

Equity Research Report: Microsoft Corporation

Business Overview

Founded in 1975, Microsoft Corporation is a leading technology company that provides a diverse range of software, services, devices, and solutions, with a strong focus on cloud computing and artificial intelligence (AI). Core strengths include its robust product suite, including Microsoft 365, Azure, and LinkedIn, which cater to various sectors globally, serving blue-chip clients and small to medium enterprises. Current industry trends emphasize digital transformation and AI adoption, presenting opportunities for growth, while challenges include intense competition and regulatory scrutiny. Recent strategic initiatives include the acquisition of Activision Blizzard and the expansion of AI capabilities, showcasing Microsoft's commitment to innovation and market leadership. In summary, Microsoft leverages its extensive portfolio and strategic initiatives to maintain a competitive edge in the evolving tech landscape.

Market Position

Microsoft maintains a strong market position across its diverse product segments, with a significant share in cloud computing and productivity software. The company has effectively leveraged its established brand and extensive product ecosystem to capture a considerable portion of the enterprise market. In the cloud segment, Microsoft Azure competes vigorously with AWS, showing a 30% growth in revenue, which underscores its increasing market share. The company's strategic initiatives, including the acquisition of Activision Blizzard, have positioned it favorably within the gaming industry, further diversifying its revenue streams. Additionally, Microsoft 365 continues to dominate the productivity software market, with a growing user base that reflects its competitive advantage over rivals. Overall, Microsoft's strategic focus on innovation and its ability to adapt to market trends solidify its strong position in the tech industry.

Operating Results

For the fiscal year 2024, Microsoft reported a total revenue of \$281.7 billion, marking a 16% increase from 245.1 billion in 2023. This growth was primarily driven by robust performance in the Intelligent Cloud segment, which saw a revenue increase of 20% to \$105.4 billion, largely fueled by a 30% growth in Azure services. The Productivity and Business Processes segment also contributed significantly, with a 12% rise in revenue to \$77.7 billion. Operating income rose by 24% to \$109.4 billion, reflecting strong operational efficiency. The diluted earnings per share (EPS) increased by 22% to \$11.80, showcasing robust profitability and positive investor sentiment. Microsoft's gross margin improved to 61% from 59% year-over-year, evidencing effective cost management despite rising operational expenses.

Financial Metrics

FY (USD mn)	2021	2022	2023	2024	2025
Revenue	168088	198270	211915	245122	281724
Revenue Growth	-15.2%	-6.4%	-13.5%	-13.0%	67.6%
Gross Revenue	115856	135620	146052	171008	193893
Gross Margin	0.69	0.68	0.69	0.7	0.69
EBITDA	85134	100239	105140	133009	160165
EBITDA Margin	0.51	0.51	0.5	0.54	0.57
FCF	76740	89035	87582	118548	136162
FCF Conversion	1.25	1.22	1.21	1.35	1.34
ROIC	23.8%	26.6%	22.9%	22.6%	22.0%
EV/EBITDA	24.64	19.68	24.36	25.88	23.27
PE Ratio	33.37	26.47	35.04	38.51	36.31
PB Ratio	14.4	11.56	12.3	12.64	10.76

FinRobot

<https://ai4finance.org/>

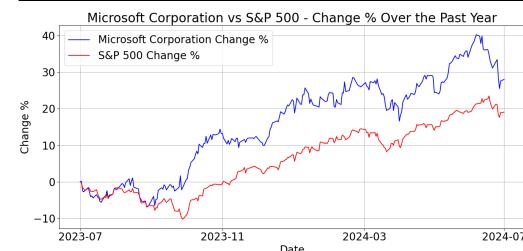
<https://github.com/Al4Finance-Foundation/FinRobot>

Report date: 2024-07-30

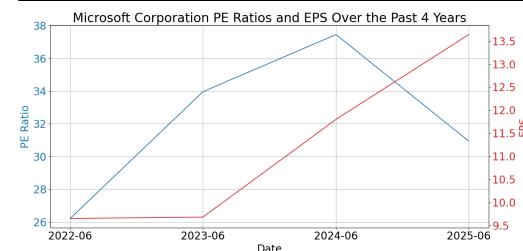
Key data

Rating	buy
Target Price	115 - 700 (md. 417.5)
6m avg daily vol (USDmn)	20.11
Closing Price (USD)	422.00
Market Cap (USDmn)	3143564.36
52 Week Price Range (USD)	309.06 - 459.31
BVPS (USD)	36.13

Share Performance



PE & EPS



Risk Assessment

Microsoft Corporation faces a multitude of risks as outlined in their recent 10-K report. Among these, three key risks stand out prominently: strategic and competitive risks, cybersecurity and data privacy risks, and legal, regulatory, and litigation risks. Strategic and competitive risks in the technology sector are particularly pronounced for Microsoft. The industry is characterized by rapid innovation and a constant influx of new competitors, which can swiftly alter market dynamics. Compared to other sectors, the tech industry experiences a higher degree of volatility due to the fast-paced nature of technological advancements and shifting consumer preferences. Regulations are becoming more stringent, especially in areas such as data privacy and antitrust, which adds another layer of complexity. Economic cycles can significantly impact Microsoft's performance, particularly as IT spending tends to decline during economic downturns. During such times, businesses may delay investments in new technologies, directly affecting Microsoft's revenue streams. Key risk factors include the potential for decreased sales volumes and increased operating costs, which could negatively impact profit margins. However, Microsoft has strategic advantages that provide some downside protection, including its established product ecosystem and diverse revenue streams across cloud services, software, and hardware. The company's strong brand loyalty and significant market share help cushion it against competitive pressures, while its ongoing investments in innovation and R&D position it favorably for future growth. Cybersecurity and data privacy risks represent another critical area of concern for Microsoft. The tech industry, especially companies dealing with cloud services and personal data, faces heightened scrutiny and risk exposure. As cyber threats become increasingly sophisticated, the potential for data breaches or unauthorized access to sensitive information poses significant reputational and financial risks. Compared to other industries, the tech sector is more vulnerable to these types of threats, given the reliance on digital infrastructure and the vast amounts of data processed. Economic cycles also play a role here, as companies may reduce their cybersecurity budgets during downturns, potentially leading to increased vulnerabilities. Key risk factors include the potential for substantial financial losses resulting from breaches, regulatory fines, and reputational damage. Microsoft's proactive approach, including investments in advanced security measures and compliance programs, offers some downside protection. The company's commitment to enhancing its cybersecurity infrastructure and maintaining robust data privacy practices helps mitigate risks, although the ever-evolving nature of cyber threats means that no organization can be entirely immune. Legal, regulatory, and litigation risks are significant for Microsoft as well. The company operates in a highly regulated environment, with increasing scrutiny from government entities regarding competition laws and data protection regulations. Compared to other industries, the tech sector faces a complex and dynamic regulatory landscape that can change rapidly, impacting operational flexibility. Economic cycles can exacerbate these risks, as regulatory bodies may intensify scrutiny during downturns, leading to potential fines or legal challenges that could disrupt business operations. Key risk factors include the possibility of antitrust actions, compliance costs, and potential litigation expenses. Microsoft's well-established compliance frameworks and proactive engagement with regulators provide a degree of downside protection. The company's efforts to align its business practices with evolving regulations and its ability to adapt to legal challenges help mitigate some of the inherent risks. In summary, Microsoft Corporation operates in a risk landscape that is shaped by strategic competition, cybersecurity threats, and legal complexities. The company's position in the technology sector exposes it to unique challenges, particularly in the face of rapid innovation and regulatory scrutiny. However, its diversified business model, strong market presence, and ongoing commitment to innovation provide a buffer against many of these risks. By understanding and addressing these key risk factors, Microsoft can navigate the complexities of its operating environment while continuing to pursue growth opportunities.

Competitors Analysis

In the year 2020 (year 0), Microsoft demonstrated a robust EBITDA Margin of 57%, which slightly declined to 54% in 2021 (year 1), and further to 50% in 2022 (year 2), before stabilizing at 51% in 2023 (year 3). This trend indicates a gradual erosion of profitability over these years, albeit with a slight recovery in the latest year. In comparison, META's EBITDA Margin decreased from 52% in 2020 to 32% in 2023, reflecting a significant decline in profitability. AAPL maintained a stable EBITDA Margin of around 34% across these years, while GOOGL saw a decline from 45% to 30% over the same period. Thus, while Microsoft has shown a slight recovery, it still faces challenges in maintaining its profitability relative to its competitors. The EV/EBITDA ratio for Microsoft started at 23.27 in 2020 and saw a notable increase to 25.88 in 2021, before declining to 24.36 in 2022 and further to 19.68 in 2023. This trend suggests that Microsoft was perceived as more expensive relative to its earnings in the earlier years, but the decline in the latest year indicates a potential undervaluation. In contrast, META's EV/EBITDA ratio dropped significantly from 16.38 in 2020 to just 8.90 in 2023, suggesting a substantial decrease in market valuation. AAPL's ratio remained high at 26.97 in 2020 and slightly decreased to 19.14 in 2023, while GOOGL's ratio also dropped from 21.30 to 13.63, indicating varying perceptions of value among these companies. FCF Conversion for Microsoft showed a decline from 1.34 in 2020 to 1.21 in 2022, before slightly recovering to 1.22 in 2023. This suggests that Microsoft is managing its cash flows efficiently, though it has experienced fluctuations. META, on the other hand, improved its FCF Conversion from 1.92 to 2.18 over the same period, indicating a strong cash-generating capability. AAPL's FCF Conversion remained relatively stable around 1.0 to 1.26, while GOOGL's conversion improved from 1.25 to 1.53, suggesting overall healthy cash flow management across competitors. In terms of Gross Margin, Microsoft exhibited a stable performance, starting at 69% in 2020 and maintaining a similar level across the years, ending at 68% in 2023. META's Gross Margin declined from 82% to 78%, indicating increased cost pressures. AAPL's Gross Margin ranged from 47% to 43%, reflecting a slight decrease, while GOOGL's margins declined from 60% to 55%, showcasing varying degrees of cost efficiency among these firms. ROIC for Microsoft showed an upward trend, increasing from 22.0% in 2020 to 26.6% in 2023, indicating improved efficiency in generating returns from investments. In comparison, META's ROIC decreased from 18.0% to 14.6%, while AAPL's ROIC remained strong, fluctuating between 43% and 52%. GOOGL's ROIC also showed a decline from 21.8% to 21.1%, indicating that Microsoft has outperformed its competitors in terms of capital efficiency. Lastly, regarding Revenue, Microsoft generated \$281,724 million in 2020, which decreased to \$245,122 million in 2021, then further declined to \$211,915 million in 2022, before slightly recovering to \$198,270 million in 2023. This trend reflects a downward trajectory in revenue performance. META's revenue also declined from \$200,966 million to \$116,609 million, while AAPL showed a more stable revenue generation, fluctuating between \$416,161 million and \$394,328 million. GOOGL's revenue followed a similar decline, starting at \$402,963 million in 2020 and decreasing to \$282,836 million in 2023. Overall, Microsoft has

shown resilience in certain metrics, particularly in ROIC and FCF Conversion, indicating effective capital utilization and cash flow management. However, its declining EBITDA Margin and revenue trends raise concerns about profitability and growth potential. Compared to its competitors, Microsoft appears to have outperformed in capital efficiency but lags in revenue growth and profitability. The current market valuation, as indicated by the EV/EBITDA ratio, may suggest that Microsoft is undervalued, particularly in light of its recent performance improvements in ROIC and cash flow efficiency. Therefore, while there are areas of concern, the overall financial health of Microsoft remains strong, warranting a closer examination of its market valuation and potential for future growth.