Microsoft Corporation MSFT.O MSFT US .

AMERICAS TECHNOLOGY

NOMURA
EQUITY RESEARCH

"Windows 8 – It's Alive"

No Surprises, Consumer Preview Looked Solid

February 29, 2012

Relative rating Remains	**Buy**
Target price Remains	USD 37.00
Closing price February 29, 2012	USD 31.74
Potential upside	+16.6%

First take on Windows 8 Consumer Preview

We attended Microsoft's Consumer Preview of Windows 8 at the Mobile World Congress in Barcelona. The product looked very stable. It was running live and with live apps from the app store. The User Interface has been finished and the fit and finish looked very good. We liked the ability to use touch together with the mouse and keyboard in any combination to permit users to have the optimum experience in any of the many form factors we expect from OEM partners. The adaptation for mouse and keyboard was better than we had expected, improving the potential upgrade opportunity for notebooks and Ultrabook touch devices. We continue to expect the release to manufacturing (RTM) by August and general availability (GA) by late September or October.

Criticism will likely be from UI changes

The main concern may center on the difference of the overall user experience, and how jarring this change is for the end-user. Obviously, people like the touch interface of the iPad, so the fact that there is change to accommodate a new user experiences is not bad in and of itself. The issue is more how this is implemented across devices from tablets to Ultrabook touch and notebook devices, and desktops. The Windows team has made significant changes to the UI in order to optimize the experience for the introduction of touch across devices. Our assessment is that the changes are easily discoverable and enable new experiences and form factors, and while they will require users to reorient to the new interface, this is a positive end result and is well implemented across devices.

Not just about competing with Apple and Android on tablets

Also, in our view the key will be not just enablement of touch, but collaboration among workgroups with the new Office and integration of cloud services such as storage through SkyDrive to provide sharing of data and apps across devices. This is a big opportunity for innovation; it is not just about competing on tablets with Apple and Android.

Reiterate our Buy rating on the shares and favorable valuation

Still like the shares at current levels, which are trading at 10.3x our CY12 earnings estimate (ex-cash) and 9.2x EV to unlevered free cash flow.

Fiscal Year end: June $ in millions, except per share data	2010A	2011A	2012E	2013E
Revenue	$62,484	$69,943	$73,341	$82,289
Operating Income	24,098	27,161	27,020	31,233
Operating Margin	38.6%	38.8%	36.8%	38.0%
EPS	$2.10	$2.69	$2.63	$3.10

Source: Company data, Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*

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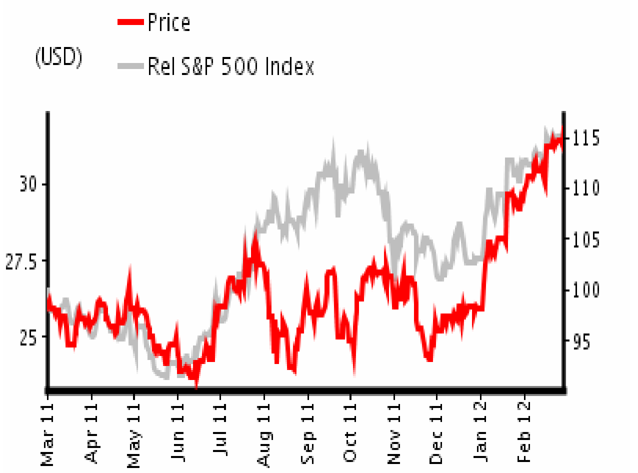
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Key data on Microsoft Corporation

Rating

Stock	Buy
Sector	Neutral

Relative performance chart



Source: ThomsonReuters, Nomura research

Performance

(%)	1M	3M	12M
Absolute	7.5	24.1	19.4
Relative to sector	3.4	14.6	16.5

Market data

Market cap (m)	266,323.1
Shares outstanding (m)	8,390.77

Source: ThomsonReuters, Nomura research

Income Statement

Year end (June), mn except per share data	FY11A	FY12E	FY13E
Revenues:			
Window s & Window s Live Division	$19,033	$18,338	$21,440
Server & Tools	16,680	18,415	20,109
Online Services Division	2,607	2,922	3,355
Microsoft Business Division	22,514	23,516	26,143
Entertainment & Devices Division	8,915	10,028	11,242
Other revenues	194	122	0
Total revenues	$69,943	$73,341	$82,289
% change year-on-year	*11.9%*	*4.9%*	*12.2%*
Operating Income	$27,161	$27,020	$31,233
% change year-on-year	*12.7%*	*(0.5%)*	*15.6%*
Operating Margin	38.8%	36.8%	38.0%
% Δ (bps)	*27 bps*	*-199 bps*	*111 bps*
Net Income	$23,150	$22,168	$25,707
% change year-on-year	*23.4%*	*(4.2%)*	*16.0%*
EPS	$2.69	$2.63	$3.10
% change year-on-year	*28.2%*	*(2.6%)*	*17.9%*
Shares O/S	8,593	8,444	8,303

Balance Sheet Metrics

Year end (June), mn except per share data	FY11A	FY12E	FY13E
Cash, Equivalents, & ST Investments	$52,772	$58,788	$75,387
Long-term investments	$10,865	$7,550	$7,550
Total Debt	$11,921	$11,932	$11,932
Net Cash	$51,716	$54,406	$71,005
Deferred Revenue	$17,120	$18,640	$20,801

Cash Flow Metrics

Year end (June), mn except per share data	FY11A	FY12E	FY13E
Operating Cash Flow	$26,994	$28,719	$31,657
Capital Expenditures	($2,355)	($2,500)	($2,323)
Free Cash Flow	$24,639	$26,219	$29,333
% change year-on-year	*11.5%*	*6.4%*	*11.9%*
Unlevered Free Cash Flow	$24,162	$25,802	$28,613
% change year-on-year	*12.0%*	*6.8%*	*10.9%*
Dividends	$5,180	$6,388	$7,970

Valuation Metrics

Year end (June), mn except per share data	FY11A	FY12E	FY13E
Price to earnings	11.8x	12.1x	10.3x
Price to earnings less cash	10.5x	10.8x	9.2x
EV to uFCF	9.7x	9.1x	8.2x

Source: Company data, Nomura estimates

Positive Assessment of Windows 8 Consumer Preview

Microsoft has been very thoughtful in how they have architected Windows 8 to optimize the user experience across devices, from the pure touch capabilities of a tablet to the mixed touch and mouse/keyboard experience required of personal productivity tools for a desktop or notebook. We had been concerned that there would be more of a discontinuity in the hardware platforms, with users no longer willing to buy the current generation of notebooks with new touch form factors coming soon, but the experience using a mouse and keyboard with Windows 8 was much better than we had expected. For example, the mouse can be easily pointed to any of the four corners of the screen to deliver functionality that would otherwise be available with touch capabilities, so there appears to have been a lot of thought in how to deliver some of the benefits of touch yet still offer the advantages of the traditional mouse and keyboard where the finger may be too blunt of a pointing/interactive device for Word or Excel.

We think the criticism will likely be two fold. First, Gartner Group never likes change for enterprise users that write their own applications to Windows, and will probably advise enterprise users to wait a few years before upgrading, so this should be no surprise. Microsoft will outline the enterprise capabilities of Windows 8 at CeBIT next week and address the manageability of Windows 8 devices (which we think will be similar to Windows 7 devices).

Second, which has also been the case with every new release of Windows, will be how jarring the change is for the end-user. The Windows team has made significant changes to the UI in order to optimize the experience for the introduction of touch. There is no start button for example. Yes, but you don't need a start button, because you are launched right into the home page that has all your applications available in tiles. There is a need for reorientation so this can be bad for users that just want it to be the same as before. People have been able to get the iPad pretty quickly, so we think there is a relatively easy transition ahead for users, but this is clearly a different experience. Our assessment is that the changes are easily discoverable, and that the net effect is going to be an overall richer experience across devices. We were pleasantly surprised by the implementation across devices, with touch for tablets but enablement of a similarly rich experience across devices.

At the event, we were concerned that we didn't see as much of ARM in the demos as we would have liked. We questioned whether this platform is as far along and as stable as the Intel version of Windows 8. We spoke with Windows President Steven Sinofsky after the event, who reaffirmed that ARM and Intel versions of Windows 8 will ship at the same time. The consumer preview version of ARM is expected to ship shortly to a select testing group. ARM is a more fragmented platform for hardware manufacturers to coordinate components with the operating system, so while we expect one or two ARM tablets to be released at the time of Windows 8 general availability, others are likely to lag a few months behind the availability on Intel.

The significance of the preview was not so much that there were many new features that we were unaware of before, but rather that the product looked good, appeared quite stable in a live setting, and seemed to optimize the user experience across various form factors that we think will be popular on the release of Windows 8, and view the release as a positive affirmation regarding our estimation of a September/October release. The Windows 8 consumer Preview is now available for download (link **here**). Betas for Windows Server 8 and Visual Studio 11 have also been made available for developing Windows 8 applications. The next milestone is the Release Candidate, then Release to Manufacturing (are thinking late July or August), followed by General Availability (possibly in September, but our model reflects October).

Consumer Preview in more detail

The Consumer Preview looked very polished, the code was clean, with live running applications, and worked well. We observed many crashes in the September build, but there were no crashes yesterday in Barcelona, only one apparent internet connection glitch in accessing the apps store with Xbox. There are over 100,000 code changes that have been made since the developer preview, so it's a very different operating system from what we saw back in September. We have outlined some of the key things we picked up from the consumer preview:

- **User experience and input:** Microsoft has completed the UI (removed the Start orb and replaced with the Start preview thumbnail which had been blogged about previously) and improved the touch and keyboard/mouse inputs for the OS. From what we saw, it looked very polished. Today's event showed that Microsoft has been very thoughtful in how they have architected the user interface and input methods not just for touch but for the keyboard and mouse. Given the significant enhancements that have been made to the mouse/keyboard input mechanisms (including new semantic zoom panning and app switching features), it became a lot more obvious to us how this would likely be less of an issue for non-touch devices than we had initially thought.
- **Availability of the Windows Store:** We view the most significant change as the availability of the applications store (the "Windows Store") with the updated consumer preview candidate. The Windows Store currently has first party and third party applications available, and all apps will be free to download during the consumer preview period. From several demonstrations we saw that popular applications like Kindle, Flixster, were available, in addition to games like Cut-the-Rope (while not opened, we were able to see a Facebook icon in the background of one of the demonstrations). The store synchronizes with a user's ID, so apps and settings follow the user seamlessly via the cloud. Additionally, apps can cross-talk and share data with each other and among users. The Windows store takes care of compatibility, making sure you download the right application
- **The Cloud and Microsoft ID:** As with the developer preview, the consumer preview showed the synchronization of settings, applications, storage, calendar, contacts, and other services via Microsoft's cloud assets. If you log into a new PC, Windows 8 will detect this and push all of your settings and applications down to you from the cloud.
- **Internet Explorer 10 Platform:** With the Consumer Preview, Microsoft has made available an updated IE10 called Platform Preview 5. The browser is designed specifically for Windows 8 devices, with hardware acceleration.
- **"Windows to Go":** Microsoft introduced "Windows to Go" which allows users to run a full instance of Windows 8 with all of their settings and applications from a USB. This feature provides users with secure access to data and applications when a device is outside of the IT department's control. More enterprise disclosures to come out of CeBIT next week.
- **Battery and power management improvements:** Since the developer preview, advancements have been made in power management. Windows 8 uses less CPU, less power, fewer threads and processing power. Background tasks are automatically managed so that they don't consume power in idle, while not detracting from the overall user experience. No specific battery performance metrics were given, although our contacts are telling us that battery life will be very good. Apps that were not being used in the foreground were quickly suspended so they do not consume power, similar to the iPad, but if information like additional messages arrive to update, the I/O is awake to receive these in the app so there is a background awareness that is still active for suspended apps.

Secondly, Microsoft showed a lot on the hardware side. We were pleased to see that Windows 8 was running across multiple form factors and chip sets. When Windows 8 ships, the array of device types are going to be huge: from tablets, to all-in-one desktops, with Ultrabooks in between. What Microsoft means by "no compromises" is a full Windows solution on the tablet, PC, and any mixture in between. Our assessment from today's event is that Microsoft has been very thoughtful in how they have architected the user interface and input methods not just for touch but for the keyboard and mouse.

- **Windows on ARM:** Microsoft demonstrated Windows on ARM running on an NVIDIA Tegra 3 tablet. Sinofsky mentioned that the next generation Qualcomm and TI chips, as well as Intel's clover trail, will round out the four SoCs that Microsoft will be going to market with, with Windows 8. Microsoft confirmed that they are expecting to deliver Windows 8 on ARM and Intel at the same time, so we think that the lack of time devoted to ARM was more a product of application compatibility being better on Intel.
- **Use case more obvious for current generation of Ultrabooks:** Microsoft showed Windows 8 running on many of the Ultrabooks released by the major OEMs at CES last month. Going into the preview, we had been concerned that the current generation of Ultrabooks would be unable to accommodate touch and there would be a discontinuity in the device form factors (nice way of saying who wants the old products when touch devices are available). Given the significant enhancements that have been made to the mouse/keyboard input mechanisms (including new semantic zoom panning and app switching features), it became a lot more obvious to us how this would likely be less of an issue than initially thought in implementing the Metro interface.

  We learned from the event that Intel is showing off its "Ultrabook 2", with new Ivy Bridge chipset and touch screen prototype. We expect these devices to be shipping coincident with the launch of Windows 8 later this year.
- **Microsoft's Surface project starting to show:** We saw elements of Microsoft's Surface project with Samsung and high resolution PixelSense starting to come through. Steve Sinofsky demonstrated an all-in-one PC that rotated flat so that two people could play a touch based game together, implying that desktop computers may have the option of a screen that rotates flat for easier interaction for some apps like games in particular or photo layout etc. In addition, Microsoft showed an 86-inch perceptive Pixel Perfect PC with up to 100 -finger multiple person (10 people if we can do the math correctly) touch, with optically bonded Gorilla Glass. This was pretty cool for niche apps.
- **Mobile connectivity and peripherals:** Windows 8 will have driver support for mobile 3G and 4G broadband, so no additional software is needed. We view this as a positive given need for always connected mobile devices. In addition, NFC was demonstrated in synching up wirelessly with speakers. On the storage side, Windows 8 can treat several connected USB drives as one large physical drive as part of Storage Spaces.

Finally, so what does this mean about Microsoft vs. Apple and Android?

We think Microsoft is focused on both tablets to address the encroachment from iPads and Android where content consumption is the primary objective, but also the opportunity to bring touch technology to other devices where content creation is a priority. The content creation market needs more than just touch capabilities, it requires mouse and keyboard capabilities for greater control (the finger is a pretty blunt instrument) and the ability to leverage the cloud for synchronization of office files as well as personal music and photos which we use with Apple's iCloud. So, we think Microsoft has a tough job addressing the pure consumer market for tablets where Office or Windows compatibility is not required; this will be very price competitive, and Apple has a 3-generation lead. We are working to quantify the size of this market, thinking that it may be 25% - 30% of the overall market that Microsoft is at risk of losing seats to others. If the remainder of the market desires some Office or Windows compatibility because of the need for content creation, then this is the rich upgrade opportunity that Microsoft will address with Windows 8. Microsoft is expected to compete vigorously for the pure consumer market as well, offering bundled versions of Word, Excel, PowerPoint and OneNote to appeal to those users that might like some PC compatibility. For our modeling, we have viewed the content producers as a much bigger market opportunity that can play to Microsoft's strengths. This market cares not only about touch, but also about SkyDrive and the ability to sync files among devices, and the new version of Office should further assist in the collaboration capabilities we think may be coming around Facebook's platform for enabling workgroups to share documents, and collaborate on content creation.

Fig. 1: Microsoft Statement of Profit & Loss

$ in millions, except per share data

	FY 2011a				FY 2012e				FY 2013e				Fiscal Year ending June			Calendar Year		
FY ending in June ($ millions)	**sep**	**dec**	**mar**	**jun**	**sep**	**dec**	**mar-e**	**jun-e**	**sep-e**	**dec-e**	**mar-e**	**jun-e**	**FY 2011a**	**FY 2012e**	**FY 2013e**	**2010a**	**2011a**	**2012e**
Statement of Profit & Loss																		
Revenue	**$ 16,195**	**$ 19,953**	**$ 16,428**	**$ 17,367**	**$ 17,372**	**$ 20,885**	**$ 16,654**	**$ 18,431**	**$ 16,323**	**$ 25,480**	**$ 19,235**	**$ 21,250**	**$ 69,943**	**$ 73,341**	**$ 82,289**	**$ 66,690**	**$ 72,052**	**$ 76,888**
% Change year-on-year	*25.3%*	*4.9%*	*13.3%*	*8.3%*	*7.3%*	*4.7%*	*1.4%*	*6.1%*	*(6.0%)*	*22.0%*	*15.5%*	*15.3%*	*11.9%*	*4.9%*	*12.2%*	*13.6%*	*8.0%*	*6.7%*
Cost of revenue	3,139	4,833	3,897	3,708	3,777	5,638	4,191	4,170	4,156	6,564	4,785	4,961	15,577	17,776	20,466	13,897	17,020	19,080
Cost of revenue as a % of revenue	*19.4%*	*24.2%*	*23.7%*	*21.4%*	*21.7%*	*27.0%*	*25.2%*	*22.6%*	*25.5%*	*25.8%*	*24.9%*	*23.3%*	*22.3%*	*24.2%*	*24.9%*	*20.8%*	*23.6%*	*24.8%*
Gross profit	**$ 13,056**	**$ 15,120**	**$ 12,531**	**$ 13,659**	**$ 13,595**	**$ 15,247**	**$ 12,463**	**$ 14,261**	**$ 12,167**	**$ 18,917**	**$ 14,450**	**$ 16,289**	**$ 54,366**	**$ 55,566**	**$ 61,823**	**$ 52,793**	**$ 55,032**	**$ 57,808**
% Gross margin	*80.6%*	*75.8%*	*76.3%*	*78.6%*	*78.3%*	*73.0%*	*74.8%*	*77.4%*	*74.5%*	*74.2%*	*75.1%*	*76.7%*	*77.7%*	*75.8%*	*75.1%*	*79.2 %*	*76.4 %*	*75.2 %*
Operating expenses:																		
Research and development	$ 2,196	$ 2,185	$ 2,269	$ 2,393	$ 2,329	$ 2,371	$ 2,366	$ 2,599	$ 2,559	$ 2,459	$ 2,410	$ 2,625	$ 9,043	$ 9,665	$ 10,052	$ 8,951	$ 9,362	$ 9,982
Sales and marketing	2,806	3,825	3,393	3,916	2,900	3,762	3,394	4,064	3,194	4,192	3,733	4,463	13,940	14,120	15,582	13,436	13,971	14,844
General and administrative	938	945	1,160	1,179	1,163	1,120	1,228	1,250	1,200	1,206	1,260	1,290	4,222	4,761	4,956	4,022	4,622	4,884
Other	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Operating expenses	$ 5,940	$ 6,955	$ 6,822	$ 7,488	$ 6,392	$ 7,253	$ 6,988	$ 7,912	$ 6,953	$ 7,856	$ 7,402	$ 8,378	$ 27,205	$ 28,545	$ 30,590	$ 26,409	$ 27,955	$ 29,710
Operating income	**$ 7,116**	**$ 8,165**	**$ 5,709**	**$ 6,171**	**$ 7,203**	**$ 7,994**	**$ 5,475**	**$ 6,348**	**$ 5,214**	**$ 11,060**	**$ 7,047**	**$ 7,911**	**$ 27,161**	**$ 27,020**	**$ 31,233**	**$ 26,384**	**$ 27,077**	**$ 28,098**
% Change year-on-year	*58.8%*	*(4.1%)*	*10.4%*	*4.1%*	*1.2%*	*(2.1%)*	*(4.1%)*	*2.9%*	*(27.6%)*	*38.4%*	*28.7%*	*24.6%*	*12.7%*	*(0.5%)*	*15.6%*	*23.2%*	*2.6%*	*3.8%*
% Operating margin	***43.9%***	***40.9%***	***34.8%***	***35.5%***	***41.5%***	***38.3%***	***32.9%***	***34.4%***	***31.9%***	***43.4%***	***36.6%***	***37.2%***	***38.8%***	***36.8%***	***38.0%***	***39.6%***	***37.6%***	***36.5%***
Dividends and interest	$ 165	$ 133	$ 132	$ 148	$ 117	$ 87	$ 147	$ 171	$ 193	$ 225	$ 225	$ 257	$ 578	$ 522	$ 901	$ 666	$ 484	$ 736
Other gains (losses)	(51)	199	184	-	(14)	158	-	-	-	-	-	-	332	144	0	42	328	0
Other income, net	$ 114	$ 332	$ 316	$ 148	$ 103	$ 245	$ 147	$ 171	$ 193	$ 225	$ 225	$ 257	$ 910	$ 666	$ 901	$ 708	$ 812	$ 736
Pre-tax income	$ 7,230	$ 8,497	$ 6,025	$ 6,319	$ 7,306	$ 8,239	$ 5,622	$ 6,519	$ 5,407	$ 11,285	$ 7,273	$ 8,168	$ 28,071	$ 27,686	$ 32,133	$ 27,092	$ 27,889	$ 28,833
% Pre-tax margin	*44.6%*	*42.6%*	*36.7%*	*36.4%*	*42.1%*	*39.4%*	*33.8%*	*35.4%*	*33.1%*	*44.3%*	*37.8%*	*38.4%*	*40.1%*	*37.7%*	*39.0%*	*40.6%*	*38.7%*	*37.5%*
Income taxes	$ 1,820	$ 1,863	$ 793	$ 445	$ 1,568	$ 1,615	$ 1,096	$ 1,239	$ 1,081	$ 2,257	$ 1,455	$ 1,634	$ 4,921	$ 5,518	$ 6,427	$ 6,524	$ 4,421	$ 5,673
% Tax rate	*25.2%*	*21.9%*	*13.2%*	*7.0%*	*21.5%*	*19.6%*	*19.5%*	*19.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*17.5%*	*19.9%*	*20.0%*	*24.1%*	*15.9%*	*19.7%*
Net income	$ 5,410	$ 6,634	$ 5,232	$ 5,874	$ 5,738	$ 6,624	$ 4,525	$ 5,281	$ 4,326	$ 9,028	$ 5,818	$ 6,534	$ 23,150	$ 22,168	$ 25,707	$ 20,568	$ 23,468	$ 23,160
Unusual items	-	-	(461)	-	-	-	-	-	-	-	-	-	(461)	-	-	284	(461)	-
Earnings per share	**$ 0.62**	**$ 0.77**	**$ 0.61**	**$ 0.69**	**$ 0.68**	**$ 0.78**	**$ 0.54**	**$ 0.63**	**$ 0.52**	**$ 1.09**	**$ 0.70**	**$ 0.79**	**$ 2.69**	**$ 2.63**	**$ 3.10**	**$ 2.35**	**$ 2.76**	**$ 2.77**
% Change year-on-year	*56.4%*	*4.0%*	*36.2%*	*34.6%*	*8.6%*	*1.1%*	*(12.7%)*	*(8.7%)*	*(23.4%)*	*38.7%*	*30.8%*	*25.9%*	*28.2%*	*(2.6%)*	*17.9%*	*29.4%*	*17.4%*	*0.1%*
EPS - pro forma	$ 0.62	$ 0.77	$ 0.56	$ 0.69	$ 0.68	$ 0.78	$ 0.54	$ 0.63	$ 0.52	$ 1.09	$ 0.70	$ 0.79	$ 2.64	$ 2.63	$ 3.10	$ 2.39	$ 2.71	$ 2.77
% Change year-on-year	*56.4%*	*(1.2%)*	*18.7%*	*31.8%*	*8.6%*	*1.1%*	*(4.2%)*	*(8.7%)*	*(23.4%)*	*38.7%*	*30.8%*	*25.9%*	*21.5%*	*(0.6%)*	*17.9%*	*25.3%*	*13.5%*	*2.1%*
Diluted shares	8,695	8,570	8,510	8,521	8,490	8,465	8,429	8,393	8,357	8,321	8,284	8,248	8,593	8,444	8,303	8,741	8,497	8,375

Source: Company data, Nomura estimates

Fig. 2: Microsoft Statement of Profit & Loss (cont'd)

%

	FY 2011a				FY 2012e				FY 2013e				Fiscal Year ending June			Calendar Year		
FY ending in June ($ millions)	**sep**	**dec**	**mar**	**jun**	**sep**	**dec**	**mar-e**	**jun-e**	**sep-e**	**dec-e**	**mar-e**	**jun-e**	**FY 2011a**	**FY 2012e**	**FY 2013e**	**2010a**	**2011a**	**2012e**
Margin analysis / % Revenue																		
Cost of revenue	19.4%	24.2%	23.7%	21.4%	21.7%	27.0%	25.2%	22.6%	25.5%	25.8%	24.9%	23.3%	22.3%	24.2%	24.9%	20.8%	23.6%	24.8%
Gross profit	80.6%	75.8%	76.3%	78.6%	78.3%	73.0%	74.8%	77.4%	74.5%	74.2%	75.1%	76.7%	77.7%	75.8%	75.1%	79.2%	76.4%	75.2%
Research and development	13.6%	11.0%	13.8%	13.8%	13.4%	11.4%	14.2%	14.1%	15.7%	9.6%	12.5%	12.4%	12.9%	13.2%	12.2%	13.4%	13.0%	13.0%
Sales and marketing	17.3%	19.2%	20.7%	22.5%	16.7%	18.0%	20.4%	22.0%	19.6%	16.5%	19.4%	21.0%	19.9%	19.3%	18.9%	20.1%	19.4%	19.3%
General and administrative	5.8%	4.7%	7.1%	6.8%	6.7%	5.4%	7.4%	6.8%	7.4%	4.7%	6.6%	6.1%	6.0%	6.5%	6.0%	6.0%	6.4%	6.4%
Operating expenses	36.7%	34.9%	41.5%	43.1%	36.8%	34.7%	42.0%	42.9%	42.6%	30.8%	38.5%	39.4%	38.9%	38.9%	37.2%	39.6%	38.8%	38.6%
Operating income	43.9%	40.9%	34.8%	35.5%	41.5%	38.3%	32.9%	34.4%	31.9%	43.4%	36.6%	37.2%	38.8%	36.8%	38.0%	39.6%	37.6%	36.5%
Net income	33.4%	33.2%	31.8%	33.8%	33.0%	31.7%	27.2%	28.7%	26.5%	35.4%	30.2%	30.7%	33.1%	30.2%	31.2%	30.8%	32.6%	30.1%
Tax rate	25.2%	21.9%	13.2%	7.0%	21.5%	19.6%	19.5%	19.0%	20.0%	20.0%	20.0%	20.0%	17.5%	19.9%	20.0%	24.1%	15.9%	19.7%
% Growth, year-on-year																		
Revenue	25.3%	4.9%	13.3%	8.3%	7.3%	4.7%	1.4%	6.1%	(6.0%)	22.0%	15.5%	15.3%	11.9%	4.9%	12.2%	13.6%	8.0%	6.7%
Cost of revenue	10.5%	33.2%	41.5%	17.0%	20.3%	16.7%	7.5%	12.5%	10.0%	16.4%	14.2%	19.0%	25.7%	14.1%	15.1%	17.1%	22.5%	12.1%
Research and development	6.3%	5.1%	2.2%	1.8%	6.1%	8.5%	4.3%	8.6%	9.9%	3.7%	1.8%	1.0%	3.8%	6.9%	4.0%	4.3%	4.6%	6.6%
Sales and marketing	0.6%	5.7%	5.9%	8.7%	3.3%	(1.6%)	0.0%	3.8%	10.2%	11.4%	10.0%	9.8%	5.5%	1.3%	10.4%	6.8%	4.0%	6.2%
General and administrative	26.6%	(15.9%)	0.7%	19.5%	24.0%	18.5%	5.9%	6.0%	3.2%	7.7%	2.6%	3.2%	5.4%	12.8%	4.1%	4.5%	14.9%	5.7%
Operating expenses	6.1%	1.1%	3.8%	7.9%	7.6%	4.3%	2.4%	5.7%	8.8%	8.3%	5.9%	5.9%	4.7%	4.9%	7.2%	4.0%	5.9%	6.3%
Operating income	58.8%	(4.1%)	10.4%	4.1%	1.2%	(2.1%)	(4.1%)	2.9%	(27.6%)	38.4%	28.7%	24.6%	12.7%	(0.5%)	15.6%	23.2%	2.6%	3.8%
Net income	51.4%	(0.4%)	30.6%	30.0%	6.1%	(0.2%)	(13.5%)	(10.1%)	(24.6%)	36.3%	28.6%	23.7%	23.4%	(4.2%)	16.0%	26.5%	14.1%	(1.3%)
Earnings per share	56.4%	4.0%	36.2%	34.6%	8.6%	1.1%	(12.7%)	(8.7%)	(23.4%)	38.7%	30.8%	25.9%	28.2%	(2.6%)	17.9%	29.4%	17.4%	0.1%
EPS - pro forma	56.4%	(1.2%)	18.7%	31.8%	8.6%	1.1%	(4.2%)	(8.7%)	(23.4%)	38.7%	30.8%	25.9%	21.5%	(0.6%)	17.9%	25.3%	13.5%	2.1%
Diluted shares	(3.2%)	(4.3%)	(4.1%)	(3.4%)	(2.4%)	(1.2%)	(1.0%)	(1.5%)	(1.6%)	(1.7%)	(1.7%)	(1.7%)	(3.7%)	(1.7%)	(1.7%)	(2.2%)	(2.8%)	(1.4%)
% Growth, sequential																		
Revenue	1.0%	23.2%	(17.7%)	5.7%	0.0%	20.2%	(20.3%)	10.7%	(11.4%)	56.1%	(24.5%)	10.5%						
Research and development	(6.6%)	(0.5%)	3.8%	5.5%	(2.7%)	1.8%	(0.2%)	9.8%	(1.5%)	(3.9%)	(2.0%)	8.9%						
Sales and marketing	(22.1%)	36.3%	(11.3%)	15.4%	(25.9%)	29.7%	(9.8%)	19.7%	(21.4%)	31.2%	(11.0%)	19.6%						
General and administrative	(5.0%)	0.7%	22.8%	1.6%	(1.4%)	(3.7%)	9.6%	1.8%	(4.0%)	0.5%	4.5%	2.4%						
Operating expenses	(14.4%)	17.1%	(1.9%)	9.8%	(14.6%)	13.5%	(3.7%)	13.2%	(12.1%)	13.0%	(5.8%)	13.2%						
Operating income	20.0%	14.7%	(30.1%)	8.1%	16.7%	11.0%	(31.5%)	16.0%	(17.9%)	112.1%	(36.3%)	12.3%						
Net income	19.7%	22.6%	(21.1%)	12.3%	(2.3%)	15.4%	(31.7%)	16.7%	(18.1%)	108.7%	(35.6%)	12.3%						
Earnings per share	21.5%	24.4%	(20.6%)	12.1%	(2.0%)	15.8%	(31.4%)	17.2%	(17.7%)	109.6%	(35.3%)	12.8%						
EPS - pro forma	18.9%	24.4%	(27.6%)	23.0%	(2.0%)	15.8%	(31.4%)	17.2%	(17.7%)	109.6%	(35.3%)	12.8%						
Diluted shares	(1.4%)	(1.4%)	(0.7%)	0.1%	(0.4%)	(0.3%)	(0.4%)	(0.4%)	(0.4%)	(0.4%)	(0.4%)	(0.4%)						

Source: Company data, Nomura estimates

Fig. 3: Microsoft Segment Summary

$ in millions

	FY 2011a				FY 2012e				FY 2013e				Fiscal Year ending June			Calendar Year		
FY ending in June ($ millions)	**sep**	**dec**	**mar**	**jun**	**sep**	**dec**	**mar-e**	**jun-e**	**sep-e**	**dec-e**	**mar-e**	**jun-e**	**FY 2011a**	**FY 2012e**	**FY 2013e**	**2010a**	**2011a**	**2012e**
Revenue																		
Windows & Windows Live Division (WWLD)	$ 4,787	$ 5,056	$ 4,447	$ 4,743	$ 4,868	$ 4,736	$ 4,001	$ 4,733	$ 2,921	$ 7,675	$ 5,271	$ 5,573	$ 19,033	$ 18,338	$ 21,440	$ 19,274	$ 18,794	$ 19,331
Server and Tools (S&T)	3,861	4,288	4,007	4,524	4,250	4,772	4,413	4,980	4,641	5,225	4,814	5,429	16,680	18,415	20,109	16,004	17,553	19,259
Online Services Division (OSD)	547	713	667	680	641	784	738	759	734	901	848	872	2,607	2,922	3,355	2,394	2,772	3,132
Microsoft Business Division (MBD)	5,202	6,110	5,329	5,873	5,607	6,279	5,411	6,219	5,870	6,806	6,004	7,463	22,514	23,516	26,143	21,028	23,088	24,307
Entertainment and Devices (EDD)	1,795	3,698	1,935	1,487	1,961	4,237	2,090	1,740	2,157	4,873	2,299	1,914	8,915	10,028	11,242	7,847	9,620	10,859
Unallocated and other	3	88	43	60	45	77	0	0	0	0	0	0	194	122	0	143	225	0
Revenue	**$ 16,195**	**$ 19,953**	**$ 16,428**	**$ 17,367**	**$ 17,372**	**$ 20,885**	**$ 16,654**	**$ 18,431**	**$ 16,323**	**$ 25,480**	**$ 19,235**	**$ 21,250**	**$ 69,943**	**$ 73,341**	**$ 82,289**	**$ 66,690**	**$ 72,052**	**$ 76,888**
% Revenue																		
Windows & Windows Live Division (WWLD)	29.6%	25.3%	27.1%	27.3%	28.0%	22.7%	24.0%	25.7%	17.9%	30.1%	27.4%	26.2%	27.2%	25.0%	26.1%	28.9%	26.1%	25.1%
Server and Tools (S&T)	23.8%	21.5%	24.4%	26.0%	24.5%	22.8%	26.5%	27.0%	28.4%	20.5%	25.0%	25.5%	23.8%	25.1%	24.4%	24.0%	24.4%	25.0%
Online Services Division (OSD)	3.4%	3.6%	4.1%	3.9%	3.7%	3.8%	4.4%	4.1%	4.5%	3.5%	4.4%	4.1%	3.7%	4.0%	4.1%	3.6%	3.8%	4.1%
Microsoft Business Division (MBD)	32.1%	30.6%	32.4%	33.8%	32.3%	30.1%	32.5%	33.7%	36.0%	26.7%	31.2%	35.1%	32.2%	32.1%	31.8%	31.5%	32.0%	31.6%
Entertainment and Devices (EDD)	11.1%	18.5%	11.8%	8.6%	11.3%	20.3%	12.5%	9.4%	13.2%	19.1%	12.0%	9.0%	12.7%	13.7%	13.7%	11.8%	13.4%	14.1%
Unallocated and other	0.0%	0.4%	0.3%	0.3%	0.3%	0.4%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.3%	0.2%	0.0%	0.2%	0.3%	0.0%
% Growth, year-on-year																		
Windows & Windows Live Division (WWLD)	66.2%	(29.6%)	(4.4%)	(0.8%)	1.7%	(6.3%)	(10.0%)	(0.2%)	(40.0%)	62.1%	31.7%	17.7%	(2.4%)	(3.7%)	16.9%	15.6%	(2.5%)	2.9%
Server and Tools (S&T)	8.9%	7.8%	8.1%	9.0%	10.1%	11.3%	10.1%	10.1%	9.2%	9.5%	9.1%	9.0%	8.5%	10.4%	9.2%	10.1%	9.7%	9.7%
Online Services Division (OSD)	12.1%	23.1%	17.8%	19.7%	17.2%	10.0%	10.7%	11.7%	14.5%	14.9%	14.8%	14.9%	18.4%	12.1%	14.8%	15.4%	15.8%	13.0%
Microsoft Business Division (MBD)	15.7%	25.6%	22.8%	9.3%	7.8%	2.8%	1.5%	5.9%	4.7%	8.4%	11.0%	20.0%	18.0%	4.5%	11.2%	14.1%	9.8%	5.3%
Entertainment and Devices (EDD)	26.1%	54.7%	59.9%	30.0%	9.2%	14.6%	8.0%	17.0%	10.0%	15.0%	10.0%	10.0%	44.5%	12.5%	12.1%	17.1%	22.6%	12.9%
Revenue	25.3%	4.9%	13.3%	8.3%	7.3%	4.7%	1.4%	6.1%	(6.0%)	22.0%	15.5%	15.3%	11.9%	4.9%	12.2%	13.6%	8.0%	6.7%
% Growth, sequential																		
Windows & Windows Live Division (WWLD)	0.1%	5.6%	(12.0%)	6.7%	2.6%	(2.7%)	(15.5%)	18.3%	(38.3%)	162.7%	(31.3%)	5.7%						
Server and Tools (S&T)	(6.9%)	11.1%	(6.6%)	12.9%	(6.1%)	12.3%	(7.5%)	12.9%	(6.8%)	12.6%	(7.9%)	12.8%						
Online Services Division (OSD)	(3.7%)	30.3%	(6.5%)	1.9%	(5.7%)	22.3%	(5.8%)	2.8%	(3.3%)	22.8%	(5.9%)	2.9%						
Microsoft Business Division (MBD)	(3.2%)	17.5%	(12.8%)	10.2%	(4.5%)	12.0%	(13.8%)	14.9%	(5.6%)	15.9%	(11.8%)	24.3%						
Entertainment and Devices (EDD)	56.9%	106.0%	(47.7%)	(23.2%)	31.9%	116.1%	(50.7%)	(16.7%)	24.0%	125.9%	(52.8%)	(16.7%)						
Revenue	1.0%	23.2%	(17.7%)	5.7%	0.0%	20.2%	(20.3%)	10.7%	(11.4%)	56.1%	(24.5%)	10.5%						

Source: Company data, Nomura estimates

Fig. 4: Microsoft Segment Summary (cont'd)

$ in millions

	FY 2011a				FY 2012e				FY 2013e				Fiscal Year ending June			Calendar Year		
FY ending in June ($ millions)	**sep**	**dec**	**mar**	**jun**	**sep**	**dec**	**mar-e**	**jun-e**	**sep-e**	**dec-e**	**mar-e**	**jun-e**	**FY 2011a**	**FY 2012e**	**FY 2013e**	**2010a**	**2011a**	**2012e**
Operating income																		
Windows & Windows Live Division (WWLD)	$ 3,288	$ 3,214	$ 2,788	$ 2,904	$ 3,251	$ 2,850	$ 2,431	$ 2,777	$ 1,167	$ 5,550	$ 3,269	$ 3,451	$ 12,194	$ 11,309	$ 13,438	$ 12,641	$ 11,793	$ 11,925
Server and Tools (S&T)	1,537	1,711	1,349	1,684	1,597	1,996	1,412	1,758	1,695	2,001	1,572	1,885	6,281	6,763	7,153	6,078	6,626	6,866
Online Services Division (OSD)	(573)	(559)	(775)	(744)	(513)	(458)	(659)	(583)	(529)	(431)	(506)	(579)	(2,651)	(2,213)	(2,045)	(2,529)	(2,490)	(2,202)
Microsoft Business Division (MBD)	3,483	4,087	3,308	3,755	3,687	4,152	3,348	3,927	3,813	4,406	3,783	4,719	14,633	15,114	16,721	13,331	14,902	15,495
Entertainment and Devices (EDD)	384	666	213	24	349	528	203	32	293	763	204	20	1,287	1,111	1,280	1,028	1,114	1,290
Corporate level activity	(1,003)	(954)	(1,174)	(1,452)	(1,168)	(1,074)	(1,260)	(1,562)	(1,226)	(1,229)	(1,273)	(1,586)	(4,583)	(5,064)	(5,313)	(4,165)	(4,868)	(5,277)
Operating income	**$ 7,116**	**$ 8,165**	**$ 5,709**	**$ 6,171**	**$ 7,203**	**$ 7,994**	**$ 5,475**	**$ 6,348**	**$ 5,214**	**$ 11,060**	**$ 7,047**	**$ 7,911**	**$ 27,161**	**$ 27,020**	**$ 31,233**	**$ 26,384**	**$ 27,077**	**$ 28,098**
% Operating margin																		
Windows & Windows Live Division (WWLD)	68.7%	63.6%	62.7%	61.2%	66.8%	60.2%	60.8%	58.7%	40.0%	72.3%	62.0%	61.9%	64.1%	61.7%	62.7%	65.6%	62.7%	61.7%
Server and Tools (S&T)	39.8%	39.9%	33.7%	37.2%	37.6%	41.8%	32.0%	35.3%	36.5%	38.3%	32.7%	34.7%	37.7%	36.7%	35.6%	38.0%	37.7%	35.7%
Online Services Division (OSD)	(104.8%)	(78.4%)	(116.2%)	(109.4%)	(80.0%)	(58.4%)	(89.3%)	(76.8%)	(72.0%)	(47.9%)	(59.7%)	(66.3%)	(101.7%)	(75.7%)	(61.0%)	(105.6%)	(89.8%)	(70.3%)
Microsoft Business Division (MBD)	67.0%	66.9%	62.1%	63.9%	65.8%	66.1%	61.9%	63.2%	65.0%	64.7%	63.0%	63.2%	65.0%	64.3%	64.0%	63.4%	64.5%	63.7%
Entertainment and Devices (EDD)	21.4%	18.0%	11.0%	1.6%	17.8%	12.5%	9.7%	1.8%	13.6%	15.7%	8.9%	1.0%	14.4%	11.1%	11.4%	13.1%	11.6%	11.9%
% Operating margin	43.9%	40.9%	34.8%	35.5%	41.5%	38.3%	32.9%	34.4%	31.9%	43.4%	36.6%	37.2%	38.8%	36.8%	38.0%	39.6%	37.6%	36.5%
% Growth, year-on-year																		
Windows & Windows Live Division (WWLD)	121.1%	(40.6%)	(9.3%)	(5.3%)	(1.1%)	(11.3%)	(12.8%)	(4.4%)	(64.1%)	94.7%	34.5%	24.3%	(6.4%)	(7.3%)	18.8%	13.9%	(6.7%)	1.1%
Server and Tools (S&T)	23.5%	16.9%	6.2%	7.9%	3.9%	16.7%	4.7%	4.4%	6.1%	0.3%	11.3%	7.3%	13.4%	7.7%	5.8%	18.3%	9.0%	3.6%
Online Services Division (OSD)	20.1%	20.7%	9.3%	8.1%	(10.5%)	(18.1%)	(15.0%)	(21.6%)	3.0%	(5.8%)	(23.1%)	(0.8%)	13.4%	(16.5%)	(7.6%)	30.6%	(1.5%)	(11.6%)
Microsoft Business Division (MBD)	24.5%	38.8%	30.1%	16.7%	5.9%	1.6%	1.2%	4.6%	3.4%	6.1%	13.0%	20.2%	27.2%	3.3%	10.6%	19.0%	11.8%	4.0%
Entertainment and Devices (EDD)	45.5%	77.1%	42.0%	NM	(9.1%)	(20.7%)	(4.9%)	32.4%	(16.0%)	44.4%	0.6%	(37.6%)	108.3%	(13.6%)	15.1%	124.5%	8.4%	15.8%
Operating income	58.8%	(4.1%)	10.4%	4.1%	1.2%	(2.1%)	(4.1%)	2.9%	(27.6%)	38.4%	28.7%	24.6%	12.7%	(0.5%)	15.6%	23.2%	2.6%	3.8%
% Growth, sequential																		
Windows & Windows Live Division (WWLD)	7.2%	(2.3%)	(13.3%)	4.2%	11.9%	(12.3%)	(14.7%)	14.2%	(58.0%)	375.5%	(41.1%)	5.6%						
Server and Tools (S&T)	(1.5%)	11.3%	(21.2%)	24.8%	(5.2%)	25.0%	(29.2%)	24.4%	(3.6%)	18.1%	(21.5%)	19.9%						
Online Services Division (OSD)	(16.7%)	(2.4%)	38.6%	(4.0%)	(31.0%)	(10.7%)	43.9%	(11.5%)	(9.3%)	(18.4%)	17.4%	14.2%						
Microsoft Business Division (MBD)	8.2%	17.3%	(19.1%)	13.5%	(1.8%)	12.6%	(19.4%)	17.3%	(2.9%)	15.6%	(14.2%)	24.7%						
Entertainment and Devices (EDD)	NM	73.4%	(68.0%)	(88.7%)	NM	51.3%	(61.6%)	(84.3%)	NM	NM	(73.3%)	(90.3%)						
Operating income	20.0%	14.7%	(30.1%)	8.1%	16.7%	11.0%	(31.5%)	16.0%	(17.9%)	112.1%	(36.3%)	12.3%						

Source: Company data, Nomura estimates

Fig. 5: Microsoft Statement of Financial Position

$ in millions

	FY 2011a				FY 2012e				FY 2013e				Fiscal Year ending June			Calendar Year		
FY ending in June ($ millions)	**sep**	**dec**	**mar**	**jun**	**sep**	**dec**	**mar-e**	**jun-e**	**sep-e**	**dec-e**	**mar-e**	**jun-e**	**FY 2011a**	**FY 2012e**	**FY 2013e**	**2010a**	**2011a**	**2012e**
Statement of Financial Position																		
Assets:																		
Cash and cash equivalents	$ 8,161	$ 4,023	$ 7,021	$ 9,610	$ 12,881	$ 10,610	$ 16,002	$ 17,662	$ 24,399	$ 24,489	$ 31,136	$ 34,261	$ 9,610	$ 17,662	$ 34,261	$ 4,023	$ 10,610	$ 24,489
Short-term investments	36,012	37,229	43,129	43,162	44,522	41,126	41,126	41,126	41,126	41,126	41,126	41,126	43,162	41,126	41,126	37,229	41,126	41,126
Cash, equivalents, and ST investmen	**$44,173**	**$41,252**	**$50,150**	**$52,772**	**$57,403**	**$51,736**	**$57,128**	**$58,788**	**$65,525**	**$65,615**	**$72,262**	**$75,387**	**$52,772**	**$58,788**	**$75,387**	**$41,252**	**$51,736**	**$65,615**
Accounts receivable, net	9,646	12,874	10,033	14,987	10,153	13,643	10,096	15,696	10,628	15,578	11,617	17,986	14,987	15,696	17,986	12,874	13,643	15,578
Inventories	1,242	861	1,056	1,372	2,270	1,351	1,351	1,351	1,351	1,351	1,351	1,351	1,372	1,351	1,351	861	1,351	1,351
Deferred income taxes	2,344	2,548	2,586	2,467	2,190	2,169	2,169	2,169	2,169	2,169	2,169	2,169	2,467	2,169	2,169	2,548	2,169	2,169
Other	2,176	2,149	2,438	3,320	3,255	3,614	3,614	3,614	3,614	3,614	3,614	3,614	3,320	3,614	3,614	2,149	3,614	3,614
Total current assets	**$ 59,581**	**$ 59,684**	**$ 66,263**	**$ 74,918**	**$ 75,271**	**$ 72,513**	**$ 74,359**	**$ 81,618**	**$ 83,287**	**$ 88,327**	**$ 91,014**	**$ 100,507**	**$ 74,918**	**$ 81,618**	**$ 100,507**	**$ 59,684**	**$ 72,513**	**$ 88,327**
Property and equipment, net	$ 7,771	$ 7,799	$ 7,969	$ 8,162	$ 8,033	$ 8,010	$ 8,362	$ 8,607	$ 8,554	$ 8,405	$ 8,238	$ 8,054	$ 8,162	$ 8,607	$ 8,054	$ 7,799	$ 8,010	$ 8,405
Equity and other investments	9,211	10,022	10,748	10,865	8,576	7,550	7,550	7,550	7,550	7,550	7,550	7,550	10,865	7,550	7,550	10,022	7,550	7,550
Goodwill	12,471	12,502	12,554	12,581	12,537	19,670	19,670	19,670	19,670	19,670	19,670	19,670	12,581	19,670	19,670	12,502	19,670	19,670
Intangible assets, net	1,077	992	840	744	1,026	2,581	2,491	2,401	2,311	2,221	2,131	2,041	744	2,401	2,041	992	2,581	2,221
Deferred income taxes	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other long-term assets	1,429	1,307	1,353	1,434	1,972	1,919	1,919	1,919	1,919	1,919	1,919	1,919	1,434	1,919	1,919	1,307	1,919	1,919
Total assets	**$ 91,540**	**$ 92,306**	**$ 99,727**	**$ 108,704**	**$ 107,415**	**$ 112,243**	**$ 114,350**	**$ 121,765**	**$ 123,291**	**$ 128,092**	**$ 130,522**	**$ 139,741**	**$ 108,704**	**$ 121,765**	**$ 139,741**	**$ 92,306**	**$ 112,243**	**$ 128,092**
Liabilities:																		
Accounts payable	$ 3,654	$ 3,863	$ 3,829	$ 4,197	$ 3,719	$ 3,884	$ 4,553	$ 5,007	$ 4,465	$ 4,884	$ 4,950	$ 5,787	$ 4,197	$ 5,007	$ 5,787	$ 3,863	$ 3,884	$ 4,884
Short-term debt	1,000	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Accrued compensation	2,252	2,402	2,917	3,575	2,388	2,677	2,677	2,677	2,677	2,677	2,677	2,677	3,575	2,677	2,677	2,402	2,677	2,677
Income taxes	2,136	1,439	839	580	705	921	921	921	921	921	921	921	580	921	921	1,439	921	921
Short-term unearned revenue	12,767	12,063	11,887	15,722	14,345	13,985	13,323	17,001	17,387	15,586	14,865	18,971	15,722	17,001	18,971	12,063	13,985	15,586
Other	4,048	4,545	4,570	4,700	4,386	3,906	3,906	3,906	3,906	3,906	3,906	3,906	4,700	3,906	3,906	4,545	3,906	3,906
Total current liabilities	**$ 25,857**	**$ 24,312**	**$ 24,042**	**$ 28,774**	**$ 25,543**	**$ 25,373**	**$ 25,379**	**$ 29,512**	**$ 29,356**	**$ 27,974**	**$ 27,319**	**$ 32,262**	**$ 28,774**	**$ 29,512**	**$ 32,262**	**$ 24,312**	**$ 25,373**	**$ 27,974**
Long-term unearned revenue	$ 1,152	$ 1,354	$ 1,132	$ 1,398	$ 1,313	$ 1,349	$ 1,285	$ 1,640	$ 1,677	$ 1,503	$ 1,434	$ 1,830	$ 1,398	$ 1,640	$ 1,830	$ 1,354	$ 1,349	$ 1,503
Long-term debt	9,665	9,671	11,915	11,921	11,927	11,932	11,932	11,932	11,932	11,932	11,932	11,932	11,921	11,932	11,932	9,671	11,932	11,932
Other long-term liabilities	7,924	8,488	9,186	9,528	9,241	9,468	9,468	9,468	9,468	9,468	9,468	9,468	9,528	9,468	9,468	8,488	9,468	9,468
Total non-current liabilities	**$ 18,741**	**$ 19,513**	**$ 22,233**	**$ 22,847**	**$ 22,481**	**$ 22,749**	**$ 22,685**	**$ 23,040**	**$ 23,077**	**$ 22,903**	**$ 22,834**	**$ 23,230**	**$ 22,847**	**$ 23,040**	**$ 23,230**	**$ 19,513**	**$ 22,749**	**$ 22,903**
Equity:																		
Preferred stock	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Common stock	61,935	61,646	63,234	63,415	63,492	63,902	63,227	62,552	61,877	61,202	60,527	59,852	63,415	62,552	59,852	61,646	63,902	61,202
Retained earnings	(14,993)	(13,165)	(9,782)	(6,332)	(4,101)	219	3,059	6,661	8,981	16,012	19,842	24,397	(6,332)	6,661	24,397	(13,165)	219	16,012
Stockholders' equity	**$ 46,942**	**$ 48,481**	**$ 53,452**	**$ 57,083**	**$ 59,391**	**$ 64,121**	**$ 66,286**	**$ 69,213**	**$ 70,858**	**$ 77,214**	**$ 80,369**	**$ 84,249**	**$ 57,083**	**$ 69,213**	**$ 84,249**	**$ 48,481**	**$ 64,121**	**$ 77,214**
Total liabilities and equity	**$ 91,540**	**$ 92,306**	**$ 99,727**	**$ 108,704**	**$ 107,415**	**$ 112,243**	**$ 114,350**	**$ 121,765**	**$ 123,291**	**$ 128,092**	**$ 130,522**	**$ 139,741**	**$ 108,704**	**$ 121,765**	**$ 139,741**	**$ 92,306**	**$ 112,243**	**$ 128,092**

Source: Company data, Nomura estimates

Fig. 6: Microsoft Statement of Cash Flows

$ in millions

	FY 2011a				FY 2012e				FY 2013e				Fiscal Year ending June			Calendar Year		
FY ending in June ($ millions)	sep	dec	mar	jun	sep	dec	mar-e	jun-e	sep	dec	mar-e	jun-e	FY 2011a	FY 2012e	FY 2013e	2010a	2011a	2012e
Statement of Cash Flows																		
Cash flow from operations:																		
GAAP Net income	**$ 5,410**	**$ 6,634**	**$ 5,232**	**$ 5,874**	**$ 5,738**	**$ 6,624**	**$ 4,525**	**$ 5,281**	**$ 4,326**	**$ 9,028**	**$ 5,818**	**$ 6,534**	**$ 23,150**	**$ 22,168**	**$ 25,707**	**$ 20,568**	**$ 23,468**	**$ 23,160**
Depreciation, amortization, and non-cash items	$ 694	$ 663	$ 720	$ 689	$ 726	$ 678	$ 521	$ 628	$ 724	$ 820	$ 838	$ 855	$ 2,766	$ 2,553	$ 3,237	$ 2,769	$ 2,813	$ 2,693
Stock-based compensation	528	553	541	544	558	575	525	525	525	525	525	525	2,166	2,183	2,100	2,044	2,218	2,100
Net recognized losses (gains) on investments	(29)	(226)	(122)	15	(30)	(112)	0	0	0	0	0	0	(362)	(142)	0	(209)	(249)	0
Stock option income tax benefits	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Excess tax benefits from stock-based payments	(5)	(4)	(5)	(3)	(70)	(4)	(9)	(9)	(9)	(9)	(9)	(9)	(17)	(92)	(36)	(30)	(82)	(36)
Deferred income taxes	(148)	(117)	(59)	326	402	14	0	0	0	0	0	0	2	416	0	(989)	683	0
Deferral of unearned revenue	5,881	6,834	6,616	11,896	6,139	7,544	(726)	4,033	424	(1,974)	(791)	4,502	31,227	16,989	2,161	28,484	32,195	1,756
Recognition of unearned revenue	(6,862)	(7,301)	(7,026)	(7,746)	(7,653)	(8,057)	0	0	0	0	0	0	(28,935)	(15,710)	0	(27,613)	(30,482)	0
Other	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Accounts receivable	$ 3,674	$(3,270)	$ 3,031	$(4,886)	$ 4,733	$(3,652)	$ 3,547	$(5,599)	$ 5,067	$(4,949)	$ 3,960	$(6,369)	$(1,451)	$(972)	$(2,290)	$(1,793)	$(774)	$(1,935)
Inventories and other current assets	(260)	303	(788)	(1,075)	(660)	1,496	0	0	0	0	0	0	(1,820)	836	0	(127)	(1,027)	0
Other long-term assets	62	118	(8)	(110)	(75)	30	0	0	0	0	0	0	62	(45)	0	19	(163)	0
A/P and other current liabilities	(1,311)	(284)	186	321	(1,435)	570	669	455	(542)	419	66	837	(1,088)	258	779	654	(358)	1,000
Other long-term liabilities	560	283	354	97	120	156	0	0	0	0	0	0	1,294	276	0	1,600	727	0
Cash flow from operations	**$ 8,194**	**$ 4,186**	**$ 8,672**	**$ 5,942**	**$ 8,493**	**$ 5,862**	**$ 9,052**	**$ 5,312**	**$ 10,514**	**$ 3,859**	**$ 10,407**	**$ 6,876**	**$ 26,994**	**$ 28,719**	**$ 31,657**	**$ 25,377**	**$ 28,969**	**$ 28,738**
Cash flow from financing:																		
Common stock issued	$ 177	$ 660	$ 1,405	$ 180	$ 336	$ 208	$ 300	$ 300	$ 300	$ 300	$ 300	$ 300	$ 2,422	$ 1,144	$ 1,200	$ 2,171	$ 2,129	$ 1,200
Common stock repurchased	(4,399)	(5,052)	(848)	(1,256)	(1,934)	(1,042)	(1,500)	(1,500)	(1,500)	(1,500)	(1,500)	(1,500)	(11,555)	(5,976)	(6,000)	(15,313)	(5,080)	(6,000)
Issuance (repayment) of debt	4,721	(1,000)	2,239	0	0	0	0	0	0	0	0	0	5,960	0	0	3,663	2,239	0
Common+preferred dividend	(1,118)	(1,363)	(1,349)	(1,350)	(1,341)	(1,683)	(1,686)	(1,679)	(2,006)	(1,997)	(1,988)	(1,980)	(5,180)	(6,388)	(7,970)	(4,750)	(5,723)	(7,367)
Excess tax benefits from stock-based payments	5	4	5	3	70	4	9	9	9	9	9	9	17	92	36	30	82	36
Other	(25)	0	(15)	0	0	0	0	0	0	0	0	0	(40)	0	0	(15)	(15)	0
Cash flow from financing	**$(639)**	**$(6,751)**	**$ 1,437**	**$(2,423)**	**$(2,869)**	**$(2,513)**	**$(2,877)**	**$(2,870)**	**$(3,197)**	**$(3,188)**	**$(3,179)**	**$(3,171)**	**$(8,376)**	**$(11,128)**	**$(12,734)**	**$(14,214)**	**$(6,368)**	**$(12,131)**
Cash flow from investing:																		
Less additions to property and equipment	$(564)	$(491)	$(658)	$(642)	$(436)	$(498)	$(783)	$(783)	$(581)	$(581)	$(581)	$(581)	$(2,355)	$(2,500)	$(2,323)	$(2,221)	$(2,234)	$(2,728)
Acquisitions of companies, net of cash acquired	0	(69)	0	(2)	(875)	(8,627)	0	0	0	0	0	0	(71)	(9,502)	0	(212)	(9,504)	0
Purchases of investments	(7,417)	(5,896)	(14,394)	(8,286)	(11,299)	(10,047)	0	0	0	0	0	0	(35,993)	(21,346)	0	(28,704)	(44,026)	0
Maturities of investments	870	1,836	2,286	1,905	2,825	6,061	0	0	0	0	0	0	6,897	8,886	0	4,765	13,077	0
Sales of investments	2,154	3,050	5,627	6,075	7,470	7,543	0	0	0	0	0	0	16,906	15,013	0	9,822	26,715	0
Cash flow from investing	**$(4,957)**	**$(1,570)**	**$(7,139)**	**$(950)**	**$(2,315)**	**$(5,568)**	**$(783)**	**$(783)**	**$(581)**	**$(581)**	**$(581)**	**$(581)**	**$(14,616)**	**$(9,449)**	**$(2,323)**	**$(16,550)**	**$(15,972)**	**$(2,728)**
Cash and equivalents, end of period:																		
Net change in cash and equivalents	$ 2,598	$(4,135)	$ 2,970	$ 2,569	$ 3,309	$(2,219)	$ 5,392	$ 1,660	$ 6,737	$ 91	$ 6,647	$ 3,125	$ 4,002	$ 8,142	$ 16,599	$(5,387)	$ 6,629	$ 13,879
Effect of exchange rates on cash and equivalents	58	(3)	28	20	(38)	(52)	0	0	0	0	0	0	103	(90)	0	(12)	(42)	0
Cash and equivalents, beginning of period	5,505	8,161	4,023	7,021	9,610	12,881	10,610	16,002	17,662	24,399	24,489	31,136	5,505	9,610	17,662	9,422	4,023	10,610
Cash and equivalents, end of period	**$ 8,161**	**$ 4,023**	**$ 7,021**	**$ 9,610**	**$ 12,881**	**$ 10,610**	**$ 16,002**	**$ 17,662**	**$ 24,399**	**$ 24,489**	**$ 31,136**	**$ 34,261**	**$ 9,610**	**$ 17,662**	**$ 34,261**	**$ 4,023**	**$ 10,610**	**$ 24,489**
Short-term investments, end of period	$ 36,012	$ 37,229	$ 43,129	$ 43,162	$ 44,522	$ 41,126	$ 41,126	$ 41,126	$ 41,126	$ 41,126	$ 41,126	$ 41,126	$ 43,162	$ 41,126	$ 41,126	$ 37,229	$ 41,126	$ 41,126
Cash, equivalents and ST investments, end of period	**$ 44,173**	**$ 41,252**	**$ 50,150**	**$ 52,772**	**$ 57,403**	**$ 51,736**	**$ 57,128**	**$ 58,788**	**$ 65,525**	**$ 65,615**	**$ 72,262**	**$ 75,387**	**$ 52,772**	**$ 58,788**	**$ 75,387**	**$ 41,252**	**$ 51,736**	**$ 65,615**

Source: Company data, Nomura estimates

Appendix A-1

Analyst Certification

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Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Microsoft Corporation	MSFT US	USD 31.74	29-Feb-2012	Buy	Neutral	A6,A9

A6 A Nomura Group Company expects to receive or intends to seek compensation for investment banking services from the issuer in the next three months.

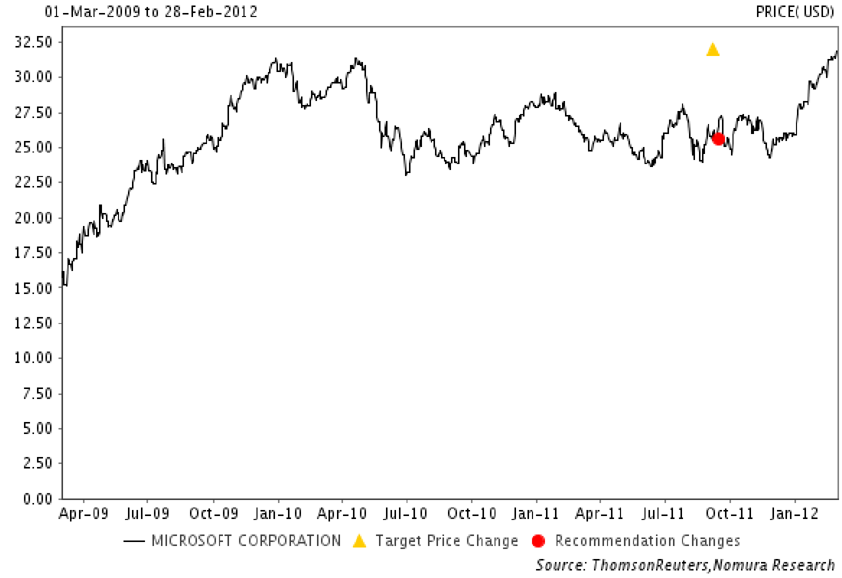
A9 Nomura Securities International Inc. makes a market in securities of the issuer.

Previous Rating

Issuer name	Previous Rating	Date of change
Microsoft Corporation	Not Rated	07-Sep-2011

Microsoft Corporation (MSFT US) **USD 31.74 (29-Feb-2012)** Buy (Sector rating: Neutral)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
07-Sep-11	Buy		26.00
07-Sep-11		32.00	26.00

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our 12-month target price is based on a weighted average of our three valuation metrics: DCF (50%), P/E (25%) and EV/uFCF (25%). We derive a weighted-average price target of $37. The benchmark for this stock is the S&P 500 Software Industry Index.

Risks that may impede the achievement of the target price The company and its products atrophy on the maturing PC platform; the PC segments of Windows and Office represent a significant share of revenues and earnings, and any serious problems here could overshadow good news elsewhere; Windows cannot move successfully to a tablet-like environment; the PC industry declines; the center of gravity shifts more quickly from PC-based computing to mobile-based communications as the platform for innovation; management changes; and macroeconomic risks to global financial stability.

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STOCKS

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SECTORS

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Explanation of Nomura's equity research rating system in Japan and Asia ex-Japan

STOCKS

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Target Price

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