

COMPANY PROFILE

Microsoft Corporation

TABLE OF CONTENTS

Company Overview 3
Key Facts 3
SWOT Analysis 4

COMPANY OVERVIEW

Microsoft Corporation (Microsoft or "the company") develops, licenses, and supports a range of software products and services. The company offers products, including operating systems; cross-device productivity applications; server applications; business solution applications; desktop and server management tools; software development tools; video games; and training and certification of computer system integrators and developers. The company operates globally and has offices in more than 190 countries. It is headquartered in Redmond, Washington.

The company reported revenues of (US Dollars) US\$85,320 million for the fiscal year ended June 2016 (FY2016), a decrease of 8.8% over FY2015. In FY2016, the company's operating margin was 23.3%, compared to an operating margin of 19.2% in FY2015. In FY2016, the company recorded a net margin of 19.7%, compared to a net margin of 13% in FY2015.

The company reported revenues of US\$22,090 million for the third quarter ended March 2017, a decrease of 8.3% over the previous quarter.

KEY FACTS

Head Office	Microsoft Corporation 1 Microsoft Way REDMOND Washington REDMOND Washington USA
Phone	1 425 8828080
Fax	1 425 7067329
Web Address	www.microsoft.com/en-us
Revenue / turnover (USD Mn)	85,320.0
Financial Year End	June
Employees	114,000
NASDAQ Ticker	MSFT

SWOT ANALYSIS

Microsoft Corporation (Microsoft or "the company") develops, licenses, and supports a range of software products and services. The company also designs, manufactures and sells devices that integrate with cloud-based services. In addition, it offers relevant online advertising to global audience. Microsoft's established market presence enables it to offer end-to-end solutions for consumer as well as enterprise clients. In addition, it provides significant cross selling opportunities thus winning a larger share of the client budget. However, declining PC market is expected to impact the demand for the company's products thus shrinking its revenues and affecting margins.

<p>Strength</p> <p>Strong R&D Capabilities Broad Products and Services Portfolio Established market presence</p>	<p>Weakness</p> <p>Legal Proceedings Substantial Indebtedness</p>
<p>Opportunity</p> <p>Increasing Adoption of Cloud Computing Services Poised to Benefit from the Growing IoT Market Strategic Acquisition of LinkedIn Strategic Partnership with Adobe Growing Application Servers Market</p>	<p>Threat</p> <p>Adverse Trends in the PC Market Government Litigation and Regulatory Activity Intense Competition</p>

Strength

Strong R&D Capabilities

Microsoft has a strong focus on research and development (R&D). The company commits significant resources in developing technologies, tools, and platforms spanning digital work and life experiences, cloud computing, and devices operating systems and hardware. In FY2016, approximately 37,000 associates were engaged in R&D activities. The company's main R&D facilities are located in Redmond, Washington. Microsoft also operates R&D facilities in other parts of the US and around the world, including Canada, China, Denmark, Finland, France, India, Ireland, Israel, Japan, and the UK. In addition to its R&D operations, Microsoft operates Microsoft Research, a computer science research organizations which work in close collaboration with top universities around the world. The company develops its products internally through three engineering groups, including Applications and Services Engineering Group, Cloud and Enterprise Engineering Group, and Windows and Devices Engineering Group.

The company's total R&D expense was approximately \$12 billion, \$12 billion, and \$11.4 billion during FY2016, FY2015, and FY2014, respectively. These amounts represented 14%, 13%, and 13% of the company's total revenue in FY2016, FY2015, and FY2014, respectively. The company's strong R&D has enabled it to add a number of patents. At the end of FY2016, the company had a patent portfolio of over

61,000 issued in the US and international patents and over 35,000 pending patents. The company's strong R&D focus has enabled it to launch new solutions. For instance, in October 2016, the company introduced Surface Studio, a new class of device that transforms from a workstation into a powerful digital canvas; Surface Dial, a new peripheral designed for the creative process; and Surface Book with Performance Base, a laptop with 6th Generation Intel Core i7 processors. Further in September 2016, Microsoft formed the Microsoft AI and Research Group, bringing together Microsoft's research organization with more than 5,000 computer scientists and engineers focused on the company's AI product efforts.

Strong R&D capabilities allow Microsoft to attain competitive advantage over its peers, maintain technological edge over its competitors and to stay ahead of industry trends. In addition, it also allows the company to differentiate its products with its competitors.

Broad Products and Services Portfolio

Broad range of products and services helps Microsoft to generate revenue from diversified sources, whilst mitigating the risk associated with concentrated product and service offerings. The company operates its business through three business segments: More Personal Computing; Productivity and Business Processes; and Intelligent Cloud. More Personal Computing segment consists of products and services for end users, developers, and IT professionals. This segment primarily comprises Windows, including Windows original equipment manufacturer (OEM) licensing and other non-volume licensing of the Windows operating system, volume licensing of the Windows operating system, patent licensing, Windows Embedded, MSN display advertising, and Windows Phone licensing; Devices, including Microsoft Surface, phones, and personal computer (PC) accessories; Gaming, including Xbox hardware; Xbox Live, comprising transactions, subscriptions, and advertising; video games; and third-party video game royalties; and Search advertising.

Microsoft's Productivity and Business Processes segment consists of products and services in its portfolio of productivity, communication, and information services, spanning various devices and platforms. This segment primarily comprises Office Commercial, including volume licensing and subscriptions to Office 365 commercial for products and services such as Office, Exchange, SharePoint, and Skype for Business, and related Client Access Licenses (CALs); Office Consumer, including Office sold through retail or through an Office 365 consumer subscription, and Office Consumer Services, including Skype, Outlook.com, and OneDrive; and Dynamics business solutions, including Dynamics ERP products, Dynamics CRM on-premises, and Dynamics CRM Online. Intelligent Cloud segment offers public, private, and hybrid server products and cloud services for businesses. The segment primarily comprises Server products and cloud services, including SQL Server, Windows Server, Visual Studio, System Center, and related CALs, as well as Azure; and Enterprise Services, including premier support services and Microsoft consulting services.

Broad offerings reduces dependence on any particular segment, apart from minimizing its business risks, and helping the company to serve a diversified customer base and generate higher revenue.

Established market presence

The company has an established presence in the software market. Microsoft is one of the leading players

in the software industry through its Windows operating system (OS) and Office utility tools. According to industry estimates, the Windows OS had a market share of 89% during April 2016. Windows 10 was installed on over 75 million personal computers (PCs) in its first four weeks, and passed 110 million after 10 weeks of its release. Further, the company had a market share of 11% in the cloud market, only next to Amazon, which had a market share of 31%. According to the company, more than 1.2 billion people use Office in 140 countries in 107 languages. In the software domain, the company's Office 365 Consumer subscribers increased to 23.1 million. The Office has been downloaded 340 million times on iPhones, iPad, and Android devices. Microsoft Dynamics CRM Online seat additions more than doubled year-over-year. Further in FY2016, Microsoft Azure revenue grew 113%, with usage of Azure compute and Azure SQL database more than doubling year-over-year. Also 80% of Fortune 500 use Microsoft Cloud. In addition, the company had more than 33,000 enterprise mobility services customers at the end of FY2016. Also, Windows 10 is active on more than 400 million devices around the world. Furthermore, Xbox Live monthly active users grew 33% year-over-year to 49 million. The company's app store had over 669,000 apps for phones, desktops and tablets. Moreover, the company's Outlook.com has over 400 million active users, and Skype is used to make over three billion minutes of calls each day.

The company's robust presence enables it to offer end-to-end solutions for consumer as well as enterprise clients. In addition, it provides significant cross selling opportunities thus winning a larger share of the client budget.

Weakness

Legal Proceedings

The company is exposed to various lawsuits and litigations which could increase the costs and margins. Antitrust and unfair competition class action lawsuits were filed against Microsoft in British Columbia. The trial of the British Columbia action commenced in May 2016. The plaintiffs are expected to file their case in chief in August 2016, setting out claims made, authorities, and evidence in support. A six-month oral hearing is scheduled to commence in September 2017, consisting of cross examination on witness affidavits. In 2014, Microsoft was informed that China's State Administration for Industry and Commerce (SAIC) had begun a formal investigation relating to China's Anti-Monopoly Law, and SAIC conducted onsite inspections of Microsoft offices in Beijing, Shanghai, Guangzhou, and Chengdu. SAIC started the investigation relating to compatibility, bundle sales, file verification issues related to Windows and Office software, and potentially other issues. In addition, the company has approximately 54 other patent infringement cases pending against it. As on June 30, 2016, the company had accrued aggregate legal liabilities of \$521 million in other current liabilities. In addition, the company anticipates its legal costs could reach approximately \$1.6 billion in aggregate.

The fines would impact the company's cost structure adversely in turn impacting profitability and also entails large outlays of cash. These lawsuits and litigations would also have a negative impact on the brand image of the company.

Substantial Indebtedness

The company has a substantial amount of indebtedness. As of June 30, 2016, the company's total debt

was \$40,783 million. This amount of indebtedness could have important consequences which include fulfilling cash obligations; limiting the company's ability to fund potential acquisitions; dedicating a portion of cash flow from operations to pay debts, which would reduce the availability of cash flow to fund working capital requirements, capital expenditures and other general corporate purposes; limiting flexibility in planning for, or reacting to, general adverse economic conditions or changes in business or industry in which the company operates; and placing Microsoft at a competitive disadvantage compared to competitors that have less debt.

In addition to the substantial amount of indebtedness, the company may incur additional indebtedness in the future. If new debt is added to the current debt levels, the related risks that the company currently faces could intensify. Substantial indebtedness could adversely affect the company's operations and financial results and prevent it from fulfilling obligations.

Opportunity

Increasing Adoption of Cloud Computing Services

The worldwide demand for cloud computing services is expected to grow significantly in the coming years. Cloud computing is a computing infrastructure model, which enables delivery of software-as-a-service (SaaS). Appeal to cloud computing has been increasing as it enables companies to reduce their expenses related to upfront royalty or licensing payments, investment in hardware infrastructure and other operating expenses. According to MarketLine, the global cloud computing industry is expected to generate total revenues of \$89.3 billion in 2016, representing a CAGR of 34.2% between 2012 and 2016. Furthermore, the performance of the industry is forecast to accelerate, with an anticipated compound annual growth rate (CAGR) of 35.6% for the 2016-21 periods, which is expected to drive the industry to a value of \$409.6 billion by the end of 2021.

As the rate of businesses moving to the cloud continues to accelerate, Microsoft has several unique advantages that can be leveraged to drive growth from its cloud offering which primarily includes Windows Azure, Office 365 and Dynamics CRM. The company offers these cloud services through Microsoft's Windows and Windows Phone operating systems, thus adding SaaS component to its PaaS and IaaS services. In July 2016, GE partnered with Microsoft to bring its Predix platform for the Industrial Internet available on the Microsoft Azure cloud for industrial businesses. Further, in February 2017, Microsoft and Flipkart entered into a strategic partnership, whereby Flipkart will incorporate Microsoft Azure as its public cloud platform.

The enterprises are moving to the cloud on their terms and often use hybrid solutions that include the cloud and their existing datacenter investments. The company's increasing presence in the cloud computing market and the growing end market will provide an opportunity for Microsoft to gain new customers and increase its market share in the future.

Poised to Benefit from the Growing IoT Market

With increasing adoption of cloud services and the big data services, the Internet of Things (IoT) market is rapidly growing. According to industry estimates, rising adoption of cloud platforms, development of

cheaper and smarter sensors, and evolution of high speed networking technologies has been driving the demand for IoT and wearables. The IoT market is expected to reach \$661.7 billion by 2021 from \$157.1 billion in 2016, growing at a CAGR of 33.3% during 2016-21 periods.

Microsoft is poised to benefit from the strong growth in the IoT market. The company offers Microsoft Azure IoT services that include Azure Event Hubs, Azure DocumentDB, Azure Stream Analytics, Azure Notification Hubs, Azure Machine Learning, Azure HDInsight, and Microsoft Power BI. Further in April 2016, Microsoft collaborated with Rolls-Royce to bring new capabilities to Rolls-Royce customers. Rolls-Royce will integrate Microsoft Azure IoT Suite and Cortana Intelligence Suite into its service solutions to expand its digital capabilities to support the current and next generation of Rolls-Royce intelligent engines.

The company's growing presence in the IoT market coupled with the growing end markets will enable it to drive strong revenues and enhance its market share in the future.

Strategic Acquisition of LinkedIn

The strategic acquisition of LinkedIn is expected to enhance the company's footprint in the enterprise social media market and provide incremental growth prospects. In December 2016, Microsoft completed the previously announced acquisition of LinkedIn for approximately \$26.2 billion, inclusive of LinkedIn's net cash. LinkedIn is one of the largest professional social network. The company offers a comprehensive platform that provides members with solutions, including applications and tools, to search, connect and communicate with business contacts, learn about career opportunities, join industry groups, research organizations and share information. LinkedIn has approximately 400 million members in over 200 countries and territories. The company also operates Lynda.com, a leading online learning platform. The acquisition is expected to provide Microsoft a larger reach in the social networking services and professional content business. Additionally, LinkedIn's large social network includes groups of employees and employers, which would act as a sales channel for Microsoft products, and also serve as a complement to those that it already offers for collaboration and communication.

According to Microsoft, LinkedIn's social graph and Sales Navigator could be offered as an integrated selling tool along Microsoft's Dynamics CRM and other systems. Such an integration is expected to provide robust background information about users that can help find leads, open conversations and close deals. Microsoft could also use LinkedIn's Lynda business to help sell Microsoft software products, and provide assistance in learning to use them. Furthermore, the acquisition is expected to bolster Microsoft's cloud business and counter the threat of rising Google's Chromebook sales, which is impacting the sales of Windows based personal computers (PCs). The deal is expected to create a market for both LinkedIn and Microsoft's Office products and would enable the combination of leading professional cloud with the leading professional network to strengthen its position as the one-stop-shop enterprise IT provider. This strategic combination is expected to establish Microsoft as a leader in data on the professional world, both at the organizational and individual level and drive growth from the growing trends of technology, including growing cloud based markets and datacenter markets, among others.

Thus, the strategic acquisition of LinkedIn would enable Microsoft to enter the social networking business in a strategic way that complements its existing, largely untapped user data and provide incremental growth prospects in the medium to long term.

Strategic Partnership with Adobe

Microsoft's strategic partnership with Adobe is expected to boost its cloud business in the medium to long term. In September 2016, Adobe and Microsoft entered into a strategic partnership to help enterprise companies embrace digital transformation. As part of the partnership, Adobe will make Microsoft Azure as its preferred cloud platform for the Adobe Marketing Cloud, Adobe Creative Cloud and Adobe Document Cloud. With the partnership, Adobe will bring its creative marketing software programs like Photoshop and Illustrator to Microsoft's Azure cloud-computing service, while Microsoft will make Adobe's marketing programs the favored choice for its internet-based software that manages customer relationships. Azure will provide Adobe with a global cloud and data platform for intelligent services, including machine learning and cognitive capabilities in Microsoft Cortana Intelligence Suite and SQL Server.

The partnership is expected to boost Azure's customer base as Adobe Creative Cloud has more than seven million subscribers. It would also minimize the customized work their customers' software developers have to do to make their products work together, paving the way for increased subscriptions. The deal brings the marketing capabilities on cloud to help companies digitally transform and engage customers in new ways and easily work across Adobe Marketing Cloud and Dynamics 365 business applications, leveraging artificial intelligence, machine learning and advance analytics. The partnership will also add enterprise application weight to the Azure platform, while the addition of Adobe's Marketing Cloud will strengthen Microsoft's marketing product and enable it to complete more effectively with Salesforce.

Thus, the strategic partnership with Adobe is expected to boost Microsoft's client base and service portfolio, boosting its topline performance in the medium to long term.

Growing Application Servers Market

The application server market is expected to achieve strong growth primarily driven by the evolution of the mobile internet and IoT. Application servers are used to create apps that run on mobile devices and enable IoT. According to industry estimates, the worldwide application server market is forecasted to grow at a CAGR of 17% during 2016-24 periods to reach \$24 billion by 2024. The increasing demand for applications to support smartphones, tablets, and integrate with the IoT is expected to drive the application server market growth over the forecast period.

Microsoft develops and markets server software, software developer tools, cloud-based services, and solutions. The company's server software includes integrated server infrastructure and middleware which is designed to support software applications built on the Windows Server operating system. This includes the server platform, database, business intelligence (BI), storage, management and operations, virtualization, service-oriented architecture platform, security and identity software. The company also builds standalone and software development lifecycle tools for software architects, developers, testers and project managers. It also offers a platform that helps developers build and connect applications and services in the cloud or on premise. The robust demand in the application servers market coupled with Microsoft's strong server portfolio will further enhance the company's growth prospects.

Threat

Adverse Trends in the PC Market

The global PC market has been decelerating recently. A broader slowdown in the economy, particularly in developing economies that had been growing very quickly in the recent past, and new competition from the iPad, other tablets, and smartphones are contributing to deteriorating PC sales. Global economic issues like falling commodity prices and weak international currencies, as well as social disruptions in EMEA and Asia-Pacific that disrupted foreign markets, were a large factor behind weak PC sales. According to industry estimates, the global PCs market is expected to decline at a compound annual rate of change (CARC) of 2.8% to reach 126.3 billion in 2020, as compared to 143.5 billion in 2015. The adverse impact of the continued PC sales declines will be detrimental for the company.

Government Litigation and Regulatory Activity

The company's operations are closely scrutinized by government agencies under the US and foreign competition laws. Some jurisdictions also provide private rights of action for competitors or consumers to assert claims of anti-competitive conduct. For example, European Commission closely scrutinizes the design of Microsoft products and the terms on which certain technologies used in these products, such as file formats, programming interfaces, and protocols, are available to other companies. In 2004, the Commission ordered Microsoft to create new versions of Windows that do not include certain multimedia technologies and to provide competitors with specifications for how to implement certain proprietary Windows communications protocols in their own products. These obligations may limit the company's ability to innovate in Windows or other products in the future, diminish the developer appeal of the Windows platform, and increase its product development costs. The availability of licenses related to protocols and file formats may enable competitors to develop software products that better mimic the functionality of Microsoft products which could hamper sales of the company's products.

The company's products and online services offerings, including new technologies are subject to government regulation in some jurisdictions, including in areas of user privacy, telecommunications, data protection, and online content. The application of these laws and regulations to Microsoft's business is often unclear, subject to change over time, and sometimes may conflict from jurisdiction to jurisdiction. Additionally, compliance with these types of regulation may involve significant costs or require changes in products or business practices that result in reduced revenue. High regulations on the company may have an adverse impact on the company's results of operations.

Intense Competition

Microsoft faces intense competition across all markets for its products and services. The company's competitors range in size from Fortune 100 companies to small, specialized single-product businesses and open source community-based projects.

In the Productivity and Business Processes segment, the company competes with software and global application vendors such as Adobe Systems, Apple, Cisco Systems, Facebook, Google, IBM, Oracle, SAP, and web-based and mobile application competitors as well as local application developers in Asia and Europe. Skype for Business and Skype competes with instant messaging, voice, and video communication providers, ranging from start-ups to established enterprises. Web-based offerings

competing with individual applications that have positioned themselves as alternatives to Microsoft's products. The company's Dynamics products compete with vendors such as Oracle and SAP in the market for large organizations and divisions of global enterprises. In the market focused on providing solutions for small and mid-sized businesses, the company's Dynamics products compete with vendors such as Infor, The Sage Group, and NetSuite. Salesforce.com's cloud CRM offerings compete directly with Dynamics CRM on-premises and CRM Online offerings.

Microsoft's server products face competition from various server operating systems and applications offered by companies, including Hewlett-Packard, IBM, and Oracle with a range of market approaches. Its web application platform software competes with open source software such as Apache, Linux, MySQL, and PHP. In middleware, the company competes against Java vendors. The company's database, business intelligence, and data warehousing solutions offerings compete with products from IBM, Oracle, SAP, and other companies. System management solutions compete with server management and server virtualization platform providers, such as BMC, CA Technologies, Hewlett-Packard, IBM, and VMware. Its products for software developers compete against offerings from Adobe, IBM, Oracle, and other companies. Azure faces diverse competition from companies such as Amazon, Google, IBM, Oracle, Salesforce.com, VMware, and open source offerings. The Windows operating system faces competition from various software products and from alternative platforms and devices, mainly from Apple and Google. Microsoft's search advertising business competes with Google and websites, social platforms like Facebook, and portals that provide content and online offerings to end users.

Growing competitive pressures may impact the company's market share and margins in near term.

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