

# Microsoft results show effects of turnaround strategy

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In this April 28, 2015, file photo, a man walks past a Microsoft sign set up for the Microsoft BUILD conference at Moscone Center in San Francisco. Microsoft reports financial earnings on Thursday, Jan. 28, 2016. (AP Photo/Jeff Chiu, File)

Like a friendly but persistent sales rep, Microsoft has a message for anyone who owns a personal computer: If you haven't yet upgraded to Windows 10, the company highly recommends it.

So highly, in fact, that in coming weeks, PC owners who have set their machines to automatically install important updates—like security fixes—could find the new operating system already downloaded and ready for activation.

Microsoft's aggressive campaign to promote Windows 10 has already led to its deployment on more than 200 million devices since its July release. It's part of a multi-pronged strategy that analysts credit with contributing to the early stages of a financial turnaround, as evidenced by Microsoft's latest earnings report on Thursday.

The Redmond, Washington-based tech company reported \$5 billion in profit on nearly \$24 billion in sales for the holiday quarter of 2015. Revenue was down 10 percent from a year ago, but after adjusting for deferred revenue, the fiscal second-quarter numbers were better than Wall Street analysts expected.

Once the dominant seller of PC-based software, Microsoft has struggled with declining profits in recent years as consumers and businesses buy fewer PCs, which cuts into licensing fees Microsoft gets from PC manufacturers. The last major upgrade of its operating system, known as Windows 8, was widely viewed as a flop, which hurt PC sales even more.

Since assuming the CEO role in February 2014, Microsoft CEO Satya Nadella has been pushing the company to adapt to a world where people are increasingly using mobile gadgets in addition to PCs, and where businesses are moving more of their operations online.

Microsoft beat Wall Street's estimates for sales in key segments, including its cloud-computing business and the division that sells PC software, Surface tablets and Xbox gaming consoles. Earnings amounted to 78 cents a share, after adjusting for one-time costs. Analysts polled by

FactSet had expected adjusted earnings of 71 cents a share.

Microsoft's stock rose more than 3 percent in extended trading after the results came out.

"All around, this looks like a quarter that Nadella can frame and put in his office," FBR Capital Markets analyst Daniel Ives said.

Microsoft broke with tradition last year by releasing Windows 10 as a free upgrade for older PCs, with no charge for future updates. It's also redesigned other popular products, such as the Office word-processing and spreadsheet programs, to work as mobile apps for devices running operating systems made by its rivals, Apple and Google.

The goal is to get people using Microsoft's latest products, no matter what kind of device they prefer, said Frank Gillett, a tech analyst with Forrester Research. He said that should give Microsoft more opportunities to make money by selling premium features or apps, such as online storage, Skype minutes or music and games.

Microsoft is also distributing more of its software through online subscriptions, which it hopes will provide a reliable stream of revenue and the opportunity to learn users' preferences. That's something that such rivals as Google and Amazon have been doing for years.

"Once you have a relationship with your user, you can better serve them, and you can explore more ways to make additional money," Gillett said.

But that's a long-term process, Gillett cautioned.

Microsoft's personal-computing division reported \$12.7 billion in sales for the December quarter, down 5 percent from a year earlier. Within that division, Microsoft said revenue from licensing Windows to PC

makers was also down 5 percent, although the company pointed out that was better than the 8.3 percent decline in overall PC sales that market researchers have estimated for the October-December quarter.

Meanwhile, analysts say Microsoft is also rapidly transforming its commercial-computing division by encouraging corporate customers to run their businesses on Microsoft's servers. Microsoft's commercial "cloud computing" service is now the industry's second-largest, after Amazon's.

Microsoft said its cloud-computing business saw sales rise 5 percent, to \$6.3 billion, for the December quarter. The company has had more success in that business than other established commercial tech giants like Hewlett-Packard and Oracle, according to Ives, who called cloud computing a "bedrock" element of Nadella's strategy.

As for the company's aggressive promotion of Windows 10, those promotional nudges have drawn a few complaints from PC owners who don't necessarily want to upgrade their software. But in coming months, Microsoft says the Windows 10 upgrade will be re-categorized from "optional" to "recommended," which means people who use the automatic update feature on older Windows PCs could find the new software has downloaded automatically.

Microsoft says users will still get a prompt asking if they want to accept or decline the upgrade. They can also revert back to their old software if they change their mind within 31 days.

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