to technological change, potential regulatory developments, and public scrutiny.

•Other competitors develop and offer free applications, online services, and content, and make money by selling third-party advertising. Advertising revenue funds development of products and services these competitors provide to users at no or little cost, competing directly with our revenue-generating products.

•Some companies compete with us by modifying and then distributing open source software at little or no cost to end users, using open source AI models, and earning revenue on advertising or integrated products and services. These firms do not bear the full costs of research and development for the open source products. Some open source products mimic the features and functionality of our products.

The competitive pressures described above may cause decreased sales volumes, price reductions, and/or increased operating costs, such as for research and development, marketing, and sales incentives. This may lead to lower revenue, gross margins, and operating income.

Our focus on cloud-based services presents execution and competitive risks. A growing part of our business involves cloud-based services available across the spectrum of computing devices. Our strategic vision is to compete and grow by building best-in-class platforms and productivity services that utilize ubiquitous computing and ambient intelligence to drive insights and productivity gains. At the same time, our competitors are rapidly developing and deploying cloud-based services for consumers and business customers. Pricing and delivery models are evolving. Devices and form factors influence how users access services in the cloud and sometimes the user's choice of which cloud-based services to use. Certain industries and customers have specific requirements for cloud services and may present enhanced risks. We are devoting significant resources to develop and deploy our cloud-based strategies. The Windows ecosystem must continue to evolve with this changing environment. We embrace cultural and organizational changes to drive accountability and eliminate obstacles to innovation. Our intelligent cloud and intelligent edge offerings are connected to the growth of the Internet of Things ("IoT"), a network of distributed and interconnected devices employing sensors, data, and computing capabilities, including AI. Our success in driving ubiquitous computing and ambient intelligence will depend on the level of adoption of our offerings such as Azure, Azure AI, and Azure IoT Edge. We may not establish market share sufficient to achieve scale necessary to meet our business objectives.

Besides software development costs, we are incurring costs to build and maintain infrastructure to support cloud computing and AI services. These costs will reduce the operating margins we have previously achieved. Whether we succeed in cloud-based services depends on our execution in several areas, including:

- Continuing to bring to market compelling cloud-based experiences that generate increasing traffic and market share.
- Maintaining the utility, compatibility, and performance of our cloud-based services on the growing array of computing devices, including PCs, smartphones, tablets, gaming consoles, and other devices, as well as sensors and other IoT endpoints.
- Continuing to enhance the attractiveness of our cloud platforms to third-party developers.
- Ensuring our cloud-based services meet the reliability expectations of our customers and maintain the security of their data as well as help them meet their own compliance needs.
- Making our suite of cloud-based services platform-agnostic, available on a wide range of devices and ecosystems, including those of our competitors.

It is uncertain whether our strategies will attract the users or generate the revenue required to succeed. If we are not effective in executing organizational and technical changes to increase efficiency and accelerate innovation, or if we fail to generate sufficient usage of our new products and services, we may not grow revenue in line with the infrastructure and development investments described above. This may negatively impact gross margins and operating income.

Some users may engage in fraudulent or abusive activities through our cloud-based services. These include unauthorized use of accounts through stolen credentials, use of stolen credit cards or other payment vehicles, failure to pay for services accessed, or other activities that violate our terms of service such as cryptocurrency mining or launching cyberattacks. If our efforts to detect such violations or our actions to control these types of fraud and abuse are not effective, we may experience adverse impacts to our revenue or incur reputational damage.

RISKS RELATING TO THE EVOLUTION OF OUR BUSINESS

We make significant investments in products and services that may not achieve expected returns. We will continue to make significant investments in research, development, and marketing for existing products, services, and technologies, including the Windows operating system, Microsoft 365, Bing, SQL Server, Windows Server, Azure, Office 365, Xbox, LinkedIn, and other products and services. In addition, we are focused on developing new AI platform services and incorporating AI into existing products and services. We also invest in the development and acquisition of a variety of hardware for productivity, communication, and entertainment, including PCs, tablets, gaming devices, and HoloLens. Investments in new technology are speculative. Commercial success depends on many factors, including innovativeness, developer support, and effective distribution and marketing. If customers do not perceive our latest offerings as providing significant new functionality or other value, they may reduce their purchases of new software and hardware products or upgrades, unfavorably affecting revenue. We may not achieve significant revenue from new product, service, and distribution channel investments for several years, if at all. New products and services may not be profitable, and even if they are profitable, operating margins for some new products and businesses will not be as high as the margins we have experienced historically. We may not get engagement in certain features, like Microsoft Edge, Bing, and Copilot, that drive post-sale monetization opportunities. Our data handling practices across our products and services will continue to be under scrutiny. Perceptions of mismanagement, driven by regulatory activity or negative public reaction to our practices or product experiences, could negatively impact product and feature adoption, product design, and product quality.

Developing new technologies is complex. It can require long development and testing periods. Significant delays in new releases or significant problems in creating new products or services could adversely affect our revenue.

Acquisitions, joint ventures, and strategic alliances may have an adverse effect on our business. We expect to continue making acquisitions and entering into joint ventures and strategic alliances as part of our long-term business strategy. For example, in March 2022 we completed our acquisition of Nuance Communications, Inc., and in October 2023 we completed our acquisition of Activision Blizzard, Inc. ("Activision Blizzard"). In January 2023 we announced the third phase of our OpenAI strategic partnership. Acquisitions and other transactions and arrangements involve significant challenges and risks, including that they do not advance our business strategy, that we get an unsatisfactory return on our investment, that they raise new compliance-related obligations and challenges, that we have difficulty integrating and retaining new employees, business systems, and technology, that they distract management from our other businesses, or that announced transactions may not be completed. If an arrangement fails to adequately anticipate changing circumstances and interests of a party, it may result in early termination or renegotiation of the arrangement. We also have limited ability to control or influence third parties with whom we have arrangements, which may impact our ability to realize the anticipated benefits. The success of these transactions and arrangements will depend in part on our ability to leverage them to enhance our existing products and services or develop compelling new ones, as well as acquired companies' ability to meet our policies and processes in areas such as data governance, privacy, and cybersecurity. It may take longer than expected to realize the full benefits from these transactions and arrangements such as increased revenue or enhanced efficiencies, or the benefits may ultimately be smaller than we expected. In addition, an acquisition may be subject to challenge even after it has been completed. For example, the Federal Trade Commission continues to challenge our Activision Blizzard acquisition and could, if successful, alter or unwind the transaction. These events could adversely affect our consolidated financial statements.

If our goodwill or amortizable intangible assets become impaired, we may be required to record a significant charge to earnings. We acquire other companies and intangible assets and may not realize all the economic benefit from those acquisitions, which could cause an impairment of goodwill or intangibles. We review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. We test goodwill for impairment at least annually. Factors that may be a change in circumstances, indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable, include a decline in our stock price and market capitalization, reduced future cash flow estimates, and slower growth rates in industry segments in which we participate. We have in the past recorded, and may in the future be required to record, a significant charge in our consolidated financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, negatively affecting our results of operations.

CYBERSECURITY, DATA PRIVACY, AND PLATFORM ABUSE RISKS

Cyberattacks and security vulnerabilities could lead to reduced revenue, increased costs, liability claims, or harm to our reputation or competitive position.

Security of our information technology

Threats to IT security can take a variety of forms. Individual and groups of hackers and sophisticated organizations, including state-sponsored organizations or nation-states, continuously undertake attacks that pose threats to our customers and our IT, and we have experienced cybersecurity incidents in which such actors have gained unauthorized access to our IT systems and data, including customer systems and data. These actors use a wide variety of methods, which include developing and deploying malicious software or exploiting vulnerabilities or intentionally designed processes in hardware, software, or other infrastructure to attack our products and services or gain access to our networks and datacenters, using social engineering techniques to induce our employees, users, partners, or customers to disclose passwords or other sensitive information or take other actions to gain access to our data or our users' or customers' data, or acting in a coordinated manner to launch distributed denial of service or other coordinated attacks. For example, as previously disclosed in our Form 8-K filed with the Securities and Exchange Commission on January 19, 2024, beginning in late November 2023, a nation-state associated threat actor used a password spray attack to compromise a legacy test account and, in turn, gain access to Microsoft email accounts. This incident may result in harm to our reputation and customer relationships, and there can be no assurance that the threat actor will not utilize the information accessed to otherwise adversely affect our business or results of operations. Additionally, we may discover additional impacts of this or other incidents as part of our ongoing examination of this incident. Nation-state and state-sponsored actors can deploy significant resources to plan and carry out attacks. Nation-state attacks against us, our customers, or our partners may intensify during periods of intense diplomatic or armed conflict, such as the ongoing conflict in Ukraine. Inadequate account security or organizational security practices, including those of companies we have acquired, have resulted and may result in unauthorized access to our IT systems and data, including customer systems and data, in the future. For example, system administrators may fail to timely remove employee account access when no longer appropriate. Employees or third parties may intentionally compromise our or our users' security or systems or reveal confidential information. Malicious actors may employ the IT supply chain to introduce malware through software updates or compromised supplier accounts or hardware.

Cyberthreats are constantly evolving and becoming increasingly sophisticated and complex, increasing the difficulty of detecting and successfully defending against them. We may have no current capability to detect certain vulnerabilities or new attack methods, which may allow them to persist in the environment over long periods of time. Cyber incidents and attacks can have cascading impacts that unfold with increasing speed across our internal networks and systems and those of our partners and customers. Breaches of our facilities, network, or data security can disrupt the security of our systems and business applications, impair our ability to provide services to our customers and protect the privacy of their data, result in product development delays, compromise confidential or technical business information harming our reputation or competitive position, result in theft or misuse of our intellectual property or other assets, subject us to ransomware attacks, require us to allocate more resources to improve technologies or remediate the impacts of attacks, or otherwise adversely affect our business. We are also subject to supply chain cyberattacks where malware can be introduced to a software provider's customers, including us, through software updates.

In addition, our internal IT environment continues to evolve. Often, we are early adopters of new devices and technologies. We embrace new ways of sharing data and communicating internally and with partners and customers using methods such as social networking and other consumer-oriented technologies. Increasing use of generative AI models in our internal systems may create new attack methods for adversaries. Our business policies and internal security controls may not keep pace with these changes as new threats emerge, or emerging cybersecurity regulations in jurisdictions worldwide.

Security of our products, services, devices, and customers' data

The security of our products and services is important in our customers' decisions to purchase or use our products or services across cloud and on-premises environments. Security threats are a significant challenge to companies like us whose business is providing technology products and services to others. Threats to or attacks on our own IT infrastructure have also affected our customers and may do so in the future. Customers using our cloud-based services rely on the security of our infrastructure, including hardware and other elements provided by third parties, to ensure the reliability of our services and the protection of their data. Adversaries tend to focus their efforts on the most popular operating systems, programs, and services, including many of ours, and we expect that to continue. In addition, adversaries can attack our customers' on-premises or cloud environments, sometimes exploiting previously unknown ("zero day") vulnerabilities, such as occurred in early calendar year 2021 with several of our Exchange Server on-premises products. Vulnerabilities in these or any product can persist even after we have issued security patches if customers have not installed the most recent updates, or if the attackers exploited the vulnerabilities before patching to install additional malware to further compromise customers' systems. Adversaries will continue to attack customers using our cloud services as customers embrace digital transformation. Adversaries that acquire user account information can use that information to compromise our users' accounts, including where accounts share the same attributes such as passwords. Inadequate account security practices may also result in unauthorized access, and user activity may result in ransomware or other malicious software impacting a customer's use of our products or services. We are increasingly incorporating open source software into our products. There may be vulnerabilities in open source software that may make our products susceptible to cyberattacks. Additionally, we are actively adding new generative AI features to our services. Because generative AI is a new field, understanding of security risks and protection methods continues to develop; features that rely on generative AI may be susceptible to unanticipated security threats from sophisticated adversaries.

Our customers operate complex IT systems with third-party hardware and software from multiple vendors that may include systems acquired over many years. They expect our products and services to support all these systems and products, including those that no longer incorporate the strongest current security advances or standards. As a result, we may not be able to discontinue support in our services for a product, service, standard, or feature solely because a more secure alternative is available. Failure to utilize the most current security advances and standards can increase our customers' vulnerability to attack. Further, customers of widely varied size and technical sophistication use our technology, and consequently may still have limited capabilities and resources to help them adopt and implement state of the art cybersecurity practices and technologies. In addition, we must account for this wide variation of technical sophistication when defining default settings for our products and services, including security default settings, as these settings may limit or otherwise impact other aspects of IT operations and some customers may have limited capability to review and reset these defaults.

Cyberattacks may adversely impact our customers even if our production services are not directly compromised. We are committed to notifying our customers whose systems have been impacted as we become aware and have actionable information for customers to help protect themselves. We are also committed to providing guidance and support on detection, tracking, and remediation. We may not be able to detect the existence or extent of these attacks for all of our customers or have information on how to detect or track an attack, especially where an attack involves on-premises software such as Exchange Server where we may have no or limited visibility into our customers' computing environments.

Development and deployment of defensive measures

To defend against security threats to our internal IT systems, our cloud-based services, and our customers' systems, we must continuously engineer more secure products and services, enhance security, threat detection, and reliability features, improve the deployment of software updates to address security vulnerabilities in our own products as well as those provided by others, develop mitigation technologies that help to secure customers from attacks even when software updates are not deployed, maintain the digital security infrastructure that protects the integrity of our network, products, and services, and provide security tools such as firewalls, anti-virus software, and advanced security and information about the need to deploy security measures and the impact of doing so. Customers in certain industries such as financial services, health care, and government may have enhanced or specialized requirements to which we must engineer our products and services.

The cost of measures to protect products and customer-facing services could reduce our operating margins. If we fail to do these things well, actual or perceived security vulnerabilities in our products and services, data corruption issues, or reduced performance could harm our reputation and lead customers to reduce or delay future purchases of products or subscriptions to services, or to use competing products or services. Customers may also spend more on protecting their existing computer systems from attack, which could delay adoption of additional products or services. Customers, and third parties granted access to their systems, may fail to update their systems, continue to run software or operating systems we no longer support, or may fail timely to install or enable security patches, or may otherwise fail to adopt adequate security practices. Any of these could adversely affect our reputation and revenue. Actual or perceived vulnerabilities may lead to claims against us. Our license agreements typically contain provisions that eliminate or limit our exposure to liability, but there is no assurance these provisions will withstand legal challenges. At times, to achieve commercial objectives, we may enter into agreements with larger liability exposure to customers.

Our products operate in conjunction with and are dependent on products and components across a broad ecosystem of third parties. If there is a security vulnerability in one of these components, and if there is a security exploit targeting it, we could face increased costs, liability claims, reduced revenue, or harm to our reputation or competitive position.

Disclosure and misuse of personal data could result in liability and harm our reputation. As we continue to grow the number, breadth, and scale of our cloud-based offerings, we store and process increasingly large amounts of personal data of our customers and users. The continued occurrence of high-profile data breaches provides evidence of an external environment increasingly hostile to information security. Despite our efforts to improve the security controls across our business groups and geographies, it is possible our security controls over personal data, our training of employees and third parties on data security, and other practices we follow may not prevent the improper disclosure or misuse of customer or user data we or our vendors store and manage. In addition, third parties who have limited access to our customer or user data may use this data in unauthorized ways. Improper disclosure or misuse could harm our reputation, lead to legal exposure to customers or users, or subject us to liability under laws that protect personal data, resulting in increased costs or loss of revenue. Our software products and services also enable our customers and users to store and process personal data on-premises or, increasingly, in a cloud-based environment we host. Government authorities can sometimes require us to produce customer or user data in response to valid legal orders. In the U.S. and elsewhere, we advocate for transparency concerning these requests and appropriate limitations on government authority to compel disclosure. Despite our efforts to protect customer and user data, perceptions that the collection, use, and retention of personal information is not satisfactorily protected could inhibit sales of our products or services and could limit adoption of our cloud-based solutions by consumers, businesses, and government entities. Additional security measures we may take to address customer or user concerns, or constraints on our flexibility to determine where and how to operate datacenters in response to customer or user expectations or governmental rules or actions, may cause higher operating expenses or hinder growth of our products and services.

We may not be able to protect information in our products and services from use by others. LinkedIn and other Microsoft products and services contain valuable information and content protected by contractual restrictions or technical measures. In certain cases, we have made commitments to our members and users to limit access to or use of this information. Changes in the law or interpretations of the law may weaken our ability to prevent third parties from scraping or gathering information or content through use of bots or other measures and using it for their own benefit, thus diminishing the value of our products and services.

Abuse of our platforms may harm our reputation or user engagement.

Advertising, professional, marketplace, and gaming platform abuses

For platform products and services that provide content or host ads that come from or can be influenced by third parties, including GitHub, LinkedIn, Microsoft Advertising, Microsoft News, Microsoft Store, Bing, and Xbox, our reputation or user engagement may be negatively affected by activity that is hostile or inappropriate. This activity may come from users impersonating other people or organizations including through the use of AI technologies, dissemination of information that may be viewed as misleading or intended to manipulate the opinions of our users, or the use of our products or services that violates our terms of service or otherwise for objectionable or illegal ends. Preventing or responding to these actions may require us to make substantial investments in people and technology and these investments may not be successful, adversely affecting our business and consolidated financial statements.

Other digital safety abuses

Our hosted consumer services as well as our enterprise services may be used to generate or disseminate harmful or illegal content in violation of our terms or applicable law. We may not proactively discover such content due to scale, the limitations of existing technologies, and conflicting legal frameworks. When discovered by users and others, such content may negatively affect our reputation, our brands, and user engagement. Regulations and other initiatives to make platforms responsible for preventing or eliminating harmful content online have been enacted, and we expect this to continue. We may be subject to enhanced regulatory oversight, civil or criminal liability, or reputational damage if we fail to comply with content moderation regulations, adversely affecting our business and consolidated financial statements.

The development of the IoT presents security, privacy, and execution risks. To support the growth of the intelligent cloud and the intelligent edge, we are developing products, services, and technologies to power the IoT. The IoT's great potential also carries substantial risks. IoT products and services may contain defects in design, manufacture, or operation that make them insecure or ineffective for their intended purposes. An IoT solution has multiple layers of hardware, sensors, processors, software, and firmware, several of which we may not develop or control. Each layer, including the weakest layer, can impact the security of the whole system. Many IoT devices have limited interfaces and ability to be updated or patched. IoT solutions may collect large amounts of data, and our handling of IoT data may not satisfy customers or regulatory requirements. IoT scenarios may increasingly affect personal health and safety. If IoT solutions that include our technologies do not work as intended, violate the law, or harm individuals or businesses, we may be subject to legal claims or enforcement actions. These risks, if realized, may increase our costs, damage our reputation or brands, or negatively impact our revenues or margins.

Issues in the development and use of AI may result in reputational or competitive harm or liability. We are building AI into many of our offerings, including our productivity services, and we are also making AI available for our customers to use in solutions that they build. This AI may be developed by Microsoft or others, including our strategic partner, OpenAI. We expect these elements of our business to grow. We envision a future in which AI operating in our devices, applications, and the cloud helps our customers be more productive in their work and personal lives. As with many innovations, AI presents risks and challenges that could affect its adoption, and therefore our business. AI algorithms or training methodologies may be flawed. Datasets may be overbroad, insufficient, or contain biased information. Content generated by AI systems may be offensive, illegal, or otherwise harmful. Ineffective or inadequate AI development or deployment practices by Microsoft or others could result in incidents that impair the acceptance of AI solutions or cause harm to individuals, customers, or society, or result in our products and services not working as intended. Human review of certain outputs may be required. Our implementation of AI systems could result in legal liability, regulatory action, brand, reputational, or competitive harm, or other adverse impacts. These risks may arise from current copyright infringement and other claims related to AI training and output, new and proposed legislation and regulations, such as the European Union's ("EU") AI Act and the U.S.'s AI Executive Order, and new applications of data protection, privacy, intellectual property, and other laws. Some AI scenarios present ethical issues or may have broad impacts on society. If we enable or offer AI solutions that have unintended consequences, unintended usage or customization by our customers and partners, are contrary to our responsible AI principles, or are otherwise controversial because of their impact on human rights, privacy, employment, or other social, economic, or political issues, we may experience brand or reputational harm, adversely affecting our business and consolidated financial statements.

OPERATIONAL RISKS

We may have excessive outages, data losses, and disruptions of our online services if we fail to maintain an adequate operations infrastructure. Our increasing user traffic, growth in services, and the complexity of our products and services demand more computing power. We spend substantial amounts to build, purchase, or lease datacenters and equipment and to upgrade our technology and network infrastructure to handle more traffic on our websites and in our datacenters. Our datacenters depend on the availability of permitted and buildable land, predictable energy, networking supplies, and servers, including graphics processing units (“GPUs”) and other components. The cost or availability of these dependencies could be adversely affected by a variety of factors, including the transition to a clean energy economy, local and regional environmental regulations, and geopolitical disruptions. These demands continue to increase as we introduce new products and services and support the growth and the augmentation of existing services such as Bing, Azure, Microsoft Account services, Microsoft 365, Microsoft Teams, Dynamics 365, OneDrive, SharePoint Online, Skype, Xbox, and Outlook.com through the incorporation of AI features and/or functionality. We are rapidly growing our business of providing a platform and back-end hosting for services provided by third parties to their end users. Maintaining, securing, and expanding this infrastructure is expensive and complex, and requires development of principles for datacenter builds in geographies with higher safety and reliability risks. It requires that we maintain an Internet connectivity infrastructure and storage and compute capacity that is robust and reliable within competitive and regulatory constraints that continue to evolve. Inefficiencies or operational failures, including temporary or permanent loss of customer data, insufficient Internet connectivity, insufficient or unavailable power supply, or inadequate storage and compute capacity, could diminish the quality of our products, services, and user experience resulting in contractual liability, claims by customers and other third parties, regulatory actions, damage to our reputation, and loss of current and potential users, subscribers, and advertisers, each of which may adversely impact our consolidated financial statements.

We may experience quality or supply problems. Our hardware products such as Xbox consoles, Surface devices, and other devices we design and market are highly complex and can have defects in design, manufacture, or associated software. We could incur significant expenses, lost revenue, and reputational harm as a result of recalls, safety alerts, or product liability claims if we fail to prevent, detect, or address such issues through design, testing, or warranty repairs.

Our software products and services also may experience quality or reliability problems. The highly sophisticated software we develop may contain bugs and other defects that interfere with their intended operation. Our customers increasingly rely on us for critical business functions and multiple workloads. Many of our products and services are interdependent with one another. Each of these circumstances potentially magnifies the impact of quality or reliability issues. Any defects we do not detect and fix in pre-release testing could cause reduced sales and revenue, damage to our reputation, repair or remediation costs, delays in the release of new products or versions, or legal liability. Although our license agreements typically contain provisions that eliminate or limit our exposure to liability, there is no assurance these provisions will withstand legal challenge.

There are limited suppliers for certain device and datacenter components. Our competitors use some of the same suppliers and their demand for hardware components can affect the capacity available to us. If components are delayed or become unavailable, whether because of supplier capacity constraint, industry shortages, legal or regulatory changes that restrict supply sources, or other reasons, we may not obtain timely replacement supplies, resulting in reduced sales or inadequate datacenter capacity to support the delivery and continued development of our products and services. Component shortages, excess or obsolete inventory, or price reductions resulting in inventory adjustments may increase our cost of revenue. Xbox consoles, Surface devices, datacenter servers, and other hardware are assembled in Asia and other geographies that may be subject to disruptions in the supply chain, resulting in shortages that would affect our revenue and operating margins.

LEGAL, REGULATORY, AND LITIGATION RISKS

Government enforcement under competition laws and new market regulation may limit how we design and market our products. Government agencies closely scrutinize us under U.S. and foreign competition laws. Governments are actively enforcing competition laws and regulations and enacting new regulations to intervene in digital markets, and this includes markets such as the EU, the U.K., the U.S., and China. Some jurisdictions also allow competitors or consumers to assert claims of anti-competitive conduct. U.S. and foreign antitrust authorities have previously brought enforcement actions and continue to scrutinize our business.

For example, the European Commission ("the Commission") has designated Windows and LinkedIn as core platform services subject to obligations under the EU Digital Markets Act, which prohibits certain self-preferencing behaviors and places limitations on certain data use among other obligations. The Commission also continues to closely scrutinize the design of high-volume Microsoft products and the terms on which we make certain technologies used in these products, such as file formats, programming interfaces, and protocols, available to other companies. Flagship product releases such as Microsoft 365 and Windows can receive significant scrutiny under EU or other competition laws.

Our portfolio of first-party devices continues to grow; at the same time our OEM partners offer a large variety of devices for our platforms. As a result, increasingly we both cooperate and compete with our OEM partners, creating a risk that we fail to do so in compliance with competition rules. Regulatory scrutiny in this area may increase. Certain foreign governments, particularly in China and other countries in Asia, have advanced arguments under their competition laws that exert downward pressure on royalties for our intellectual property.

Competition law enforcement actions and court decisions along with new market regulations may result in fines or hinder our ability to provide the benefits of our software to consumers and businesses, reducing the attractiveness of our products and the revenue that comes from them. New competition law actions or obligations under market regulation schemes could be initiated, potentially using previous actions as precedent. The outcome of such actions, or steps taken to avoid them, could adversely affect us in a variety of ways, including causing us to withdraw products from or modify products for certain markets, decreasing the value of our assets, adversely affecting our ability to monetize our products, or inhibiting our ability to consummate acquisition or impose conditions on acquisitions that may reduce their value.

Laws and regulations relating to anti-corruption and trade could result in increased costs, fines, criminal penalties, or reputational damage. The Foreign Corrupt Practices Act ("FCPA") and other anti-corruption laws and regulations ("Anti-Corruption Laws") prohibit corrupt payments by our employees, vendors, or agents, and the accounting provisions of the FCPA require us to maintain accurate books and records and adequate internal controls. From time to time, we receive inquiries from authorities in the U.S. and elsewhere which may be based on reports from employees and others about our business activities outside the U.S. and our compliance with Anti-Corruption Laws. Periodically, we receive such reports directly and investigate them, and also cooperate with investigations by U.S. and foreign law enforcement authorities. An example of increasing international regulatory complexity is the EU Whistleblower Directive, initiated in 2021, which presents compliance challenges as it is implemented in different forms by EU member states. Most countries in which we operate also have competition laws that prohibit competitors from colluding or otherwise attempting to reduce competition between themselves. While we devote substantial resources to our U.S. and international compliance programs and have implemented policies, training, and internal controls designed to reduce the risk of corrupt payments and collusive activity, our employees, partners, vendors, or agents may violate our policies. Our failure to comply with Anti-Corruption Laws or competition laws could result in significant fines and penalties, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our business, and damage to our reputation.

Increasing trade laws, policies, sanctions, and other regulatory requirements also affect our operations in and outside the U.S. relating to trade and investment. Economic sanctions in the U.S., the EU, and other countries prohibit most business with restricted entities or countries. U.S. export controls restrict Microsoft from offering many of its products and services to, or making investments in, certain entities in specified countries. U.S. import controls restrict us from integrating certain information and communication technologies into our supply chain and allow for government review of transactions involving information and communications technology from countries determined to be foreign adversaries. Supply chain regulations may impact the availability of goods or result in additional regulatory scrutiny. Periods of intense diplomatic or armed conflict, such as the ongoing conflict in Ukraine, may result in (1) new and rapidly evolving sanctions and trade restrictions, which may impair trade with sanctioned individuals and countries, and (2) negative impacts to regional trade ecosystems among our customers, partners, and us. Non-compliance with sanctions as well as general ecosystem disruptions could result in reputational harm, operational delays, monetary fines, loss of revenues, increased costs, loss of export privileges, or criminal sanctions.

Laws and regulations relating to the handling of personal data may impede the adoption of our services or result in increased costs, legal claims, fines against us, or reputational damage. The growth of our Internet- and cloud-based services internationally relies increasingly on the movement of data across national boundaries. Legal requirements relating to the collection, storage, handling, and transfer of personal data continue to evolve. For example, while the EU-U.S. Data Privacy Framework ("DPF") has been recognized as adequate under EU law to allow transfers of personal data from the EU to certified companies in the U.S., the DPF is subject to further legal challenge which could cause the legal requirements for data transfers from the EU to be uncertain. EU data protection authorities have and may again block the use of certain U.S.-based services that involve the transfer of data to the U.S. In the EU and other markets, potential new rules and restrictions on the flow of data across borders could increase the cost and complexity of delivering our products and services.

In addition, the EU General Data Protection Regulation ("GDPR"), which applies to all of our activities conducted from an establishment in the EU or related to products and services offered in the EU, imposes a range of compliance obligations regarding the handling of personal data. More recently, the EU has been developing new requirements related to the use of data, including in the Digital Markets Act, the Digital Services Act, and the Data Act, that add additional rules and restriction on the use of data in our products and services. Engineering efforts to build and maintain capabilities to facilitate compliance with these laws involve substantial expense and the diversion of engineering resources from other projects. We might experience reduced demand for our offerings if we are unable to engineer products that meet our legal duties or help our customers meet their obligations under these and other data regulations, or if our implementation to comply makes our offerings less attractive. Compliance with these obligations depends in part on how particular regulators interpret and apply them. If we fail to comply, or if regulators assert we have failed to comply (including in response to complaints made by customers), it may lead to regulatory enforcement actions, which can result in significant monetary penalties, private lawsuits, reputational damage, blockage of product offerings or of international data transfers, and loss of customers. The highest fines assessed under GDPR have recently been increasing, especially against large technology companies, and European data protection authorities have taken action to block or remove services from their markets. Jurisdictions around the world, such as China, India, and states in the U.S. have adopted, or are considering adopting or expanding, laws and regulations imposing obligations regarding the collection, handling, and transfer of personal data.

Our investment in gaining insights from data is becoming central to the value of the services, including AI services, we deliver to customers, to operational efficiency and key opportunities in monetization, and to customer perceptions of quality. Our ability to use data in this way may be constrained by regulatory developments that impede realizing the expected return from this investment. Ongoing legal analyses, reviews, and inquiries by regulators of Microsoft practices, or relevant practices of other organizations, may result in burdensome or inconsistent requirements, including data sovereignty and localization requirements, affecting the location, movement, collection, and use of our customer and internal employee data as well as the management of that data. Compliance with applicable laws and regulations regarding personal data may require changes in services, business practices, or internal systems that result in increased costs, lower revenue, reduced efficiency, or greater difficulty in competing with foreign-based firms. Compliance with data regulations might limit our ability to innovate or offer certain features and functionality in some jurisdictions where we operate. Failure to comply with existing or new rules may result in significant penalties or orders to stop the alleged noncompliant activity, as well as negative publicity and diversion of management time and effort.

Existing and increasing legal and regulatory requirements could adversely affect our results of operations. We are subject to a wide range of laws, regulations, and legal requirements in the U.S. and globally, including those that may apply to our products and online services offerings, and those that impose requirements related to user privacy, telecommunications, data storage and protection, advertising, and online content. Laws in several jurisdictions, including EU Member State laws under the European Electronic Communications Code, increasingly define certain of our services as regulated telecommunications services. This trend may continue and will result in these offerings being subjected to additional data protection, security, law enforcement surveillance, and other obligations. Regulators and private litigants may assert that our collection, use, and management of customer data and other information is inconsistent with their laws and regulations, including laws that apply to the tracking of users via technology such as cookies. In addition, laws requiring us to retrieve and produce customer data in response to compulsory legal demands from law enforcement and governmental authorities are expanding and the requests we are experiencing are increasing in volume and complexity. New environmental, social, and governance laws and regulations are expanding mandatory disclosure, reporting, and diligence requirements. Legislative or regulatory action relating to cybersecurity requirements may increase the costs to develop, implement, or secure our products and services. Compliance with evolving digital accessibility laws and standards will require engineering and is important to our efforts to empower all people and organizations to achieve more. Legislative and regulatory action is emerging in the areas of AI and content moderation, which could increase costs or restrict opportunity. For example, in the EU, an AI Act is being considered, and may entail increased costs or decreased opportunities for the operation of our AI services in the European market.

How these laws and regulations apply to our business is often unclear, subject to change over time, and sometimes may be inconsistent from jurisdiction to jurisdiction. In addition, governments' approach to enforcement, and our products and services, are continuing to evolve. Compliance with existing, expanding, or new laws and regulations may involve significant costs or require changes in products or business practices that could adversely affect our results of operations. Noncompliance could result in the imposition of penalties, criminal sanctions, or orders we cease the alleged noncompliant activity. In addition, there is increasing pressure from advocacy groups, regulators, competitors, customers, and other stakeholders across many of these areas. If our products do not meet customer expectations or legal requirements, we could lose sales opportunities or face regulatory or legal actions.

We have claims and lawsuits against us that may result in adverse outcomes. We are subject to a variety of claims and lawsuits. These claims may arise from a wide variety of business practices and initiatives, including major new product releases such as Windows, AI services, significant business transactions, warranty or product claims, employment practices, and regulation. Adverse outcomes in some or all of these claims may result in significant monetary damages or injunctive relief that could adversely affect our ability to conduct our business. The litigation and other claims are subject to inherent uncertainties and management's view of these matters may change in the future. A material adverse impact in our consolidated financial statements could occur for the period in which the effect of an unfavorable outcome becomes probable and reasonably estimable.

Our business with government customers may present additional uncertainties. We derive substantial revenue from government contracts. Government contracts generally can present risks and challenges not present in private commercial agreements. For instance, we may be subject to government audits and investigations relating to these contracts, we could be suspended or debarred as a governmental contractor, we could incur civil and criminal fines and penalties, and under certain circumstances contracts may be rescinded. Some agreements may allow a government to terminate without cause and provide for higher liability limits for certain losses. Some contracts may be subject to periodic funding approval, reductions, cancellations, or delays which could adversely impact public-sector demand for our products and services. These events could negatively impact our results of operations, financial condition, and reputation.

We may have additional tax liabilities. We are subject to income taxes in the U.S. and many foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes. In the course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. For example, compliance with the 2017 United States Tax Cuts and Jobs Act ("TCJA") and possible future legislative changes may require the collection of information not regularly produced within the company, the use of estimates in our consolidated financial statements, and the exercise of significant judgment in accounting for its provisions. As regulations and guidance evolve with respect to the TCJA or possible future legislative changes, and as we gather more information and perform more analysis, our results may differ from previous estimates and may materially affect our consolidated financial statements.

We are regularly under audit by tax authorities in different jurisdictions. Although we believe that our provision for income taxes and our tax estimates are reasonable, tax authorities may disagree with certain positions we have taken. In addition, economic and political pressures to increase tax revenue in various jurisdictions may make resolving tax disputes favorably more difficult. We are currently under Internal Revenue Service ("IRS") audit for prior tax years and have received Notices of Proposed Adjustment ("NOPAs") from the IRS for the tax years 2004 to 2013. The primary issues in the NOPAs relate to intercompany transfer pricing. In the NOPAs, the IRS is seeking an additional tax payment of $28.9 billion plus penalties and interest. The final resolution of the proposed adjustments, and other audits or litigation, may differ from the amounts recorded in our consolidated financial statements and may materially affect our consolidated financial statements in the period or periods in which that determination is made.

We earn a significant amount of our operating income outside the U.S. A change in the mix of earnings and losses in countries with differing statutory tax rates, changes in our business or structure, or the expiration of or disputes about certain tax agreements in a particular country may result in higher effective tax rates for the company. In addition, changes in U.S. federal and state or international tax laws applicable to corporate multinationals, other fundamental law changes currently being considered by many countries, including in the U.S., and changes in taxing jurisdictions' administrative interpretations, decisions, policies, and positions may materially adversely impact our consolidated financial statements.

INTELLECTUAL PROPERTY RISKS

We face risks related to the protection and utilization of our intellectual property that may result in our business and operating results may be harmed. Protecting our intellectual property rights and combating unlicensed copying and use of our software and other intellectual property on a global basis is difficult. Similarly, the absence of harmonized patent laws makes it more difficult to ensure consistent respect for patent rights.

Changes in the law may continue to weaken our ability to prevent the use of patented technology or collect revenue for licensing our patents. Additionally, licensees of our patents may fail to satisfy their obligations to pay us royalties or may contest the scope and extent of their obligations. Finally, our increasing engagement with open source software will also cause us to license our intellectual property rights broadly in certain situations. If we are unable to protect our intellectual property, our revenue may be adversely affected.

Source code, the detailed program commands for our operating systems and other software programs, is critical to our business. If our source code leaks, we might lose future trade secret protection for that code. It may then become easier for third parties to compete with our products by copying functionality, which could adversely affect our revenue and operating results. Unauthorized disclosure of source code also could increase the security risks described elsewhere in these risk factors.

Third parties may claim that we infringe their intellectual property. From time to time, others claim we infringe their intellectual property rights, including current copyright infringement and other claims arising from AI training and output. To resolve these claims, we may enter into royalty and licensing agreements on terms that are less favorable than currently available, stop selling or redesign affected products or services, or pay damages to satisfy indemnification commitments with our customers. Adverse outcomes could also include monetary damages or injunctive relief that may limit or prevent importing, marketing, and selling our products or services that have infringing technologies. We have paid significant amounts to settle claims related to the use of technology and intellectual property rights and to procure intellectual property rights as part of our strategy to manage this risk, and may continue to do so.

GENERAL RISKS

If our reputation or our brands are damaged, our business and operating results may be harmed. Our reputation and brands are globally recognized and are important to our business. Our reputation and brands affect our ability to attract and retain consumer, business, and public-sector customers. There are numerous ways our reputation or brands could be damaged. These include product safety or quality issues, our environmental impact and sustainability, supply chain practices, or human rights record. We may experience backlash from customers, government entities, advocacy groups, employees, and other stakeholders that disagree with our product offering decisions or public policy positions. Damage to our reputation or our brands may occur from, among other things:

- The introduction of new features, products, services, or terms of service that customers, users, or partners do not like.
- Public scrutiny of our decisions regarding user privacy, data practices, or content.
- Data security breaches, compliance failures, or actions of partners or individual employees.

The proliferation of social media may increase the likelihood, speed, and magnitude of negative brand events. If our brands or reputation are damaged, it could negatively impact our revenues or margins, or ability to attract the most highly qualified employees.

Adverse economic or market conditions may harm our business. Worsening economic conditions, including inflation, recession, pandemic, or other changes in economic conditions, may cause lower IT spending and adversely affect our revenue. If demand for PCs, servers, and other computing devices declines, or consumer or business spending for those products declines, our revenue will be adversely affected.

Our product distribution system relies on an extensive partner and retail network. OEMs building devices that run our software have also been a significant means of distribution. The impact of economic conditions on our partners, such as the bankruptcy of a major distributor, OEM, or retailer, could cause sales channel disruption.

Challenging economic conditions also may impair the ability of our customers to pay for products and services they have purchased. As a result, allowances for doubtful accounts and write-offs of accounts receivable may increase.

We maintain an investment portfolio of various holdings, types, and maturities. These investments are subject to general credit, liquidity, market, and interest rate risks, which may be exacerbated by market downturns or events that affect global financial markets. A significant part of our investment portfolio comprises U.S. government securities. If global financial markets decline for long periods, or if there is a downgrade of the U.S. government credit rating due to an actual or threatened default on government debt, our investment portfolio may be adversely affected and we could determine that more of our investments have experienced a decline in fair value, requiring impairment charges that could adversely affect our consolidated financial statements.

Catastrophic events or geopolitical conditions may disrupt our business. A disruption or failure of our systems or operations because of a major earthquake, weather event, cyberattack, terrorist attack, pandemic, or other catastrophic event could cause delays in completing sales, providing services, or performing other critical functions. Our corporate headquarters, a significant portion of our research and development activities, and certain other essential business operations are in the Seattle, Washington area, and we have other business operations in the Silicon Valley area of California, both of which are seismically active regions. A catastrophic event that results in the destruction or disruption of any of our critical business or IT systems, or the infrastructure or systems they rely on, such as power grids, could harm our ability to conduct normal business operations. Providing our customers with more services and solutions in the cloud puts a premium on the resilience of our systems and strength of our business continuity management plans and magnifies the potential impact of prolonged service outages in our consolidated financial statements.

Abrupt political change, terrorist activity, and armed conflict, such as the ongoing conflict in Ukraine, pose economic and other risks, which may negatively impact our ability to sell to and collect from customers, increase our operating costs, or otherwise disrupt our operations in markets both directly and indirectly impacted by such events. These conditions also may add uncertainty to the timing and budget for technology investment decisions by our customers and may cause supply chain disruptions for hardware manufacturers. Geopolitical change may result in changing regulatory systems and requirements and market interventions that could impact our operating strategies, access to national, regional, and global markets, hiring, and profitability. Geopolitical instability may lead to sanctions and impact our ability to do business in some markets or with some public-sector customers. Any of these changes may negatively impact our revenues.

The occurrence of regional epidemics or a global pandemic, such as COVID-19, may adversely affect our operations, financial condition, and results of operations. The extent to which global pandemics impact our business going forward will depend on factors such as the duration and scope of the pandemic; governmental, business, and individuals' actions in response to the pandemic; and the impact on economic activity, including the possibility of recession or financial market instability. Measures to contain a global pandemic may intensify other risks described in these Risk Factors.

We may incur increased costs to effectively manage these aspects of our business. If we are unsuccessful, it may adversely impact our revenues, cash flows, market share growth, and reputation.

The long-term effects of climate change on the global economy and the IT industry in particular are unclear. Environmental regulations or changes in the supply, demand, or available sources of energy or other resources may affect the availability or cost of goods and services, including natural resources, necessary to run our business. Changes in climate where we operate may increase the costs of powering and cooling computer hardware we use to develop software and provide cloud-based services.

Our global business exposes us to operational and economic risks. Our customers are located throughout the world and a significant part of our revenue comes from international sales. The global nature of our business creates operational, economic, and geopolitical risks. Our results of operations may be affected by global, regional, and local economic developments, monetary policy, inflation, and recession, as well as political and military disputes. In addition, our international growth strategy includes certain markets, the developing nature of which presents several risks, including deterioration of social, political, labor, or economic conditions in a country or region, and difficulties in staffing and managing foreign operations. Emerging nationalist and protectionist trends and concerns about human rights, the environment, and political expression in specific countries may significantly alter the trade and commercial environments. Changes to trade policy or agreements as a result of populism, protectionism, or economic nationalism may result in higher tariffs, local sourcing initiatives, and non-local sourcing restrictions, export controls, investment restrictions, or other developments that make it more difficult to sell our products in foreign countries. Disruptions of these kinds in developed or emerging markets could negatively impact demand for our products and services, impair our ability to operate in certain regions, or increase operating costs. Although we hedge a portion of our international currency exposure, significant fluctuations in foreign exchange rates between the U.S. dollar and foreign currencies may adversely affect our results of operations.

Our business depends on our ability to attract and retain talented employees. Our business is based on successfully attracting and retaining talented employees representing diverse backgrounds, experiences, and skill sets. The market for highly skilled workers and leaders in our industry is extremely competitive. Maintaining our brand and reputation, as well as a diverse and inclusive work environment that enables all our employees to thrive, are important to our ability to recruit and retain employees. We are also limited in our ability to recruit internationally by restrictive domestic immigration laws. Restraints on the flow of technical and professional talent, including as a result of changes to U.S. immigration policies or laws, may inhibit our ability to adequately staff our research and development efforts. If we are less successful in our recruiting efforts, or if we cannot retain highly skilled workers and key leaders, our ability to develop and deliver successful products and services may be adversely affected. Effective succession planning is also important to our long-term success. Failure to ensure effective transfer of knowledge and smooth transitions involving key employees could hinder our strategic planning and execution. How employment-related laws are interpreted and applied to our workforce practices may result in increased operating costs and less flexibility in how we meet our workforce needs. Our global workforce is predominantly non-unionized, although we do have some employees in the U.S. and internationally who are represented by unions or works councils. In the U.S., there has been a general increase in workers exercising their right to form or join a union. The unionization of significant employee populations could result in higher costs and other operational changes necessary to respond to changing conditions and to establish new relationships with worker representatives.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

SHARE REPURCHASES AND DIVIDENDS

Following are our monthly share repurchases for the second quarter of fiscal year 2024:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs
				(In millions)
October 1, 2023 – October 31, 2023	380,292	$ 336.46	380,292	$ 18,621
November 1, 2023 – November 30, 2023	3,653,892	367.39	3,653,892	17,279
December 1, 2023 – December 31, 2023	3,575,759	371.85	3,575,759	15,949
	7,609,943		7,609,943	

All share repurchases were made using cash resources. Our share repurchases may occur through open market purchases or pursuant to a Rule 10b5-1 trading plan. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards.

Our Board of Directors declared the following dividends during the second quarter of fiscal year 2024:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
				(In millions)
November 28, 2023	**February 15, 2024**	**March 14, 2024**	**$ 0.75**	**$ 5,574**

We returned $8.4 billion to shareholders in the form of share repurchases and dividends in the second quarter of fiscal year 2024. Refer to Note 15 – Stockholders' Equity of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for further discussion regarding share repurchases and dividends.

ITEM 5. OTHER INFORMATION

Insider Trading Arrangements

None of our officers or directors, as defined in Rule 16a-1(f) of the Securities Exchange Act of 1934, adopted, modified, or terminated a “Rule 10b5-1 trading arrangement” or a “non-Rule 10b5-1 trading arrangement,” as defined in Item 408 of Regulation S-K, during the three months ended December 31, 2023.

ITEM 6. EXHIBITS

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
4.1	Fifteenth Supplemental Indenture, dated as of November 6, 2023, by and between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	11/06/2023
4.2	Registration Rights Agreement, dated as of November 6, 2023, by and among Microsoft Corporation, BofA Securities, Inc., J.P. Morgan Securities LLC, Wells Fargo Securities, LLC, Academy Securities, Inc., CastleOak Securities, L.P., Drexel Hamilton, LLC, Loop Capital Markets LLC, MFR Securities, Inc., Mischler Financial Group, Inc., RBC Capital Markets, LLC, Samuel A Ramirez & Company, Inc. and Siebert Williams Shank & Co., LLC		8-K		4.8	11/06/2023
4.3	Indenture, dated as of September 19, 2016, by and between Activision Blizzard, Inc. and Wells Fargo Bank, National Association, as Trustee, with respect to Activision Blizzard, Inc.'s 3.400% Senior Notes due 2026		8-K		4.9	11/06/2023
4.4	Base Indenture, dated as of May 26, 2017, by and between Activision Blizzard, Inc. and Wells Fargo Bank, National Association, as Trustee, with respect to Activision Blizzard, Inc.'s 3.400% Senior Notes due 2027, 1.350% Senior Notes due 2030, 4.500% Senior Notes due 2047 and 2.500% Senior Notes due 2050		8-K		4.10	11/06/2023
4.5	First Supplemental Indenture, dated as of May 26, 2017, by and between Activision Blizzard, Inc. and Wells Fargo Bank, National Association, as Trustee, with respect to Activision Blizzard, Inc.'s 3.400% Senior Notes due 2027 and 4.500% Senior Notes due 2047		8-K		4.11	11/06/2023
4.6	Second Supplemental Indenture, dated as of August 10, 2020, by and between Activision Blizzard, Inc. and Wells Fargo Bank, National Association, as Trustee, with respect to Activision Blizzard, Inc.'s 1.350% Senior Notes due 2030 and 2.500% Senior Notes due 2050		8-K		4.12	11/06/2023
4.7	First Supplemental Indenture, dated as of October 27, 2023, by and between Activision Blizzard, Inc. and Computershare Trust Company, N.A., with respect to Activision Blizzard, Inc.'s 3.400% Senior Notes due 2026		8-K		4.13	11/06/2023
4.8	Third Supplemental Indenture, dated as of October 27, 2023, by and between Activision Blizzard, Inc. and Computershare Trust Company, N.A., with respect to Activision Blizzard, Inc.'s 3.400% Senior Notes due 2027 and 4.500% Senior Notes due 2047		8-K		4.14	11/06/2023

4.9	Fourth Supplemental Indenture, dated as of October 27, 2023, by and between Activision Blizzard, Inc. and Computershare Trust Company, N.A., with respect to Activision Blizzard, Inc.'s 1.350% Senior Notes due 2030 and 2.500% Senior Notes due 2050		8-K	4.15	11/06/2023
15.1	Letter regarding unaudited interim financial information	X			
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X			
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X			
32.1*	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X			
32.2*	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X			
101.INS	Inline XBRL Instance Document–the instance document does not appear in the Interactive Data File as its XBRL tags are embedded within the Inline XBRL document	X			
101.SCH	Inline XBRL Taxonomy Extension Schema With Embedded Linkbase Documents	X			
104	Cover page formatted as Inline XBRL and contained in Exhibit 101	X			

* *Furnished, not filed.*

Items 3 and 4 are not applicable and have been omitted.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned; thereunto duly authorized.

MICROSOFT CORPORATION

/s/ ALICE L. JOLLA

Alice L. Jolla
Corporate Vice President and Chief Accounting Officer (Duly Authorized Officer)

January 30, 2024