Dear shareholders, customers, partners, and employees:

I’m proud of the progress we’ve made as a company this past year and excited about the opportunity for even more progress in the year ahead. We’ve advanced our mission to **empower every person and every organization on the planet to achieve more.** We’ve continued to cultivate a Microsoft culture in which people connect their individual energies and passions for technology to this mission. We’re leading profound digital transformation both for people and institutions. We’ve achieved strong financial results. And we’re building a sturdy foundation for an even brighter future.

We generated $85.3 billion in revenue, $52.5 billion in gross margin, and $20.2 billion in operating income this past fiscal year. Adjusting for Windows 10 revenue deferrals and impairment, integration and restructuring expenses, revenue was $92.0 billion with $27.9 billion in operating income. Even as we invested in innovation and expanded geographically, we maintained our commitment to shareholder return and increased our total cash return to $26.1 billion, up 12 percent from last fiscal year. These results reflect exciting new product innovations as well as increases in customer usage and engagement across our businesses:

* Commercial cloud annualized revenue run rate exceeded $12.1 billion, up more than 50 percent year-over-year.
* More than 70 million people use Office 365 commercial every single month.
* Revenue from our cloud platform, Azure, grew triple digits, with usage of key computing and database workloads more than doubling year-over-year.
* Windows 10 is now active on more than 400 million devices around the world and over 197 billion hours of usage. This is the fastest adoption rate of any prior Windows release.
* Bing has leveraged this incredible usage to become profitable with search advertising revenue up 17 percent, excluding traffic acquisition costs.
* Xbox Live monthly active users grew 33 percent year-over-year to 49 million.

Over the past year, Microsoft has built momentum in each of its reportable segments, which is detailed below, but it’s the larger opportunity – how technology can inspire and ignite change and renewal – that I want to emphasize in this year’s letter.

**A transformational opportunity**

Microsoft is uniquely positioned in this era of massive business and societal transformation. We're the company that cares most deeply about computing technologies for *both* people and the organizations they build. Our entire purpose is to make things that help our customers make things -- and make things happen. We build the platforms upon which others build digital platforms. After all, each of us, as individuals, is trying to build something that outlasts ourselves, whether that’s a small business, a school, a clinic, or an enterprise.

Over the years Microsoft has experienced great success, and today we are just at the beginning of an incredible new wave of opportunity. The next generation of ubiquitous computing and ambient intelligence is going to transform every life, every industry, and every country.

What this means for organizations is that Microsoft is their partner in digital transformation – engaging customers, empowering employees, optimizing operations, and transforming products. What it means for people is that Microsoft helps them get more out of every moment – creating, collaborating, learning, gaming, being mobile, and staying secure.

Let’s look at how we’re doing this within each segment.

**Productivity and Business Processes**

Productivity is in our DNA, and so everything we do supports our customers’ digital work and life. Nowhere is digital transformation more evident than how we live and work today. We work on the go. We are on more teams, both inside and outside the company. We don’t have time for the information we need personally and professionally to live in different silos.

We’re not simply building individual tools, but rather designing an intelligent fabric based on four principles – collaboration, mobility, intelligence, and trust. People still do important work as individuals, but collaboration is the new norm, so we build our tools to empower teams. We aspire to help everyone be productive no matter where they are, regardless of the device they use. Your data, apps, and settings – all of your content – roam with you across your computing experiences. Intelligence is an amazing force multiplier. To be successful amid the explosion of data, people need analytics, services, and agents that use intelligence to help them manage their scarcest resource – time. Finally, trust is the foundation upon which everything we do is built. That’s why we are investing deeply in security and compliance that set the standard for enterprise-grade productivity.

The two pillars of this ambition are Office 365 and Dynamics 365.

Office 365 is changing the nature of work for individuals and teams. Customers love the power of Office on Windows and Mac as well as their iOS and Android mobile devices. In fact, Office is on more than 50 million iOS and Android monthly active devices, up more than four times over last year. Industry analyst surveys report that in cloud email, Microsoft is the clear choice. And we continue to see great momentum as innovative companies like GE, Facebook, Hershey, and Discovery Communications adopt Office 365.

We recently launched Dynamics 365 to empower business users with built-in insights and intelligence, accessed from within the business applications they’re working on – cloud-based apps like field service, sales, finance, and operations. It is deeply integrated with Office 365 to bring together all of the capabilities people need to get their jobs done. Business process tools in the past were hostage to silos of information and monolithic suites of applications. We’re removing those impedances by bringing together communications and collaboration capabilities so they work seamlessly for every role. Overall, Dynamics 365 builds on a strong base of nearly 10 million monthly paid seats, up more than 20 percent year-over-year. And in this past year, we saw Dynamics CRM Online seat additions more than double year-over-year, driving overall Dynamics revenue growth.

This year Microsoft and LinkedIn announced our agreement to join forces to connect the world’s professional cloud and the world’s professional network – creating new experiences and new value for users. Together we will have a transformative effect through our shared ambition to reinvent ways for professionals to be more productive. With more than 1.2 billion Office users and 433 million LinkedIn members, our combined data graphs will forever change how Sales, HR, and other professionals get work done. Meetings will get better when Cortana can draw on your professional network to connect the dots so you stay one step ahead. Your online newsfeed will become more intelligent as the professional cloud and network tailor information to what’s going on at work, upcoming meetings, and projects underway. This acquisition will grow our total addressable market by creating a vibrant network that brings together a professional’s information in LinkedIn’s public network with the information created in Office 365 and Dynamics 365.

Looking ahead, our vision is to teach human language to all of the computing experiences that surround us. We imagine a world in which a deeply personal agent understands you, your organization, and your world, helping you get more out of every moment. Skype and Outlook with their hundreds of millions of users already are conversational canvases that will increasingly become rich platforms for getting every task done with new applications in the form of bots.

**Intelligent Cloud**

Our ambition to build the intelligent cloud is closely linked with the previous ambition. In fact, together with cloud-based applications like Office 365 and Dynamics 365, we are on track to achieve $20 billion in commercial cloud annualized revenue run rate in fiscal year 2018.

Every organization needs new cloud-based infrastructure and applications that can convert vast amounts of data into predictive and analytical power through the use of advanced machine learning, analytics, and cognitive services. The combination of Azure’s infrastructure and data services makes it possible for businesses to build digital transformation applications that better engage customers, optimize operations, and transform products and business models.

From an infrastructure perspective, we’ve continued to deliver on the promise of a global, hyperscale cloud platform with 30 unique Azure regions around the world. For perspective, we cover more countries and regions than any other cloud provider, from North America, to Asia, to Europe, to Latin America. We’re continuing to invest billions of dollars each year to build out more and more infrastructure. What this means for our customers is that they can scale their solutions without worrying about their cloud platform’s capacity or the complex demands of transparency, reliability, security, privacy, and compliance. In essence, we’re meeting their real-world needs both for today and tomorrow.

The Microsoft Cloud is open and offers choice. We broadly support a wide range of platforms and developer tools on Azure. Our acquisition of Xamarin, and our work with Red Hat, Docker, Mesosphere, and others reflect our commitment to working cross-platform. Nearly a third of customer virtual machines on Azure run Linux.

We are building our server products to become the edge of our cloud, supporting true hybrid computing. SQL Server 2016, Windows Server 2016, and System Center 2016 as well as Azure Stack enable customers to build a cloud platform that spans their own data centers and the public cloud.

Revenue within the Intelligent Cloud segment alone increased $1.3 billion, or 6 percent, driven in part by impressive gains in our Azure business. Azure revenue and usage grew by more than 100 percent in the final quarter of the year. More than 70 percent of the Fortune 500 have at least two different Microsoft Cloud offerings. And more than 80 percent of the world’s largest banks are Azure customers. We clearly are now one of the two enterprise cloud leaders.

It’s not just infrastructure driving this growth, but also the intelligence we infuse into applications. Customers such as Boeing, Jabil Circuit, and Land O’Lakes are using Microsoft’s industry-leading data management, machine learning, analytics, and cognitive services to infuse intelligence into their applications. The integration of cloud-based cognitive services like Cortana is just the tip of the spear, and will fuel our vision for conversation as a platform. We have more than 20 cognitive services APIs today, including for vision, speech, text, recommendations, and face and emotion detection. Developers use these APIs within their applications to augment users’ experiences by enabling solutions to see, hear, speak, and interpret the world around them. Our intelligent cloud is democratizing these capabilities for startups, small businesses, and enterprises alike.

**More Personal Computing**

Just as we are transforming business and society through cloud computing, we’re also revolutionizing the workplace to help organizations be more productive, and people do more. This was the year of reinventing Windows and delivering a renewed vision of one of the world’s most successful operating systems. We launched Windows 10 with a new concept – to enable Windows as a service, continuously delivering differentiated value across our ecosystem to better serve the needs of our customers. We engineered Windows 10 to enable innovative and more natural ways to interact and engage with devices – ask a question with your voice, draw with the flick of a pen, and secure your most important things with a smile or a touch. These experiences place users at the center so they can move seamlessly across all devices – from the PC, Xbox, phones, and Surface Hub, to mixed reality with Microsoft HoloLens and Windows Holographic.

With an installed base of more than 1 billion Windows devices – more than 400 million of which are already on Windows 10 and its 197 billion hours of usage – we have an opportunity to offer new experiences and deepen our engagement with Windows users. We see opportunities to innovate and grow in areas such as productivity and gaming, bringing these experiences to every device. And we continue to inspire new, innovative device categories like the two-in-one Surface, the pioneering HoloLens, and over 1,500 new Windows devices designed with our OEM partners.

Led by state-of-the-art security, Windows 10 is starting to drive digital transformation for customers in the enterprise. The U.S. Department of Defense and Accenture are just a few of the customers deploying Windows 10 to millions of employees to help protect them with industry-leading security features like Credential Guard, Device Guard, Windows Hello, and new cloud-based security services like Windows Defender Advanced Threat Protection. Our belief in building world-class enterprise security in Windows has contributed to nearly every one of our enterprise customers piloting Windows 10 this past fiscal year.

Windows is also built to support everyday experiences for everyone. Cortana – the first truly personal digital assistant -- came to life in Windows 10. Embedded within Windows 10, Cortana gets to know each user, helping to get things done, to organize schedules, respond to questions – all through natural user interaction.  And by learning more about the user over time, Cortana becomes increasingly useful every day. The Windows 10 Cortana search box has over 126 million monthly active users, and has been asked 12 billion questions to date. In turn, this intensity and frequency of usage helped drive Bing’s U.S. PC query share to nearly 22 percent in the final quarter of our past fiscal year.

Gaming is another area where Windows 10 will open new user experiences and scenarios. Gaming has been among the leading drivers of engagement on Windows 10, with more than 17.5 billion hours of gameplay on Windows 10 PCs in its first year. Xbox Live is connecting fans across Windows 10, iOS, and Android. Microsoft has an incredibly engaged gaming audience on Xbox Live with 49 million monthly users and growing – up 33 percent year-over-year. This growth is driven in part by strong franchises like Minecraft, which has sold more than 106 million copies to date. In fact, Xbox Live players of Minecraft increased 62 percent in the last year. Our gaming roadmap over the next 18 months is anchored by two significant console releases – Xbox One S and Project Scorpio – and investments in growth areas such as virtual reality, video, and eSports.

We continue to grow the Windows ecosystem by creating new computing categories. Surface, Surface Hub, and Microsoft HoloLens have pushed the boundaries of how personal the computing experience can be, with Surface Book and Surface Pro 4 released in the last year. Forward-looking customers like Rolls Royce, the PGA Tour, Japan Airlines, and Volvo already are embracing Microsoft HoloLens and the Windows Holographic platform, transforming the way they work by breaking down the barriers between virtual and physical reality. We are excited about these future growth areas but are also committed to ensuring that we are investing thoughtfully across our portfolio. Over the past fiscal year, we increased investment in key capabilities within Windows 10 and in new growth markets, while at the same time scaling back our investment commensurate with the opportunity in areas like phone.

Across each of these ambitions, Microsoft made significant progress this past year. And we’re investing in a future that is even more exciting.

**Investing in the Future**

Earlier in this letter I described the transformational opportunities that lie ahead, particularly in the realm of digital intelligence. We’re growing today’s core businesses and technologies, incubating for the future and investing in long-term computing breakthroughs. Within our research labs we’re hard at work on advanced machine learning – artificial intelligence – that will produce forewarnings that can put an end to distracted driving and one day identify a crisis like Zika before it happens. Quantum computing, theorized for decades by some of the world’s greatest minds as a way to harness the very building blocks of matter and energy for unimaginable computing capabilities and intelligence, is emerging today as a feasible technology. Its realization will bring new power to cure disease and address global challenges like climate change. Our people and partners right now are solving the hard problems of experimental and theoretical physics, mathematics, and computer science that will accelerate quantum computing’s becoming a reality.

And that brings us right back to our mission – to **empower every person and every organization on the planet to achieve more.**

**Computing and societal impact**

Last year I concluded this letter committing that we would continue to ask ourselves what are the challenges humankind faces, how can technology help, and what is the contribution of Microsoft? To me, these questions are essential to the rediscovery of the soul of Microsoft, and more broadly, the purpose of global companies in society. This past year we’ve witnessed movements that understandably question globalization and its impact on economic equality. With worldwide per capita GDP and productivity growth at roughly 1 percent, how do we return to vigorous growth that benefits everyone? That’s part of what we’re working to address both through our core business and through our broader work societally, including this past year with the founding of Microsoft Philanthropies.

When I meet with leaders in every part of the world, I hear their desire to work with Microsoft to create world class, cloud-enabled platforms, and applications that advance health, education, and economic growth, locally in their countries and communities. That is what inspires me most. And it’s why we are working with public and private sector partners to promote a public cloud for public good – expanding affordable internet connectivity, building next generation skills, and fostering policies that promote trustworthy computing in the cloud. This past year we announced that Microsoft Philanthropies will donate $1 billion in public cloud computing for nonprofits around the world.

Throughout our discussions with LinkedIn this year, I was struck in my conversations with founder Reid Hoffman and CEO Jeff Weiner that we share a commitment to more directly and more evenly spread opportunity for everyone. In fact, LinkedIn’s vision has been to create economic opportunity for every member of the global workforce—all 3 billion of them—by building the world’s first economic graph, a digital representation of the global economy and opportunity. The goal is to make labor markets work better for everyone by making them more efficient and open. Together we aspire to help everyone navigate an increasingly challenging global economy more effectively.

In conclusion, the test of any brand is its ability to have measurable impact and to remain relevant over time. Microsoft has done this in times of transition by innovating boldly. When I walk the hallways of Microsoft and talk with our talented people, the sense of purpose and urgency in realizing our mission through world class innovation is unmistakable.

Satya Nadella

Chief Executive Officer

October 18, 2016