Microsoft 3Q growth overshadowed by tablet threat (Update)

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In this Jan. 5, 2011 file photo, Microsoft chief executive officer Steve Ballmer gives his Keynote speech for the Consumer Electronics Show, in Las Vegas. Microsoft reports quarterly earnings Thursday, April 28, 2011, after the market close.(AP Photo/Julie Jacobson, file)

Even as Microsoft Corp.'s earnings grow at a robust rate, investors can't seem to shake the feeling that the boom days are winding down for the world's largest software maker.

The company's fiscal third-quarter results, released Thursday, provided little reassurance despite a 31 percent increase in earnings, exceeding analyst estimates. Microsoft shares still dipped.

The main reason for the anxiety: Revenue in the division that includes Microsoft's foundation, the Windows operating system, declined from the same time last year for the second-straight quarter. The slide stems from consumers buying fewer personal computers that run the company's software.

The downturn occurred during the same period that rival Apple Inc. couldn't produce enough iPads, a potentially game-changing computer tablet, to meet the rabid demand.

That trend feeds into the theory that Microsoft's lucrative franchise in PC software will head into a gradual decline unless the company can make up for its late start in a tablet market that currently depends on rival operating systems made by Apple Inc. and Google Inc.

Catching and surpassing rivals was once something that Microsoft did well. Its word-processing and spreadsheet programs, Internet Explorer browser and Xbox 360 video game consoles all are examples of widely used products inspired by the success of other companies.

In a sign that it may have lost a step, Microsoft hasn't been able to make up as much ground during the past seven years as technology usage as shifted to the Internet and smartphones. It hasn't been for a lack of trying, especially on the Internet, where Microsoft has invested billions dollars in mostly fruitless effort to undercut Google's dominance of online search and advertising.

Microsoft made some Internet strides in the January-March period as it picked up search market share and its online division's revenue rose 14 percent.

But there also was a significant stumble: Microsoft's technology is producing less revenue per search than anticipated from a recently launched partnership with Yahoo Inc. The trouble required Microsoft to pay Yahoo extra money during the quarter and may have contributed to a slightly larger operating loss in the online operations than the same time last year.

Revenue in Microsoft's Windows division during the January-March period fell 4 percent from a year ago, slightly worse than the fall-off in PC shipments tracked by the research firm IDC.

The negatives seemed to overshadow the bright spots that enabled Microsoft to generate earnings that exceeded analyst estimates. The pluses included higher software and server sales to businesses and a hot consumer electronics commodity in the Kinect motion sensor controller that's causing more video game players to buy the Xbox 360 too.

Microsoft shares still shed 39 cents to $26.32 in extended trading Thursday after the quarterly results came out. Before that drop, the stock had fallen by about 4 percent so far this year. That contrasted with a 10 percent increase in the Dow Jones industrial average, which includes Microsoft, during that time.

Microsoft, which is based in Redmond, Wash., earned $5.2 billion, or 61 cents per share, in the latest quarter. That compares with net income of $4 billion, or 45 cents per share, a year ago.

It wasn't as impressive a quarter as Apple's performance. Apple's earnings nearly doubled during the first three months of the year to almost $6 billion. Higher net income is one reason investors have minted Apple with a $320 billion market value - nearly $100 billion more than Microsoft's

The results in Microsoft's latest quarter included a tax benefit of 5 cents per share from a settlement of an audit covering 2004 to 2006. Even without that one-time gain, Microsoft's earnings would have topped the average estimate of 55 cents per share among analysts surveyed by FactSet.

Revenue increased 13 percent to $16.4 billion - about $250 million above analyst estimates.

Driven by the Kinect demand, revenue in the company's entertainment division climbed 60 percent.

The tablet threat seems likely to dog Microsoft for years. Apple sold 19.5 million iPads in the sleek devices' first year on the market, prompting other hardware workers to design tablets running on Google's Android software. Goldman Sachs estimates about 47 million fewer notebook computers could be sold this year and next year as more people embrace tablet computers.

PCs aren't becoming obsolescent, especially for businesses that have grown comfortable with Microsoft's operating system and Office productivity software. But consumers are holding on to the Windows-driven PCs that they already have and recent trends indicate that the tablet might be a suitable choice when they replace their machines. In the latest quarter, Microsoft said sales of the lightweight laptops known as "netbooks" fell 40 percent - another indication of tablets' momentum.