

Microsoft Skids on Surface, Earnings Disappoint

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Los Angeles (AP) — Less than a year after Microsoft entered the tablet computer market with the Surface, the cracks are starting to show.

The software giant on Thursday booked a large write-off to its Surface RT business after it slashed prices on the tablets to stimulate demand this week. Its quarterly earnings results also showed that Windows 8, an operating system designed to bridge the divide between PCs and tablets, has been so poorly received that it contributed to a revenue drop in its operating system software unit.

The missteps in both strategic product lines disappointed Wall Street and shares plunged nearly 7 percent to \$33.10 in after-hours trading Thursday.

The write-down for expected losses on the Surface RT tablet amounted to \$900 million. Even without it, Microsoft's results would have fallen short of expectations.

The results came a week after the company announced a major reorganization to help it transform into a "devices and services" company that is less reliant on providing software for personal computers. The earnings miss raised new questions as to whether the transition will succeed.

"It doesn't inspire a lot of confidence," said Nomura Securities analyst Rick Sherlund. "You're in the hardware business now, and pretty shortly after entering it you have a pretty big write down. That's embarrassing."

Both Windows 8 and the Surface tablet represent Microsoft's big bets on the tablet computer market as PC sales continue to decline. Research firms IDC and Gartner said last week that global PC shipments fell 11 percent in the April-June quarter. It was the fifth consecutive quarterly decrease.

Acknowledging the company's difficulties with the change, Microsoft Chief Financial Officer Amy Hood told investors on a conference call that "this journey will take time."

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"We know we have to do better," she said. "We are confident we are moving in the right direction."

Microsoft cut the price of Surface RT from \$499 to \$349 on Sunday, a move designed to spur sales amid sluggish demand.

Microsoft began selling Surface tablets in October. The company shipped about a million tablets in the first three months of 2013, according to research firm IDC. That includes about 260,000 of the slimmed-down RT version and 750,000 of the Pro version of Surface, which is compatible with older Windows programs.

The shipments gave Microsoft a meager 2 percent share of the tablet market. Apple Inc. remained the leader with 39.1 percent and was followed by Samsung Electronics Co., AsusTek Computer Inc., Amazon.com Inc. and Acer Inc.

Microsoft also saw revenue from its flagship Windows operating system decline 6 percent in the recent quarter after excluding the late recognition of revenue from last year, when it offered discounted upgrades to users of older versions of Windows.

Consumers haven't responded well to Microsoft's latest operating system, Windows 8, and the results reflect the poor reception. IDC has said the new operating system is contributing to the longest slump in the history of personal computer sales. Gartner disagrees that Windows 8 is to blame.

Brendan Barnicle, an analyst with Pacific Crest Securities, said the entire PC market is undergoing a massive shift, especially as device makers increasingly develop their own operating systems, like Apple Inc. and Google Inc. do for their tablets and personal computers.

"Microsoft can't charge \$100 per device for Windows the way they could 20 years ago," Barnicle said.

In a sign that Microsoft is adjusting, the company said it expects to derive 65 percent of Windows revenue from third party computer manufacturers in the July-September quarter, down from 75 percent a year ago, prior to the Surface launch. More Windows revenue is coming from its own Surface line.

Revenue and profitability improved in Microsoft's other lines of business, including enterprise software, servers and tools, the Xbox video game division and the Bing search unit, but those results also fell short of analysts' forecasts.

Net income in the April-June quarter came to \$4.97 billion, or 59 cents per share, reversing a loss of \$492 million a year ago when it wrote down almost the entire value of its 2007 purchase of online ad service aQuantive.

Excluding the negative 7-cents-per-share Surface charge, earnings were 66 cents per share, short of the 75 cents per share expected by analysts polled by FactSet.

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Revenue grew 10 percent to \$19.90 billion, also below the \$20.72 million expected.

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