Microsoft Cloud and Devices Momentum Highlights Second Quarter Results

*Commercial cloud revenue grows triple-digits for the sixth consecutive quarter, reaching an annualized revenue run rate of $5.5 billion*

**REDMOND, Wash. — January 26, 2015 —** Microsoft Corp. today announced revenue of $26.5 billion for the quarter ended December 31, 2014. Gross margin, operating income, and diluted earnings per share (“EPS”) for the quarter were $16.3 billion, $7.8 billion, and $0.71 per share, respectively.

These financial results include $243 million of integration and restructuring expenses, or a $0.02 per share negative impact, related to both Microsoft’s restructuring plan announced in July 2014 and the ongoing integration of the Nokia Devices and Services (“NDS”) business. There is also a $0.04 per share negative impact related to income tax expense resulting from an IRS audit adjustment.

Microsoft also announced its intention to complete the existing $40 billion share repurchase authorization by December 31, 2016.

The following table notes the impact of the integration and restructuring expenses on the company’s financial performance (“Noted Items”). This financial information is provided to aid investors in better understanding the company’s performance. All growth comparisons relate to the corresponding period in the last fiscal year.

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| --- | --- | --- | --- | --- |
|  | **Three Months Ended December 31,** | | | |
| ($ in millions, except per share amounts) | **Revenue** | **Gross Margin** | **Operating Income** | **Diluted EPS** |
| **2013 As Reported (GAAP)** | **$24,519** | **$16,197** | **$7,969** | **$0.78** |
| **2014 As Reported (GAAP)** | **$26,470** | **$16,334** | **$7,776** | **$0.71** |
| **%Y/Y (GAAP)** | **8%** | **1%** | **(2)%** | **(9)%** |
| **2014 Impact of Noted Items** | **-** | **-** | **$(243)** | **$(0.02)** |

“Microsoft is continuing to transform, executing against our strategic priorities and extending our cloud leadership,” said Satya Nadella, chief executive officer of Microsoft.  “We are taking bold steps forward across our business, and specifically with Windows 10, to deliver new experiences, new categories, and new opportunities to our customers.”

“We remain disciplined in our approach to operational and execution excellence, balanced with investments that drive meaningful growth for the business while increasing capital return to shareholders,” said Amy Hood, executive vice president and chief financial officer of Microsoft.

Devices and Consumer revenue grew 8% to $12.9 billion, with the following business highlights:

* Surface revenue of $1.1 billion, up 24%, driven by Surface Pro 3 and accessories
* Office 365 Home and Personal subscribers increased to over 9.2 million, up 30% sequentially over prior quarter
* Search advertising revenue grew 23%, with Bing U.S. market share at 19.7%, up 150 basis points over prior year
* Xbox console sales totaled 6.6 million units, with strong holiday season performance
* Phone Hardware revenue of $2.3 billion, with 10.5 million Lumia units sold driven by growth in affordable smartphones
* Windows OEM Pro revenue declined 13%; revenue was impacted by the business PC market and Pro mix returning to pre-Windows XP end of support levels and by new lower-priced licenses for devices sold to academic customers
* Windows OEM non-Pro revenue declined 13%, with license growth from opening price point devices

Commercial revenue grew 5% to $13.3 billion, with the following business highlights:

* Commercial cloud revenue grew 114% driven by Office 365, Azure and Dynamics CRM Online, and is now on an annualized revenue run rate of $5.5 billion
* Office Commercial products and services revenue declined 1%; transactional revenue was impacted by the continued transition to Office 365 and declines in commercial PCs following the XP refresh cycle
* Server products and services revenue grew 9%, with double-digit growth of SQL Server and System Center
* Windows volume licensing revenue increased by 3%, with annuity revenue growth partially offset by declining transactional revenue

“We again saw enthusiasm and demand around our cloud offerings like Office 365, Dynamics CRM Online and Azure, as well as Surface Pro 3,” said Kevin Turner, chief operating officer at Microsoft. “Our sales engagement worldwide continues to focus on helping customers and partners transition to the cloud and navigate the shifting product mix related to our services and solutions.”

**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, John Seethoff, deputy general counsel, and Chris Suh, general manager of Investor Relations, will host a conference call and webcast at 2:30 p.m. PST (5:30 p.m. EST) 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/investor>. The webcast will be available for replay through the close of business on January 26, 2016.

**Noted Items Definition**

Integration and restructuring expenses were $243 million during the three months ended December 31, 2014. Integration and restructuring expenses include employee severance expenses and costs associated with the consolidation of facilities and manufacturing operations, including asset write-downs and contract termination costs, resulting from Microsoft’s restructuring plan. Integration and restructuring expenses also include systems consolidation and other business integration expenses, as well as transaction fees and direct acquisition costs, associated with the acquisition of NDS.

**About Microsoft**

Founded in 1975, Microsoft (Nasdaq “MSFT”) is the worldwide leader in software, services, devices, and solutions that help people and businesses realize their full potential.

**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 Microsoft’s markets;
* increasing focus on services presents execution and competitive risks;
* significant investments in new products and services that may not be profitable;
* acquisitions, joint ventures, and strategic alliances may have an adverse effect on our business;
* impairment of goodwill or amortizable intangible assets causing a significant charge to earnings;
* Microsoft’s continued ability to protect and earn revenues from its intellectual property rights;
* claims that Microsoft has infringed the intellectual property rights of others;
* the possibility of unauthorized disclosure of significant portions of Microsoft’s source code;
* cyber-attacks and security vulnerabilities in Microsoft products and services that could reduce revenue or lead to liability;
* disclosure of personal data that could cause liability and harm to Microsoft’s reputation;
* outages, data losses, and disruptions of our online services if we fail to maintain an adequate operations infrastructure;
* government litigation and regulation that may limit how Microsoft designs and markets its products;
* potential liability under trade protection and anti-corruption laws resulting from our international operations;
* Microsoft’s ability to attract and retain talented employees;
* adverse results in legal disputes;
* unanticipated tax liabilities;
* Microsoft’s hardware and software products may experience quality or supply problems;
* exposure to increased economic and operational uncertainties from operating a global business;
* catastrophic events or geo-political conditions may disrupt our business; and
* adverse economic or market conditions may harm our business.

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/investor>.

All information in this release is as of January 26, 2015. 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. PST conference call with investors and analysts, is available at <http://www.microsoft.com/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,** | | |
|  | |  |  |
|  | | **2014** | |  |  | **2013** |  | **2014** |  | **2013** |
| Revenue | | **$ 26,470** | |  |  | $24,519 |  | **$ 49,671** |  | $43,048 |
| Cost of revenue | | **10,136** | |  |  | 8,322 |  | **18,409** |  | 13,467 |
| Gross margin | | **16,334** | |  |  | 16,197 |  | **31,262** |  | 29,581 |
| Research and development | | **2,903** | |  |  | 2,748 |  | **5,968** |  | 5,515 |
| Sales and marketing | | **4,315** | |  |  | 4,283 |  | **8,043** |  | 7,587 |
| General and administrative | | **1,097** | |  |  | 1,197 |  | **2,248** |  | 2,176 |
| Integration and restructuring | | **243** | |  |  | 0 |  | **1,383** |  | 0 |
| Operating income | | **7,776** | |  |  | 7,969 |  | **13,620** |  | 14,303 |
| Other income (expense), net | | **74** | |  |  | (91) |  | **126** |  | (17) |
| Income before income taxes | | **7,850** | |  |  | 7,878 |  | **13,746** |  | 14,286 |
| Provision for income taxes | | **1,987** | |  |  | 1,320 |  | **3,343** |  | 2,484 |
| Net income | | **$ 5,863** | |  |  | $ 6,558 |  | **$ 10,403** |  | $11,802 |
|  | |  | |  |  |  |  |  |  |  |
| Earnings per share: | |  | |  |  |  |  |  |  |  |
| Basic | | **$ 0.71** | |  |  | $ 0.79 |  | **$ 1.26** |  | $ 1.42 |
| Diluted | | **$ 0.71** | |  |  | $ 0.78 |  | **$ 1.25** |  | $ 1.40 |
| Weighted average shares outstanding: | | | |  |  |  |  |  |  |  |
| Basic | | **8,228** | |  |  | 8,326 |  | **8,238** |  | 8,333 |
| Diluted | | **8,297** | |  |  | 8,395 |  | **8,321** |  | 8,423 |
| Cash dividends declared per  common share | | **$ 0.31** | |  |  | $ 0.28 |  | **$ 0.62** |  | $ 0.56 |

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| **MICROSOFT CORPORATION** |  |  |  |  |  |  |  |
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| COMPREHENSIVE INCOME STATEMENTS | | | | | | | |
| (In millions)(Unaudited) | | | | | | | |
|  |  |  |  |  |  |  |  |
|  | **Three Months Ended December 31,** | | |  | **Six Months Ended December 31,** | | |
|  |  |
|  | **2014** |  | **2013** |  | **2014** |  | **2013** |
| Net income | **$ 5,863** |  | $ 6,558 |  | **$ 10,403** |  | $11,802 |
| Other comprehensive income (loss): | |  |  |  |  |  |  |
| Net unrealized gains on   derivatives (net of tax effects   of **$6**, $1, **$10**   and $(2)) | **247** |  | 43 |  | **566** |  | 17 |
| Net unrealized gains (losses) on   investments (net of tax   effects of **$(124)**, $245,   **$(226)** and $737) | **(231)** |  | 482 |  | **(420)** |  | 1,434 |
| Translation adjustments and   other (net of tax effects   of **$(211)**, $11, **$(258)**   and $44) | **(390)** |  | 21 |  | **(471)** |  | 83 |
| Other comprehensive income   (loss) | **(374)** |  | 546 |  | **(325)** |  | 1,534 |
| Comprehensive income | **$ 5,489** |  | $ 7,104 |  | **$ 10,078** |  | $13,336 |

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| **MICROSOFT CORPORATION** | | | |  | | |  | |  | | |
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| BALANCE SHEETS | | | | | | | | | | | |
| (In millions)(Unaudited) | | | | | | | | | | | |
|  | | | |  | | |  | |  | | |
|  | | | | **December 31, 2014** | | |  | | **June 30, 2014** | | |
| **Assets** | | | |  | | |  | |  | | |
| Current assets: | | | |  | | |  | |  | | |
| Cash and cash equivalents | | | | **$ 6,426** | | |  | | $ 8,669 | | |
| Short-term investments (including securities  loaned of **$414** and $541) | | | | **83,823** | | |  | | 77,040 | | |
| Total cash, cash equivalents, and short-term   investments | | | | **90,249** | | |  | | 85,709 | | |
| Accounts receivable, net of allowance for doubtful  accounts of **$288** and $301 | | | | **16,186** | | |  | | 19,544 | | |
| Inventories | | | | **2,053** | | |  | | 2,660 | | |
| Deferred income taxes | | | | **1,701** | | |  | | 1,941 | | |
| Other | | | | **6,173** | | |  | | 4,392 | | |
| Total current assets | | | | **116,362** | | |  | | 114,246 | | |
| Property and equipment, net of accumulated  depreciation of **$16,192** and $14,793 | | | | **13,607** | | |  | | 13,011 | | |
| Equity and other investments | | | | **12,665** | | |  | | 14,597 | | |
| Goodwill | | | | **21,855** | | |  | | 20,127 | | |
| Intangible assets, net | | | | **7,299** | | |  | | 6,981 | | |
| Other long-term assets | | | | **3,060** | | |  | | 3,422 | | |
| Total assets | | | | **$ 174,848** | | |  | | $ 172,384 | | |
|  | | | |  | | |  | |  | | |
| **Liabilities and stockholders' equity** | | | |  | | |  | |  | | |
| Current liabilities: | | | |  | | |  | |  | | |
| Accounts payable | | | | **$ 6,932** | | |  | | $ 7,432 | | |
| Short-term debt | | | | **8,299** | | |  | | 2,000 | | |
| Current portion of long-term debt | | | | **1,749** | | |  | | 0 | | |
| Accrued compensation | | | | **3,479** | | |  | | 4,797 | | |
| Income taxes | | | | **711** | | |  | | 782 | | |
| Short-term unearned revenue | | | | **19,192** | | |  | | 23,150 | | |
| Securities lending payable | | | | **430** | | |  | | 558 | | |
| Other | | | | **6,623** | | |  | | 6,906 | | |
| Total current liabilities | | | | **47,415** | | |  | | 45,625 | | |
| Long-term debt | | | | **18,260** | | |  | | 20,645 | | |
| Long-term unearned revenue | | | | **2,051** | | |  | | 2,008 | | |
| Deferred income taxes | | | | **2,820** | | |  | | 2,728 | | |
| Other long-term liabilities | | | | **12,423** | | |  | | 11,594 | | |
| Total liabilities | | | | **82,969** | | |  | | 82,600 | | |
| Commitments and contingencies | | | |  | | |  | |  | | |
| Stockholders' equity: | | | |  | | |  | |  | | |
| Common stock and paid-in capital - shares  authorized 24,000; outstanding **8,218** and 8,239 | | | | **68,765** | | |  | | 68,366 | | |
| Retained earnings | | | | **19,731** | | |  | | 17,710 | | |
| Accumulated other comprehensive income | | | | **3,383** | | |  | | 3,708 | | |
| Total stockholders' equity | | | | **91,879** | | |  | | 89,784 | | |
| Total liabilities and stockholders' equity | | | | **$ 174,848** | | |  | | $ 172,384 | | |
| **MICROSOFT CORPORATION** |  |  |  | |  |  | |  | |  |
|  |  |  |  | |  |  | |  | |  |
| CASH FLOWS STATEMENTS | | | | | | | | | | |
| (In millions)(Unaudited) | | | | | | | | | | |
|  |  |  |  | |  |  | |  | |  |
|  | **Three Months Ended December 31,** | | | |  | **Six Months Ended December 31,** | | | | |
|  |  |
|  | **2014** |  | **2013** | |  | **2014** | |  | | **2013** |
| **Operations** |  |  |  | |  |  | |  | |  |
| Net income | **$ 5,863** |  | $ 6,558 | |  | **$ 10,403** | |  | | $11,802 |
| Adjustments to reconcile net   income to net cash from   operations: |  |  |  | |  |  | |  | |  |
| Depreciation, amortization, and  other | **1,521** |  | 1,261 | |  | **2,949** | |  | | 2,215 |
| Stock-based compensation  expense | **633** |  | 591 | |  | **1,279** | |  | | 1,226 |
| Net recognized losses (gains)  on investments and  derivatives | **(179)** |  | 47 | |  | **(124)** | |  | | 140 |
| Excess tax benefits from  stock-based compensation | **(22)** |  | (20) | |  | **(524)** | |  | | (225) |
| Deferred income taxes | **314** |  | (176) | |  | **615** | |  | | 228 |
| Deferral of unearned revenue | **10,200** |  | 9,845 | |  | **18,222** | |  | | 17,281 |
| Recognition of unearned  revenue | **(11,495)** |  | (10,578) | |  | **(22,138)** | |  | | (20,255) |
| Changes in operating assets  and liabilities: |  |  |  | |  |  | |  | |  |
| Accounts receivable | **(3,378)** |  | (4,875) | |  | **3,249** | |  | | 1,742 |
| Inventories | **1,070** |  | 1,029 | |  | **587** | |  | | 362 |
| Other current assets | **(159)** |  | (95) | |  | **(439)** | |  | | (651) |
| Other long-term assets | **170** |  | (315) | |  | **449** | |  | | (396) |
| Accounts payable | **137** |  | 602 | |  | **(522)** | |  | | 326 |
| Other current liabilities | **(986)** |  | 388 | |  | **(2,152)** | |  | | (867) |
| Other long-term liabilities | **651** |  | 151 | |  | **840** | |  | | (310) |
| Net cash from operations | **4,340** |  | 4,413 | |  | **12,694** | |  | | 12,618 |
| **Financing** |  |  |  | |  |  | |  | |  |
| Proceeds from issuance of  short-term debt, maturities of  90 days or less, net | **4,798** |  | (712) | |  | **7,797** | |  | | 0 |
| Proceeds from issuance of debt | **0** |  | 8,262 | |  | **0** | |  | | 8,850 |
| Repayments of debt | **0** |  | (588) | |  | **(1,500)** | |  | | (1,588) |
| Common stock issued | **121** |  | 117 | |  | **337** | |  | | 320 |
| Common stock repurchased | **(2,145)** |  | (2,113) | |  | **(5,033)** | |  | | (4,301) |
| Common stock cash dividends paid | **(2,547)** |  | (2,332) | |  | **(4,854)** | |  | | (4,248) |
| Excess tax benefits from  stock-based compensation | **22** |  | 20 | |  | **524** | |  | | 225 |
| Other | **285** |  | (39) | |  | **285** | |  | | (39) |
| Net cash from (used in)  financing | **534** |  | 2,615 | |  | **(2,444)** | |  | | (781) |
| **Investing** |  |  |  | |  |  | |  | |  |
| Additions to property and  equipment | **(1,490)** |  | (1,732) | |  | **(2,772)** | |  | | (2,963) |
| Acquisition of companies, net of  cash acquired, and purchases of  intangible and other assets | **(2,794)** |  | (139) | |  | **(2,935)** | |  | | (154) |
| Purchases of investments | **(19,167)** |  | (13,126) | |  | **(43,252)** | |  | | (27,894) |
| Maturities of investments | **2,389** |  | 1,451 | |  | **4,082** | |  | | 1,798 |
| Sales of investments | **16,108** |  | 12,354 | |  | **32,553** | |  | | 23,471 |
| Securities lending payable | **238** |  | 167 | |  | **(129)** | |  | | 103 |
| Net cash used in investing | **(4,716)** |  | (1,025) | |  | **(12,453)** | |  | | (5,639) |
| Effect of exchange rates on cash  and cash equivalents | **(34)** |  | 33 | |  | **(40)** | |  | | 57 |
| Net change in cash and cash  equivalents | **124** |  | 6,036 | |  | **(2,243)** | |  | | 6,255 |
| Cash and cash equivalents,  beginning of period | **6,302** |  | 4,023 | |  | **8,669** | |  | | 3,804 |
| Cash and cash equivalents, end of  period | **$ 6,426** |  | $10,059 | |  | **$ 6,426** | |  | | $10,059 |

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| **MICROSOFT CORPORATION** |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| SEGMENT REVENUE AND GROSS MARGIN | | | | | | | |
| (In millions)(Unaudited) | | | | | | | |
|  |  |  |  |  |  |  |  |
|  | **Three Months Ended December 31,** | | |  | **Six Months Ended December 31,** | | |
|  |  |
|  | **2014** |  | **2013** |  | **2014** |  | **2013** |
| **Revenue** |  |  |  |  |  |  |  |
| Devices and Consumer Licensing | **$ 4,167** |  | $ 5,544 |  | **$ 8,260** |  | $10,028 |
| Computing and Gaming Hardware | **3,997** |  | 4,470 |  | **6,450** |  | 5,879 |
| Phone Hardware | **2,284** |  | 0 |  | **4,893** |  | 0 |
| Devices and Consumer Other | **2,436** |  | 1,874 |  | **4,245** |  | 3,428 |
| Commercial Licensing | **10,679** |  | 10,906 |  | **20,552** |  | 20,517 |
| Commercial Other | **2,593** |  | 1,780 |  | **5,000** |  | 3,382 |
| Corporate and Other | **314** |  | (55) |  | **271** |  | (186) |
| Total revenue | **$ 26,470** |  | $24,519 |  | **$ 49,671** |  | $43,048 |
|  |  |  |  |  |  |  |  |
| **Gross Margin** |  |  |  |  |  |  |  |
| Devices and Consumer Licensing | **$ 3,876** |  | $ 4,981 |  | **$ 7,694** |  | $ 8,901 |
| Computing and Gaming Hardware | **460** |  | 411 |  | **939** |  | 616 |
| Phone Hardware | **331** |  | 0 |  | **809** |  | 0 |
| Devices and Consumer Other | **550** |  | 387 |  | **862** |  | 711 |
| Commercial Licensing | **9,926** |  | 10,080 |  | **19,026** |  | 18,885 |
| Commercial Other | **900** |  | 415 |  | **1,705** |  | 689 |
| Corporate and Other | **291** |  | (77) |  | **227** |  | (221) |
| Total gross margin | **$ 16,334** |  | $16,197 |  | **$ 31,262** |  | $29,581 |