

EQUITY RESEARCH REPORT

STRATTON PIERCE SECURITIES
Technology Research Division

MICROSOFT CORPORATION (NASDAQ: MSFT)

Rating: STRONG BUY

Price Target: \$450.00

Current Price: \$415.25 (as of December 1, 2024)

Analyst: David Chen, CFA

Date: November 25, 2024

Sector: Cloud Computing & Enterprise Software

EXECUTIVE SUMMARY

We upgrade Microsoft Corporation (MSFT) to STRONG BUY with a revised price target of \$450, implying 8.4% upside from current levels. Our bullish stance is underpinned by:

- **Azure AI Acceleration:** Azure OpenAI services driving 35% growth in cloud segment
- **Copilot Monetization:** Microsoft 365 Copilot reaching 10M+ paid subscribers
- **Enterprise Software Dominance:** Sustained pricing power in productivity suite
- **Margin Expansion:** Operating leverage from high-margin AI services

KEY INVESTMENT HIGHLIGHTS

1. AI Revolution Leadership Position Microsoft's strategic partnership with OpenAI and integration of AI across its product portfolio has created a significant competitive moat. Key developments: - Azure OpenAI services revenue up 180% YoY - Microsoft 365 Copilot achieving 65% renewal rates - GitHub Copilot generating \$100M+ annual recurring revenue - Windows Copilot driving PC refresh cycle acceleration

2. Azure Cloud Momentum Continues Despite macro headwinds, Azure maintains robust growth: - Q4 2024 Azure growth: 29% YoY (31% constant currency) - Azure AI workloads now 12% of total Azure consumption - New Azure regions launched in Mexico, Denmark, and Malaysia - Enterprise migration accelerating post-pandemic digital transformation

3. Productivity Suite Pricing Power Microsoft 365 demonstrates exceptional pricing power: - Commercial products revenue up 12% YoY to \$17.8B - Office 365 Commercial seat growth of 8% YoY - Average revenue per user

(ARPU) up 6% driven by premium tiers - Teams integration creating switching costs and enterprise stickiness

FINANCIAL ANALYSIS

Q4 2024 Financial Highlights: - Total Revenue: \$65.6B (+16% YoY, above \$64.5B consensus) - Operating Income: \$30.6B (+14% YoY) - EPS: \$3.30 (vs. \$3.10 estimate) - More Personal Computing: \$13.2B (+17% YoY) - Productivity & Business: \$19.9B (+12% YoY) - Intelligent Cloud: \$31.8B (+20% YoY)

Margin Profile Improving: - Gross Margin: 69.4% (up 180 bps YoY) - Operating Margin: 46.7% (stable vs. prior year) - Strong operating leverage in high-margin cloud services

Balance Sheet & Capital Allocation: - Cash & short-term investments: \$75.4B - Total debt: \$47.7B - Free cash flow: \$23.2B in Q4 - Quarterly dividend: \$0.75 (+10.3% vs. prior year)

VALUATION ANALYSIS

Our \$450 price target reflects multiple expansion warranted by AI leadership:

Sum-of-the-Parts Valuation: - Azure & Cloud Services: \$320 per share (25x EV/Revenue) - Productivity & Business: \$85 per share (12x EV/Revenue) - More Personal Computing: \$30 per share (3x EV/Revenue) - Net Cash: \$15 per share

Trading Multiple Comparison: - Current P/E (NTM): 28.5x - Target P/E (NTM): 31.0x (justified by AI leadership premium) - EV/Revenue (NTM): 11.2x vs. 12.5x target

RISKS TO RATING

Downside Risks: - Increased competition in cloud computing from Amazon and Google - Potential AI regulation impacting OpenAI partnership - Economic slowdown affecting enterprise IT spending - Execution risk on AI product integrations

Upside Risks:

- Faster enterprise AI adoption than modeled - Successful expansion into new AI verticals (healthcare, manufacturing) - Market share gains in collaboration software post-remote work - Breakthrough in quantum computing commercialization

INVESTMENT RECOMMENDATION

Microsoft represents the best way to play the AI revolution in enterprise software. The company's distribution advantage, technical capabilities, and finan-

cial resources position it to maintain leadership as AI transforms knowledge work. We view any weakness as a buying opportunity.

- Key Catalysts:**
- Q1 2025 earnings (January 2025): Azure growth acceleration
 - Copilot usage metrics and monetization updates
 - New AI product launches at Build conference (May 2025) - Potential OpenAI IPO value unlock

Recommendation: STRONG BUY

Price Target: \$450.00 (+8.4% upside)

Risk Rating: MODERATE

QUARTERLY ESTIMATES REVISION

Metric	Q1 2025E	Q2 2025E	FY 2025E	FY 2026E
Revenue	3.42	3.58	13.85	15.60
(B) 67.2 69.8 272.5 298.7 EPS()				

Important Disclosures: Stratton Pierce Securities received investment banking compensation from Microsoft Corporation in the past 12 months. This report is intended for institutional investors only.

Analyst Certification: David Chen certifies that the views expressed in this report accurately reflect his personal views about Microsoft Corporation and its securities.

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