MICROSOFT CORP
Form 10-Q
April 19, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended March 31, 2012

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition Period From to

Commission File Number: 0-14278

MICROSOFT CORPORATION

(Exact name of registrant as specified in its charter)

Washington	**91-1144442**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
One Microsoft Way, Redmond, Washington	**98052-6399**
(Address of principal executive offices)	**(Zip Code)**

(425) 882-8080

(Registrant s telephone number, including area code)

None

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	**Outstanding at April 17, 2012**
Common Stock, $0.00000625 par value per share	8,400,866,103 shares

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FORM 10-Q

For the Quarter Ended March 31, 2012

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INCOME STATEMENTS

(In millions, except per share amounts) (Unaudited)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	**2011**	**2012**	**2011**
Revenue	**$ 17,407**	$ 16,428	**$ 55,664**	$ 52,576
Operating expenses:				
Cost of revenue	**3,952**	3,897	**13,367**	11,869
Research and development	**2,517**	2,269	**7,217**	6,650
Sales and marketing	**3,414**	3,393	**10,076**	10,024
General and administrative	**1,150**	1,160	**3,433**	3,043
Total operating expenses	**11,033**	10,719	**34,093**	31,586
Operating income	**6,374**	5,709	**21,571**	20,990
Other income (expense)	**(11)**	316	**337**	762
Income before income taxes	**6,363**	6,025	**21,908**	21,752
Provision for income taxes	**1,255**	793	**4,438**	4,476
Net income	**$ 5,108**	$ 5,232	**$ 17,470**	$ 17,276
Earnings per share:				
Basic	**$ 0.61**	$ 0.62	**$ 2.08**	$ 2.03
Diluted	**$ 0.60**	$ 0.61	**$ 2.05**	$ 2.01
Weighted average shares outstanding:				
Basic	**8,401**	8,420	**8,398**	8,511
Diluted	**8,498**	8,510	**8,502**	8,609
Cash dividends declared per common share	**$ 0.20**	$ 0.16	**$ 0.60**	$ 0.48

See accompanying notes.

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BALANCE SHEETS

(In millions) (Unaudited)

	March 31, 2012	June 30, 2011[1]
Assets		
Current assets:		
Cash and cash equivalents	**$ 6,388**	$ 9,610
Short-term investments (including securities loaned of **$1,181** and $1,181)	**53,141**	43,162
Total cash, cash equivalents, and short-term investments	**59,529**	52,772
Accounts receivable, net of allowance for doubtful accounts of **$322** and $333	**10,961**	14,987
Inventories	**1,412**	1,372
Deferred income taxes	**2,350**	2,467
Other	**2,608**	3,320
Total current assets	**76,860**	74,918
Property and equipment, net of accumulated depreciation of **$10,952** and $9,829	**8,225**	8,162
Equity and other investments	**9,068**	10,865
Goodwill	**19,698**	12,581
Intangible assets, net	**2,756**	744
Other long-term assets	**1,403**	1,434
Total assets	**$ 118,010**	$ 108,704
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	**$ 3,790**	$ 4,197
Accrued compensation	**3,272**	3,575
Income taxes	**958**	580
Short-term unearned revenue	**13,929**	15,722
Securities lending payable	**1,210**	1,208
Other	**3,011**	3,492
Total current liabilities	**26,170**	28,774
Long-term debt	**11,938**	11,921
Long-term unearned revenue	**1,262**	1,398
Deferred income taxes	**1,456**	1,456
Other long-term liabilities	**8,525**	8,072
Total liabilities	**49,351**	51,621
Commitments and contingencies		
Stockholders equity:		

Common stock and paid-in capital shares authorized 24,000; outstanding **8,400** and 8,376	**65,273**	63,415
Retained earnings (deficit), including accumulated other comprehensive income of **$1,332** and $1,863	**3,386**	(6,332)
Total stockholders equity	**68,659**	57,083
Total liabilities and stockholders equity	**$ 118,010**	$ 108,704

(1) *Derived from audited financial statements.*

See accompanying notes.

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CASH FLOWS STATEMENTS

(In millions) (Unaudited)	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011	Nine Months Ended March 31, 2012	Nine Months Ended March 31, 2011
Operations				
Net income	**$ 5,108**	$ 5,232	**$ 17,470**	$ 17,276
Adjustments to reconcile net income to net cash from operations:				
Depreciation, amortization, and other	**766**	720	**2,170**	2,077
Stock-based compensation expense	**591**	541	**1,724**	1,622
Net recognized losses (gains) on investments and derivatives	**68**	(122)	**(74)**	(377)
Excess tax benefits from stock-based compensation	**(10)**	(5)	**(84)**	(14)
Deferred income taxes	**(134)**	(59)	**282**	(324)
Deferral of unearned revenue	**8,142**	6,616	**21,825**	19,331
Recognition of unearned revenue	**(8,283)**	(7,026)	**(23,993)**	(21,189)
Changes in operating assets and liabilities:				
Accounts receivable	**2,770**	3,031	**3,851**	3,435
Inventories	**(50)**	(170)	**(79)**	(258)
Other current assets	**73**	(618)	**938**	(487)
Other long-term assets	**9**	(8)	**(36)**	172
Accounts payable	**(114)**	(51)	**(380)**	(235)
Other current liabilities	**492**	237	**(107)**	(1,174)
Other long-term liabilities	**166**	354	**442**	1,197
Net cash from operations	**9,594**	8,672	**23,949**	21,052
Financing				
Short-term debt repayments, maturities of 90 days or less, net	**0**	0	**0**	(186)
Proceeds from issuance of debt, maturities longer than 90 days	**0**	2,239	**0**	6,960
Repayments of debt, maturities longer than 90 days	**0**	0	**0**	(814)
Common stock issued	**1,091**	1,405	**1,635**	2,242
Common stock repurchased	**(1,023)**	(848)	**(3,999)**	(10,299)
Common stock cash dividends paid	**(1,683)**	(1,349)	**(4,707)**	(3,830)
Excess tax benefits from stock-based compensation	**10**	5	**84**	14
Other	**0**	(15)	**0**	(40)
Net cash from (used in) financing	**(1,605)**	1,437	**(6,987)**	(5,953)
Investing				
Additions to property and equipment	**(749)**	(658)	**(1,683)**	(1,713)
Acquisition of companies, net of cash acquired, and purchases of intangible and other assets	**(84)**	0	**(9,586)**	(69)
Purchases of investments	**(23,951)**	(14,394)	**(45,297)**	(27,707)
Maturities of investments	**4,236**	2,286	**13,122**	4,992
Sales of investments	**7,946**	5,738	**23,317**	9,768

Securities lending payable	**361**	(111)	**3**	1,063
Net cash used in investing	**(12,241)**	(7,139)	**(20,124)**	(13,666)
Effect of exchange rates on cash and cash equivalents	**30**	28	**(60)**	83
Net change in cash and cash equivalents	**(4,222)**	2,998	**(3,222)**	1,516
Cash and cash equivalents, beginning of period	**10,610**	4,023	**9,610**	5,505
Cash and cash equivalents, end of period	**$ 6,388**	$ 7,021	**$ 6,388**	$ 7,021

See accompanying notes.

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STOCKHOLDERS EQUITY STATEMENTS

(In millions) (Unaudited)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	**2011**	**2012**	**2011**
Common stock and paid-in capital				
Balance, beginning of period	**$ 63,902**	$ 61,646	**$ 63,415**	$ 62,856
Common stock issued	**1,091**	1,405	**1,635**	2,242
Common stock repurchased	**(262)**	(240)	**(1,426)**	(3,220)
Stock-based compensation expense	**591**	541	**1,724**	1,622
Stock-based compensation income tax deficiencies	**(50)**	(118)	**(79)**	(266)
Other, net	**1**	0	**4**	0
Balance, end of period	**65,273**	63,234	**65,273**	63,234
Retained earnings (deficit)				
Balance, beginning of period	**219**	(13,165)	**(6,332)**	(16,681)
Net income	**5,108**	5,232	**17,470**	17,276
Other comprehensive income:				
Net unrealized gains (losses) on derivatives	**(44)**	(70)	**192**	(656)
Net unrealized gains (losses) on investments	**474**	83	**(551)**	1,099
Translation adjustments and other	**76**	99	**(172)**	311
Comprehensive income	**5,614**	5,344	**16,939**	18,030
Common stock cash dividends	**(1,686)**	(1,353)	**(5,046)**	(4,052)
Common stock repurchased	**(761)**	(608)	**(2,175)**	(7,079)
Balance, end of period	**3,386**	(9,782)	**3,386**	(9,782)
Total stockholders equity	**$ 68,659**	$ 53,452	**$ 68,659**	$ 53,452

See accompanying notes.

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NOTES TO FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 ACCOUNTING POLICIES

Accounting Principles

In the opinion of management, the accompanying balance sheets and related interim statements of income, cash flows, and stockholders equity include all adjustments, consisting only of normal recurring items, necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP). Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with information included in the Microsoft Corporation 2011 Form 10-K filed on July 28, 2011 with the U.S. Securities and Exchange Commission.

Principles of Consolidation

The financial statements include the accounts of Microsoft Corporation and its subsidiaries. Intercompany transactions and balances have been eliminated. Equity investments through which we exercise significant influence over but do not control the investee and are not the primary beneficiary of the investee s activities are accounted for using the equity method. Investments through which we are not able to exercise significant influence over the investee and which do not have readily determinable fair values are accounted for under the cost method.

Estimates and Assumptions

Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples include: estimates of loss contingencies, product warranties, product life cycles, product returns, and stock-based compensation forfeiture rates; assumptions such as the elements comprising a software arrangement, including the distinction between upgrades/enhancements and new products; when technological feasibility is achieved for our products; the potential outcome of future tax consequences of events that have been recognized in our financial statements or tax returns; estimating the fair value and/or potential goodwill impairment for our reporting units; and determining when investment impairments are other-than-temporary. Actual results and outcomes may differ from management s estimates and assumptions.

Recently Adopted Accounting Guidance

On July 1, 2011, we adopted guidance issued by the Financial Accounting Standards Board (FASB) on disclosure requirements related to fair value measurements. The guidance requires the disclosure of roll-forward activities on purchases, sales, issuance, and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). Adoption of this new guidance did not have a material impact on our financial statements.

On January 1, 2012, we adopted guidance issued by the FASB on accounting and disclosure requirements related to fair value measurements. The guidance limits the highest-and-best-use measure to nonfinancial assets, permits certain financial assets and liabilities with offsetting positions in market or counterparty credit risks to be measured at a net basis, and provides guidance on the applicability of premiums and discounts. Additionally, the guidance expands the disclosures on Level 3 inputs by requiring quantitative disclosure of the unobservable inputs and assumptions, as well as description of the valuation processes and the sensitivity of the fair value to changes in unobservable inputs. Adoption of this new guidance did not have a material impact on our financial statements.

Recent Accounting Guidance Not Yet Adopted

In December 2011, the FASB issued guidance enhancing disclosure requirements about the nature of an entity s right to offset and related arrangements associated with its financial instruments and derivative instruments. The new guidance requires the disclosure of the gross amounts subject to rights of set-off, amounts offset in accordance with the accounting standards followed, and the related net exposure. The new guidance will be effective for us beginning July 1, 2013. Other than requiring additional disclosures, we do not anticipate material impacts on our financial statements upon adoption.

In September 2011, the FASB issued guidance on testing goodwill for impairment. The new guidance provides an entity the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a

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reporting unit is less than its carrying amount. If an entity determines that this is the case, it is required to perform the currently prescribed two-step goodwill impairment test to identify potential goodwill impairment and measure the amount of goodwill impairment loss to be recognized for that reporting unit (if any). If an entity determines that the fair value of a reporting unit is greater than its carrying amount, the two-step goodwill impairment test is not required. The new guidance will be effective for us beginning July 1, 2012.

In June 2011, the FASB issued guidance on presentation of comprehensive income. The new guidance eliminates the current option to report other comprehensive income and its components in the statement of changes in stockholders equity. Instead, an entity will be required to present either a continuous statement of net income and other comprehensive income or in two separate but consecutive statements. This portion of the guidance will be effective for us beginning July 1, 2012 and will require financial statement presentation changes only. The new guidance also required entities to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented. However, in December 2011, the FASB issued guidance which indefinitely defers the guidance related to the presentation of reclassification adjustments.

NOTE 2 EARNINGS PER SHARE

Basic earnings per share (EPS) is computed based on the weighted average number of shares of common stock outstanding during the period. Diluted EPS is computed based on the weighted average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include outstanding stock options, stock awards, and shared performance stock awards. The components of basic and diluted EPS are as follows:

(In millions, except earnings per share)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	**2011**	**2012**	**2011**
Net income available for common shareholders (A)	**$ 5,108**	$ 5,232	**$ 17,470**	$ 17,276
Weighted average outstanding shares of common stock (B)	**8,401**	8,420	**8,398**	8,511
Dilutive effect of stock-based awards	**97**	90	**104**	98
Common stock and common stock equivalents (C)	**8,498**	8,510	**8,502**	8,609
Earnings Per Share:				
Basic (A/B)	**$ 0.61**	$ 0.62	**$ 2.08**	$ 2.03
Diluted (A/C)	**$ 0.60**	$ 0.61	**$ 2.05**	$ 2.01

We excluded the following shares underlying stock-based awards from the calculations of diluted EPS because their inclusion would have been anti-dilutive:

(In millions)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	**2011**	**2012**	**2011**

Shares excluded from calculations of diluted EPS	**0**	18	**1**	22

The decrease in anti-dilutive shares from the comparable period was due to the decrease in employee stock options outstanding and higher average share prices.

In June 2010, we issued $1.25 billion of zero-coupon debt securities that are convertible into shares of our common stock if certain conditions are met. As of March 31, 2012, none of these securities had met price or other conditions that would make them eligible for issuance and therefore were excluded from the calculation of both the basic and diluted EPS. See Note 11 Debt for additional information.

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NOTE 3 OTHER INCOME (EXPENSE)

The components of other income (expense) were as follows:

(In millions)	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011	Nine Months Ended March 31, 2012	Nine Months Ended March 31, 2011
Dividends and interest income	**$ 180**	$ 216	**$ 573**	$ 631
Interest expense	**(95)**	(84)	**(284)**	(201)
Net recognized gains on investments	**34**	187	**352**	339
Net gains (losses) on derivatives	**(102)**	(65)	**(278)**	38
Net gains (losses) on foreign currency remeasurements	**(8)**	55	**(52)**	(14)
Other	**(20)**	7	**26**	(31)