Microsoft Cloud Growth Fuels Second Quarter Results

*Results include a net charge of $13.8 billion related to the Tax Cuts and Jobs Act*

**REDMOND, Wash. — January 31, 2018 —** Microsoft Corp. today announced the following results for the quarter ended December 31, 2017:

* Revenue was $28.9 billion and increased 12%
* Operating income was $8.7 billion and increased 10%
* GAAP net loss was $(6.3) billion and non-GAAP net income was $7.5 billion
* GAAP diluted loss per share was $(0.82) and non-GAAP diluted earnings per share was $0.96
* GAAP results include a $13.8 billion net charge related to the Tax Cuts and Jobs Act (TCJA)

“This quarter’s results speak to the differentiated value we are delivering to customers across our productivity solutions and as the hybrid cloud provider of choice,” said Satya Nadella, chief executive officer of Microsoft. “Our investments in IoT, data, and AI services across cloud and the edge position us to further accelerate growth.”

The following table reconciles our financial results reported in accordance with generally accepted accounting principles (GAAP) to non-GAAP financial results. Additional information regarding our non-GAAP definition is provided below. All growth comparisons relate to the corresponding period in the last fiscal year.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Three Months Ended December 31,** | | | |
| ($ in millions, except per share amounts) | **Revenue** | **Operating Income** | **Net Income (Loss)** | **Diluted Earnings (Loss) per Share** | |
| **2016 As Reported (GAAP)** | **$25,826** | **$7,905** | **$6,267** | **$0.80** | |
| **2017 As Reported (GAAP)** | **$28,918** | **$8,679** | **$(6,302)** | **$(0.82)** | |
| Net TCJA Impact | - | - | 13,800 | 1.78 | |
| **2017 As Adjusted for TCJA (non-GAAP)** | **$28,918** | **$8,679** | **$7,498** | **$0.96** | |
| Percentage Change Y/Y (GAAP) | 12% | 10% | (201%) | (203%) | |
| Percentage Change Y/Y (non-GAAP) | 12% | 10% | 20% | 20% | |
| Percentage Change Y/Y (non-GAAP) Constant Currency | 11% | 10% | 20% | 20% | |

GAAP results include a net charge of $13.8 billion related to TCJA, which is excluded from our non-GAAP results.

Microsoft returned $5.0 billion to shareholders in the form of share repurchases and dividends in the second quarter of fiscal year 2018.

“We delivered another strong quarter with commercial cloud revenue growing 56% year-over-year to $5.3 billion,” said Amy Hood, executive vice president and chief financial officer of Microsoft. "Strong execution from our sales teams and partners is driving growth across our businesses."

Revenue in Productivity and Business Processes was $9.0 billion and increased 25% (up 24% in constant currency), with the following business highlights:

* Office commercial products and cloud services revenue increased 10% (up 10% in constant currency) driven by Office 365 commercial revenue growth of 41% (up 41% in constant currency)
* Office consumer products and cloud services revenue increased 12% (up 11% in constant currency) and Office 365 consumer subscribers increased to 29.2 million
* Dynamics products and cloud services revenue increased 10% (up 9% in constant currency) driven by Dynamics 365 revenue growth of 67% (up 68% in constant currency)
* LinkedIn contributed revenue of $1.3 billion during the quarter with sessions growth of over 20% for the fifth consecutive quarter

Revenue in Intelligent Cloud was $7.8 billion and increased 15% (up 15% in constant currency), with the following business highlights:

* Server products and cloud services revenue increased 18% (up 18% in constant currency) driven by Azure revenue growth of 98% (up 98% in constant currency)
* Enterprise Services revenue increased 5% (up 3% in constant currency) driven by Premier Support Services

Revenue in More Personal Computing was $12.2 billion and increased 2% (up 2% in constant currency), with the following business highlights:

* Windows OEM revenue increased 4% (up 4% in constant currency) driven by OEM Pro revenue growth of 11%
* Windows commercial products and cloud services revenue decreased 4% (down 5% in constant currency) due to the impact of a prior year large deal
* Gaming revenue increased 8% (up 8% in constant currency) driven by Xbox hardware revenue growth from the Xbox One X launch
* Search advertising revenue excluding traffic acquisition costs increased 15% (up 15% in constant currency) driven by higher revenue per search and search volume
* Surface revenue increased 1% (relatively unchanged in constant currency)

**Business Outlook**

Microsoft will provide forward-looking guidance in connection with this quarterly earnings announcement on its earnings conference call and webcast.

**Webcast Details**

Satya Nadella, chief executive officer, Amy Hood, executive vice president and chief financial officer, Frank Brod, chief accounting officer, Carolyn Frantz, deputy general counsel and corporate secretary, and Chris Suh, general manager of Investor Relations, will host a conference call and webcast at 2:30 p.m. Pacific time (5:30 p.m. Eastern time) today to discuss details of the company’s performance for the quarter and certain forward-looking information. The session may be accessed at <http://www.microsoft.com/en-us/investor>. The webcast will be available for replay through the close of business on January 31, 2019.

**Non-GAAP Definition**

*TCJA Impact.* We recorded a net charge of $13.8 billion related to TCJA during the three months ended December 31, 2017. As of December 31, 2017, we have not completed our accounting for the tax effects of TCJA. Our net charge is provisional based on reasonable estimates for those tax effects. Changes to these estimates or new guidance issued by regulators may materially impact our provision for income taxes and effective tax rate in the period in which the adjustments are made. Our accounting for the tax effects of TCJA will be completed during the measurement period, which should not extend beyond the second fiscal quarter of 2019.

We have provided non-GAAP financial measures related to TCJA to aid investors in better understanding our performance. 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. The non-GAAP financial measures presented in this release should not be considered as a substitute for, or superior to, the measures of financial performance prepared in accordance with GAAP.

**New Accounting Standards**

We adopted new accounting standards related to revenue recognition and leases effective July 1, 2017. The prior periods presented here have been restated to reflect adoption of these new standards.

**Constant Currency**

Microsoft presents constant currency information to provide a framework for assessing how our underlying businesses performed excluding the effect of foreign currency rate fluctuations. To present this information, current and comparative prior period results for entities reporting in currencies other than United States dollars are converted into United States dollars using the average exchange rates from the comparative period rather than the actual exchange rates in effect during the respective periods. All growth comparisons relate to the corresponding period in the last fiscal year. Microsoft has provided this non-GAAP financial information to aid investors in better understanding the company’s performance. The non-GAAP financial measures presented in this release should not be considered as a substitute for, or superior to, the measures of financial performance prepared in accordance with GAAP.

**Financial Performance Constant Currency Reconciliation**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Three Months Ended December 31,** | | | |
| ($ in millions, except per share amounts) | **Revenue** | **Operating Income** | **Net Income (Loss)** | **Diluted Earnings (Loss) per Share** | |
| **2016 As Reported (GAAP)** | **$25,826** | **$7,905** | **$6,267** | **$0.80** | |
| **2017 As Reported (GAAP)** | **$28,918** | **$8,679** | **$(6,302)** | **$(0.82)** | |
| **2017 As Adjusted (non-GAAP)** | **$28,918** | **$8,679** | **$7,498** | **$0.96** | |
| Percentage Change Y/Y (GAAP) | 12% | 10% | (201%) | (203%) | |
| Percentage Change Y/Y (non-GAAP) | 12% | 10% | 20% | 20% | |
| **Constant Currency Impact** | **$124** | **$(26)** | **$6** | **$0.00** | |
| Percentage Change Y/Y (non-GAAP) Constant Currency | 11% | 10% | 20% | 20% | |

**Segment Revenue Constant Currency Reconciliation**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Three Months Ended December 31,** | | |
| ($ in millions) | **Productivity and Business Processes** | **Intelligent Cloud** | **More Personal Computing** |
| **2016 As Reported (GAAP)** | **$7,179** | **$6,758** | **$11,889** |
| **2017 As Reported (GAAP)** | **$8,953** | **$7,795** | **$12,170** |
| Percentage Change Y/Y (GAAP) | 25% | 15% | 2% |
| **Constant Currency Impact** | **$34** | **$49** | **$41** |
| Percentage Change Y/Y (non-GAAP) Constant Currency | 24% | 15% | 2% |

**Selected Product and Service Revenue Constant Currency Reconciliation**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Three Months Ended December 31, 2017** | | |
|  | **Percentage Change Y/Y (GAAP)** | **Constant Currency Impact** | **Percentage Change Y/Y Constant Currency** |
| **Office commercial products and cloud services** | **10%** | **0%** | **10%** |
| **Office 365 commercial** | **41%** | **0%** | **41%** |
| **Office consumer products and cloud services** | **12%** | **(1)%** | **11%** |
| **Dynamics products and cloud services** | **10%** | **(1)%** | **9%** |
| **Dynamics 365** | **67%** | **1%** | **68%** |
| **Server products and cloud services** | **18%** | **0%** | **18%** |
| **Azure** | **98%** | **0%** | **98%** |
| **Enterprise Services** | **5%** | **(2)%** | **3%** |
| **Windows OEM** | **4%** | **0%** | **4%** |
| **Windows commercial products and cloud services** | **(4)%** | **(1)%** | **(5)%** |
| **Search advertising excluding traffic acquisition costs** | **15%** | **0%** | **15%** |
| **Surface** | **1%** | **(1)%** | **0%** |
| **Gaming** | **8%** | **0%** | **8%** |

**About Microsoft**

Microsoft (Nasdaq “MSFT” @microsoft) enables digital transformation for the era of an intelligent cloud and an intelligent edge. Its mission is to empower every person and every organization on the planet to achieve more.

**Forward-Looking Statements**

Statements in this release that are “forward-looking statements” are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially because of factors such as:

* intense competition in all of our markets that may lead to lower revenue or operating margins;
* increasing focus on services presenting execution and competitive risks;
* significant investments in new products and services that may not achieve expected returns;
* acquisitions, joint ventures, and strategic alliances that may have an adverse effect on our business;
* impairment of goodwill or amortizable intangible assets causing a significant charge to earnings;
* a change in our ability to earn expected revenues from its intellectual property rights;
* claims that Microsoft has infringed the intellectual property rights of others;
* the possibility that we may fail to protect our source code;
* the possibility that we may not be able to protect information on our products and services from use by others;
* cyber-attacks and security vulnerabilities that could lead to reduced revenue, increased costs, liability claims, or harm to our reputation or competitive position;
* disclosure of personal data that could cause liability and harm to our reputation;
* abuse of our advertising or social platforms that may harm our reputation or user engagement;
* outages, data losses, and disruptions of our online services if we fail to maintain an adequate operations infrastructure;
* government litigation and regulatory activity relating to competition rules that may limit how we design and market our products;
* potential liability under trade protection, anti-corruption, and other laws resulting from our global operations;
* laws and regulations relating to the handling of personal data that may impede the adoption of our services or result in increased costs, legal claims, or fines against us;
* the dependence of our business on our ability to attract and retain talented employees;
* claims against us that may result in adverse outcomes in legal disputes;
* additional tax liabilities;
* quality or supply problems;
* exposure to increased economic and operational uncertainties from operating a global business, including the effects of foreign currency exchange;
* catastrophic events or geo-political conditions that may disrupt our business;
* adverse economic or market conditions that may harm our business; and
* changes in our sales organization that may impact revenues.

For more information about risks and uncertainties associated with Microsoft’s business, please refer to the “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Risk Factors” sections of Microsoft’s SEC filings, including, but not limited to, its annual report on Form 10-K and quarterly reports on Form 10-Q, copies of which may be obtained by contacting Microsoft’s Investor Relations department at (800) 285-7772 or at Microsoft’s Investor Relations website at <http://www.microsoft.com/en-us/investor>.

All information in this release is as of January 31, 2018. The company undertakes no duty to update any forward-looking statement to conform the statement to actual results or changes in the company’s expectations.

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Note to editors: For more information, news and perspectives from Microsoft, please visit the Microsoft News Center at <http://www.microsoft.com/news>. Web links, telephone numbers, and titles were correct at time of publication, but may since have changed. Shareholder and financial information, as well as today’s 2:30 p.m. Pacific time conference call with investors and analysts, is available at <http://www.microsoft.com/en-us/investor>.

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| **MICROSOFT CORPORATION** |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| INCOME STATEMENTS | | | | | | | |
| (In millions, except per share amounts)(Unaudited) | | | | | | | |
|  |  |  |  |  |  |  |  |
|  | **Three Months Ended December 31,** | | |  | **Six Months Ended December 31,** | | |
|  |  |
|  | **2017** |  | **2016** |  | **2017** |  | **2016** |
| Revenue: |  |  |  |  |  |  |  |
| Product | **$17,926** |  | $18,273 |  | **$32,224** |  | $33,241 |
| Service and other | **10,992** |  | 7,553 |  | **21,232** |  | 14,513 |
| Total revenue | **28,918** |  | 25,826 |  | **53,456** |  | 47,754 |
| Cost of revenue: |  |  |  |  |  |  |  |
| Product | **5,498** |  | 5,378 |  | **8,478** |  | 8,959 |
| Service and other | **5,566** |  | 4,523 |  | **10,864** |  | 8,786 |
| Total cost of revenue | **11,064** |  | 9,901 |  | **19,342** |  | 17,745 |
| Gross margin | **17,854** |  | 15,925 |  | **34,114** |  | 30,009 |
| Research and development | **3,504** |  | 3,062 |  | **7,078** |  | 6,168 |
| Sales and marketing | **4,562** |  | 4,079 |  | **8,374** |  | 7,297 |
| General and administrative | **1,109** |  | 879 |  | **2,275** |  | 1,924 |
| Operating income | **8,679** |  | 7,905 |  | **16,387** |  | 14,620 |
| Other income, net | **490** |  | 117 |  | **766** |  | 229 |
| Income before income taxes | **9,169** |  | 8,022 |  | **17,153** |  | 14,849 |
| Provision for income taxes | **15,471** |  | 1,755 |  | **16,879** |  | 2,915 |
| Net income (loss) | **$(6,302)** |  | $6,267 |  | **$274** |  | $11,934 |
| Earnings (loss) per share: |  |  |  |  |  |  |  |
| Basic | **$(0.82)** |  | $0.81 |  | **$0.04** |  | $1.54 |
| Diluted | **$(0.82)** |  | $0.80 |  | **$0.04** |  | $1.52 |
| Weighted average shares outstanding: |  |  |  |  |  |  |  |
| Basic | **7,710** |  | 7,755 |  | **7,709** |  | 7,772 |
| Diluted | **7,710** |  | 7,830 |  | **7,799** |  | 7,853 |
| Cash dividends declared per  common share | **$0.42** |  | $0.39 |  | **$0.84** |  | $0.78 |

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| --- | --- | --- | --- | --- | --- | --- | --- |
| COMPREHENSIVE INCOME STATEMENTS | | | | | | | |
| (In millions)(Unaudited) | | | | | | | |
|  |  |  |  |  |  |  |  |
|  | **Three Months Ended December 31,** | | |  | **Six Months Ended December 31,** | | |
|  |  |
|  | **2017** |  | **2016** |  | **2017** |  | **2016** |
| Net income (loss) | **$(6,302)** |  | $6,267 |  | **$274** |  | $11,934 |
| Other comprehensive income (loss),  net of tax: |  |  |  |  |  |  |  |
| Net change related to derivatives | **(7)** |  | 280 |  | **(113)** |  | 243 |
| Net change related to investments | **(878)** |  | (994) |  | **(1,166)** |  | (911) |
| Translation adjustments and other | **(40)** |  | (592) |  | **253** |  | (474) |
| Other comprehensive loss | **(925)** |  | (1,306) |  | **(1,026)** |  | (1,142) |
| Comprehensive income (loss) | **$(7,227)** |  | $4,961 |  | **$(752)** |  | $10,792 |

|  |  |  |  |
| --- | --- | --- | --- |
| BALANCE SHEETS | | | |
| (In millions)(Unaudited) | | | |
|  |  |  |  |
|  | **December 31, 2017** |  | **June 30, 2017** |
| **Assets** |  |  |  |
| Current assets: |  |  |  |
| Cash and cash equivalents | **$12,859** |  | $7,663 |
| Short-term investments (including securities  loaned of **$4,247** and $3,694) | **129,921** |  | 125,318 |
| Total cash, cash equivalents, and short-term investments | **142,780** |  | 132,981 |
| Accounts receivable, net of allowance for doubtful  accounts of **$337** and $345 | **18,428** |  | 22,431 |
| Inventories | **2,003** |  | 2,181 |
| Other | **4,422** |  | 5,103 |
| Total current assets | **167,633** |  | 162,696 |
| Property and equipment, net of accumulated  depreciation of **$26,849** and $24,179 | **26,304** |  | 23,734 |
| Operating lease right-of-use assets | **6,749** |  | 6,555 |
| Equity and other investments | **3,961** |  | 6,023 |
| Goodwill | **35,355** |  | 35,122 |
| Intangible assets, net | **9,034** |  | 10,106 |
| Other long-term assets | **6,967** |  | 6,076 |
| Total assets | **$256,003** |  | $250,312 |
| **Liabilities and stockholders' equity** |  |  |  |
| Current liabilities: |  |  |  |
| Accounts payable | **$7,850** |  | $7,390 |
| Short-term debt | **12,466** |  | 9,072 |
| Current portion of long-term debt | **3,446** |  | 1,049 |
| Accrued compensation | **4,427** |  | 5,819 |
| Short-term income taxes | **788** |  | 718 |
| Short-term unearned revenue | **21,309** |  | 24,013 |
| Securities lending payable | **26** |  | 97 |
| Other | **7,787** |  | 7,587 |
| Total current liabilities | **58,099** |  | 55,745 |
| Long-term debt | **73,348** |  | 76,073 |
| Long-term income taxes | **30,050** |  | 13,485 |
| Long-term unearned revenue | **2,500** |  | 2,643 |
| Deferred income taxes | **3,186** |  | 5,734 |
| Operating lease liabilities | **5,640** |  | 5,372 |
| Other long-term liabilities | **4,820** |  | 3,549 |
| Total liabilities | **177,643** |  | 162,601 |
| Commitments and contingencies |  |  |  |
| Stockholders' equity: |  |  |  |
| Common stock and paid-in capital - shares  authorized 24,000; outstanding **7,705** and 7,708 | **70,192** |  | 69,315 |
| Retained earnings | **8,567** |  | 17,769 |
| Accumulated other comprehensive income (loss) | **(399)** |  | 627 |
| Total stockholders' equity | **78,360** |  | 87,711 |
| Total liabilities and stockholders' equity | **$256,003** |  | $250,312 |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| CASH FLOWS STATEMENTS | | | | | | | |
| (In millions)(Unaudited) | | | | | | | |
|  |  |  |  |  |  |  |  |
|  | **Three Months Ended December 31,** | | |  | **Six Months Ended December 31,** | | |
|  |  |
|  | **2017** |  | **2016** |  | **2017** |  | **2016** |
| **Operations** |  |  |  |  |  |  |  |
| Net income (loss) | **$(6,302)** |  | $6,267 |  | **$274** |  | $11,934 |
| Adjustments to reconcile net income   (loss) to net cash from operations: |  |  |  |  |  |  |  |
| Depreciation, amortization, and other | **2,536** |  | 2,166 |  | **5,035** |  | 3,982 |
| Stock-based compensation expense | **986** |  | 767 |  | **1,959** |  | 1,470 |
| Net recognized gains on  investments and derivatives | **(684)** |  | (652) |  | **(1,207)** |  | (963) |
| Deferred income taxes | **(2,305)** |  | 5 |  | **(2,358)** |  | 545 |
| Changes in operating assets and   liabilities: |  |  |  |  |  |  |  |
| Accounts receivable | **(3,908)** |  | (2,789) |  | **4,041** |  | 4,398 |
| Inventories | **1,205** |  | 1,132 |  | **182** |  | 265 |
| Other current assets | **354** |  | 1,300 |  | **36** |  | 335 |
| Other long-term assets | **(344)** |  | (200) |  | **(622)** |  | (293) |
| Accounts payable | **938** |  | 99 |  | **531** |  | (344) |
| Unearned revenue | **(1,065)** |  | (1,077) |  | **(2,871)** |  | (2,884) |
| Income taxes | **15,974** |  | 843 |  | **16,635** |  | 1,407 |
| Other current liabilities | **643** |  | (1,267) |  | **(1,521)** |  | (1,727) |
| Other long-term liabilities | **(153)** |  | (301) |  | **201** |  | (283) |
| Net cash from operations | **7,875** |  | 6,293 |  | **20,315** |  | 17,842 |
| **Financing** |  |  |  |  |  |  |  |
| Proceeds from issuance  (repayments) of short-term debt,  maturities of 90 days or less, net | **3,759** |  | (3,755) |  | **49** |  | (7,145) |
| Proceeds from issuance of debt | **3,229** |  | 17,069 |  | **7,183** |  | 42,046 |
| Repayments of debt | **(3,327)** |  | (4,118) |  | **(4,496)** |  | (4,343) |
| Common stock issued | **189** |  | 131 |  | **496** |  | 372 |
| Common stock repurchased | **(2,008)** |  | (3,599) |  | **(4,578)** |  | (7,961) |
| Common stock cash dividends paid | **(3,238)** |  | (3,024) |  | **(6,241)** |  | (5,824) |
| Other, net | **(156)** |  | 312 |  | **(306)** |  | 200 |
| Net cash from (used in) financing | **(1,552)** |  | 3,016 |  | **(7,893)** |  | 17,345 |
| **Investing** |  |  |  |  |  |  |  |
| Additions to property and equipment | **(2,586)** |  | (1,988) |  | **(4,718)** |  | (4,151) |
| Acquisition of companies, net of  cash acquired, and purchases of  intangible and other assets | **(27)** |  | (24,760) |  | **(206)** |  | (24,784) |
| Purchases of investments | **(45,154)** |  | (46,775) |  | **(78,115)** |  | (103,956) |
| Maturities of investments | **6,352** |  | 8,715 |  | **11,578** |  | 17,374 |
| Sales of investments | **41,261** |  | 48,987 |  | **64,297** |  | 81,310 |
| Securities lending payable | **(177)** |  | 1,070 |  | **(71)** |  | 986 |
| Net cash used in investing | **(331)** |  | (14,751) |  | **(7,235)** |  | (33,221) |
| Effect of foreign exchange rates on   cash and cash equivalents | **(17)** |  | (18) |  | **9** |  | (8) |
| Net change in cash and cash equivalents | **5,975** |  | (5,460) |  | **5,196** |  | 1,958 |
| Cash and cash equivalents,  beginning of period | **6,884** |  | 13,928 |  | **7,663** |  | 6,510 |
| Cash and cash equivalents, end of period | **$12,859** |  | $8,468 |  | **$12,859** |  | $8,468 |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| SEGMENT REVENUE AND OPERATING INCOME | | | | | | | |
| (In millions)(Unaudited) | | | | | | | |
|  |  |  |  |  |  |  |  |
|  | **Three Months Ended December 31,** | | |  | **Six Months Ended December 31,** | | |
|  |  |
|  | **2017** |  | **2016** |  | **2017** |  | **2016** |
| **Revenue** |  |  |  |  |  |  |  |
| Productivity and Business Processes | **$8,953** |  | $7,179 |  | **$17,191** |  | $13,615 |
| Intelligent Cloud | **7,795** |  | 6,758 |  | **14,717** |  | 12,855 |
| More Personal Computing | **12,170** |  | 11,889 |  | **21,548** |  | 21,284 |
| Total | **$28,918** |  | $25,826 |  | **$53,456** |  | $47,754 |
| **Operating Income** |  |  |  |  |  |  |  |
| Productivity and Business Processes | **$3,337** |  | $3,053 |  | **$6,343** |  | $5,958 |
| Intelligent Cloud | **2,832** |  | 2,291 |  | **4,969** |  | 4,068 |
| More Personal Computing | **2,510** |  | 2,561 |  | **5,075** |  | 4,594 |
| Total | **$8,679** |  | $7,905 |  | **$16,387** |  | $14,620 |