

# Microsoft sales fall; cost cuts please investors

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Packages of Microsoft's newly-released operating system, Windows 7, are lined up for purchase inside the company's first retail store grand opening Thursday, Oct. 22, 2009, in Scottsdale, Ariz. Microsoft's profit fell 18 percent in the last quarter, partly because it deferred revenue to let summertime PC buyers get free upgrades to Windows 7, which launched Thursday.(AP Photo/Paul Connors)

(AP) -- Consumers may be shopping for computers again, but Microsoft Corp. still needs businesses to start doing the same.

Microsoft said Friday its revenue kept falling and its net income dropped 18 percent in the last quarter, partly because of the hesitation of businesses, which are more profitable for Microsoft than consumers are.

Big cost cuts at Microsoft made a difference, though, helping the company deliver earnings well above analysts' expectations. Its stock surged \$1.29, nearly 5 percent, to \$27.88 in afternoon trading. Earlier in

the day, the stock reached a 52-week high of \$29.35.

But while the quarterly results looked good to Wall Street, they also showed how much Microsoft is still wrestling with a PC industry that remains much weaker than a year ago. In the past year the software maker resorted to its first wide-scale layoffs, and in July it said its annual revenue had fallen for the first time since the company went public in 1986.

After skidding for six months, computer shipments rose in the July-September period. But shoppers tended to buy inexpensive laptops and even smaller, cheaper netbooks, which have older and less profitable versions of Windows installed. Many consumers also passed on buying Microsoft's Office, the package that includes Word, Excel and Outlook, which contributed to a 14 percent total decline in revenue in the quarter.

Businesses watched their spending even more closely. That dragged down Windows results because business-level versions of the operating system are more expensive. And companies that have cut workers are ordering fewer copies of Office and other Microsoft software commonly used at work. Revenue and profit in the group that makes Office sank even as businesses spent more on newer software such as Sharepoint.

Chris Liddell, Microsoft's chief financial officer, said in a conference call that businesses could start replacing aging PCs and servers starting in 2010, "although it could be gradual and occur over a couple of years."

Other companies, especially Intel Corp., have indicated they expect things to improve faster, in the current quarter.

Microsoft's earnings in the last quarter dropped to \$3.6 billion, or 40 cents per share, though that was much higher than the analysts' estimate of 32 cents per share in a Thomson Reuters survey. In the same period

last year Microsoft earned \$4.4 billion, or 48 cents per share.

Microsoft's bottom line was hurt by a summer program in which the company let people buy a PC with the Windows Vista operating system and later install Windows 7 on the machine for free. That meant Microsoft counted only half of its Windows sales in the period and will report the rest as customers upgrade to Windows 7, which was released this week, through January, when the offer expires.

If it had counted its deferred Windows revenue, Microsoft's earnings would have increased 8 percent from last year.

Revenue sank to \$12.9 billion, though if Microsoft had counted all the Windows sales, it would have posted a smaller 4 percent drop in revenue, to \$14.4 billion.

A big reason that Microsoft's earnings would have increased, if not for the Windows deferrals, despite lower revenue is that layoffs and other expense cuts are paying off. Microsoft employs 4 percent fewer people than a year ago and has spent less on marketing and outside contractors, pushing operating expenses down more than \$600 million compared with a year ago.

Microsoft said expenses in the current fiscal year, which ends in June, could be as much as \$400 million lower than previously expected.

The company also lifted its earnings per share by resuming purchases of its own stock after a six-month pause, spending \$1.45 billion in the quarter.

Even with the buybacks, Microsoft managed to sock away plenty of cash. The company said its cash and short-term investments that could be quickly converted to cash totaled \$36.7 billion at the end of the

quarter, up from \$31.4 billion at the start.

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