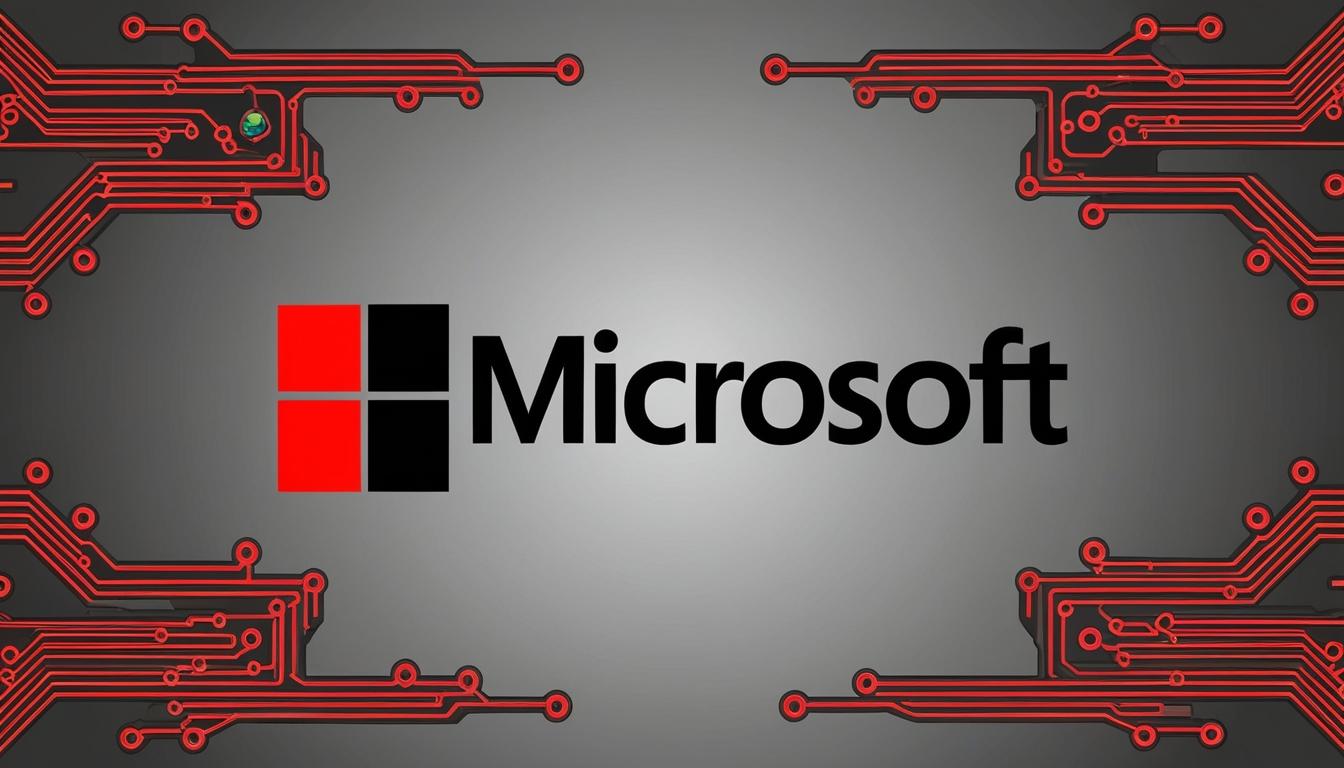
# Microsoft's AI growth amid challenges in Azure operations



In a recent report by PYMNTS, Microsoft showcased significant growth driven by the surging demand for artificial intelligence (AI) during its second quarter results. The company’s Copilot and Azure operations have played pivotal roles in propelling revenue and earnings, surpassing the expectations set by Wall Street. However, the company faced challenges within its non-AI business segment, specifically pertaining to its Azure operations, which fell at the low end of market forecasts.

Microsoft's CEO, Satya Nadella, highlighted that the AI sector of the business has achieved an annual revenue run rate exceeding $13 billion, reflecting an impressive year-on-year increase of 175%. He noted that enterprises are transitioning from merely proof-of-concept projects to implementing enterprise-wide AI deployments in order to unlock their full return on investment. “Enterprises are beginning to move from proofs-of-concept to enterprise-wide deployments to unlock the full ROI of AI,” Nadella remarked.

In the wake of the excitement generated by the arrival of generative AI technologies like ChatGPT, many companies have been slow to fully incorporate these innovations into their operations, frequently lingering in the preliminary stages of testing. However, Nadella believes that momentum is building, as costs associated with AI technologies decrease. He stated, “As AI becomes more efficient and accessible, we will see exponentially more demand.”

In addition to its existing offerings, Microsoft has announced that DeepSeek’s reasoning model, R1, will be integrated into the Azure lineup, becoming available to its customers. This model will allow DeepSeek to operate locally on Windows-based AI PCs, reducing the dependency on cloud services or constant internet connectivity. The announcement regarding DeepSeek's operational capabilities comes in light of its recent activities that stirred the market, particularly its reported expenditure of $5.6 million to develop a foundational model, significantly utilising older Nvidia H800 chips, which contrasts starkly with the estimated $100 million cost associated with training GPT-4.

Nadella praised DeepSeek's recent engineering advancements, indicating a noteworthy shift towards reducing training costs. He elaborated on the broader efficiency trends in the AI industry, attributing these advancements to Moore’s Law alongside AI scaling laws that enhance the performance of AI models as they consume more data and computational power. He explained, “When the cost to use deployed AI models (inference) come down, that means people consume more, and there will be more apps written,” indicating that lower costs could lead to more widespread adoption of AI technologies.

Furthermore, Microsoft has also observed growth in the realm of AI agents, which automate tasks for users beyond merely providing information. The company reported that over 160,000 organisations have utilised Microsoft’s Copilot Studio to generate upwards of 400,000 custom agents within a recent three-month period, doubling the output from the preceding quarter.

Despite the optimistic outlook on AI, Microsoft signalled potential difficulties in its non-AI business tied to Azure, particularly those involving third-party client interactions. The company acknowledged facing “execution challenges” as it aims to balance its AI and non-AI operations. Nadella expressed his preference for innovation over maintaining existing structures, stating, “you would rather win the new than just protect the past.”

Financially, Microsoft recorded a net income of $24.1 million for the second quarter, translating to $3.23 per share, which was above the Wall Street consensus estimate of $3.11 per share, and marking a 10% increase year on year. The company also reported a revenue figure of $69.63 billion, representing a 12% increase compared to the same period last year, surpassing expected results of $68.7 billion.

However, Microsoft shares experienced a downward trend, marking a 6% decline in late morning trading on Thursday. BofA Global Research analyst Brad Sills pointed out that “rare execution challenges impact Azure,” which has contributed to the revenue growth landing at the lower end of guidance, primarily due to difficulties in the broad partner channel. Despite these concerns, Sills maintained a “buy” rating for Microsoft stock, with a target price set at $510, while currently trading at $415.48. Sills summarised, “We continue to believe that Microsoft remains uniquely positioned to monetize the vast new AI opportunity across applications and infrastructure at scale.”

Source: [Noah Wire Services](https://www.noahwire.com)

## References

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