

## [Buy]

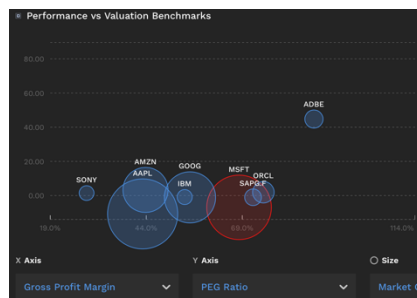
Price: US \$279.43

Price Target: US \$308

Upside: 10.2%

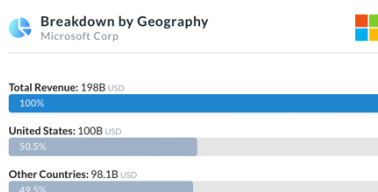
Company Info	
Ticker	MSFT
Exchange	NQGS
Market Cap	US \$2,080.02B
52-week High	US \$315.95
Headquarters	Redmond, WA   US
GICS Sector	Information Technology
Industry	Software
Sub-Industry	Systems Software

Figure 1: MSFT Competitor Performance



Source: Finbox Research

Figure 2: MSFT's Revenue breakdown - Geography



Source: Alpha Spread Research

## Microsoft Corporation

*A sure-shot flyer!*

### Investment Summary

Based on its strong positioning in software and cloud services markets, emphasis on developing and integrating AI technology into various products, seasonality driven revenue growth expectations in upcoming quarters, and its commitment to key ESG policies, along with our forecasted upside potential of 10.2%, we believe Microsoft Corporation to be a **BUY**.

### Business Description

Microsoft Corporation is a technology company, which develops and supports software, services, devices, and solutions. The company operates in three segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing. The Productivity and Business Processes segment consists of products and services in its portfolio of productivity, communication, and information services, spanning a variety of devices and platforms. This segment includes Office Consumer, LinkedIn, dynamics business solutions, and Office Commercial. The Intelligent Cloud segment consists of public, private, and hybrid server products and cloud services that can power modern businesses and developers. This segment includes server products and cloud services, and enterprise services. The More Personal Computing segment consists of products and services that put customers at the centre of the experience with its technology. This segment includes Windows, devices, gaming, and search and news advertising. Microsoft Corporation was founded in 1975 and is a constituent of the big three benchmark indices: Dow Jones Industrial Average (DJIA), Standard and Poor's 500 (S&P 500), and the Nasdaq-100 index.

### Industry & Competitor Overview

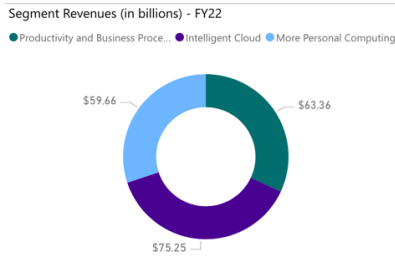
#### Headwinds:

- Global Chip Shortage:** The global semiconductor shortage is affecting the entire technology industry, and Microsoft is no exception. The shortage has led to increased prices for computer chips and delays in the production and shipment of devices. This can impact Microsoft's ability to release new products and services, as well as increase its costs for producing and selling its products.
- Regulatory Scrutiny:** As one of the largest technology companies in the world, Microsoft is subject to significant regulatory scrutiny from governments around the world. This includes antitrust and competition laws, data privacy regulations, and content moderation policies. Any changes in regulatory policies or legal challenges can create headwinds for the company, and potentially impact its operations and financial performance.

#### Tailwinds:

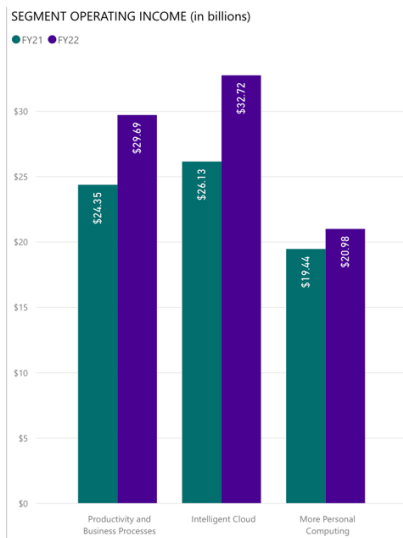
- Growing Cloud Computing Market:** MSFT is a major player in the cloud computing industry through its Azure platform. The global cloud computing market is expected to continue growing rapidly, with increasing demand for cloud-based services and solutions. This represents a significant tailwind for business growth and revenue potential in the coming years.
- Digital Transformation Acceleration:** The COVID-19 pandemic has caused a rapid acceleration in the adoption of digital technologies across industries, including cloud computing, collaboration tools, and online services. This trend is likely to continue as more businesses and individuals shift towards digital-first operations. As a leader in the technology sector, Microsoft is well-positioned to benefit from this tailwind and capture more market share in various business segments.

**Figure 3: MSFT Segment Revenue breakdown - FY22**



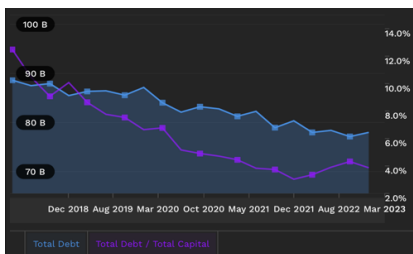
Source: FY22 Annual report – Power BI

**Figure 4: MSFT Segment Operating Income (FY21 vs FY22)**



Source: FY22 Annual report – Power BI

**Figure 5: MSFT Financial Leverage**



Source: Finbox Research

3. **AI age:** The recent advancements in AI with the likes of Chat-GPT and GPT-4 have garnered significant interest from various businesses and consumers, and Microsoft is at the forefront of this revolution with their partnership with OpenAI.

**Competitors:** In the software market, Microsoft faces competition from companies like Apple, Google, and Adobe. In the cloud computing market, Microsoft's main competitors include IBM, Oracle, SAP, Amazon Web Services (AWS), and Google Cloud. Within the gaming segment, it's Xbox competes with the likes of Sony's PlayStation and Nintendo's consoles. Despite fierce competition, Microsoft has maintained a strong market position in these industries due to its ability to innovate and quickly adapt to changing market conditions. The company has also made strategic acquisitions and partnerships to expand its product offerings and market reach.

## Environmental, Social, and Governance

**Environmental:** Microsoft has been committed to reducing its carbon footprint and has set ambitious goals to achieve carbon-negative status by 2030, and to remove all carbon the company has emitted since its founding in 1975 by 2050. Microsoft has also invested in renewable energy (signed PPAs for ~5.8GW) and has pledged to use 100% renewable energy by 2025. In addition, the company focuses on Responsible Sourcing, with strong commitments to become zero-waste and water-positive by 2030.

**Social:** Microsoft has been actively working to increase diversity and inclusion in its workforce, with a focus on hiring and retaining more women and underrepresented minorities. In addition, the company has implemented several policies to support its employees' well-being, such as parental leave policies, mental health resources, and flexible work arrangements. Microsoft has also been involved in philanthropic efforts through the Microsoft Philanthropies program, which supports nonprofits and provides technology access to underserved communities.

**Governance:** Microsoft has implemented strong governance practices, including an independent board of directors, regular audits, and transparency in financial reporting. The company has also been committed to ethical and responsible practices in its business operations and has implemented policies around privacy, security, and responsible AI (AI4Good).

## Financial Analysis

**Strong Performance:** According to Microsoft's financial statements, the company increased its profits and returned a substantial amount of cash to investors in the form of share repurchases (\$28.03B) and dividends (\$18.56B). FY22 witnessed a strong EBIT growth across all three operating segments: Productivity and Business Processes EBIT increased 22% driven by growth in Office 365 Commercial and LinkedIn; Intelligent Cloud EBIT rose 25% driven by Azure and other cloud services; and EBIT for More Personal Computing increased a marginal 8% owing to higher expenses driven by investments in Gaming, Search and news advertising. Revenue has virtually tripled, and growth has increased in the five years since Microsoft purchased LinkedIn.

**Solvency and Liquidity Remains Low:** MSFT had a Current Ratio of 1.78 at the end of FY22, which is 37.1% lower than the Technology sector. This was majorly due to the recent cash fuelled acquisitions and other macroeconomic impacts. However, it has improved since to H1 FY23 value of 1.93. It also has a high Interest Coverage ratio of 43.59 and a declining Debt-to-Equity ratio, signifying their focus on debt reduction.

**Strong Market Position:** Microsoft is one of the world's largest technology companies, with a strong presence in the software, cloud computing, and gaming markets. Microsoft's strong market position and financial performance reflect the company's ability to innovate and adapt to changing market conditions, as well as its commitment to investing in research and development and strategic acquisitions. The company's consumer businesses benefited from the remote environment as well, with strong engagement across Gaming platform and continued demand for PCs and productivity tools.

Figure 6: MSFT's top acquisitions



Source: FinShots Research Infographics

**Share Price Analysis:** The stock price was on a strong upward trend for almost 3 years, starting from CY18 till the end of CY21, achieving over 300% jump in value. However, the stock experienced a short fall (~28%) in its share price during Q3 of FY20 owing to the Covid-19 induced market selloff, but quickly bounced back to continue on its earlier upward trajectory. Over this period, MSFT went on an acquisitions spree to expand its market reach, which included some marquee businesses/products like GitHub and Nuance Communications. This boosted the stock performance significantly and led it to outperform the market (S&P 500 and Nasdaq-100). Microsoft also benefited from the rapid adoption of digital technologies during the lockdowns and remote-work phase with the surge in demand for online gaming and collaboration tools.

The MSFT stock, however, dropped by 27.69% in the CY22 owing to macroeconomic volatility. Extended production shutdowns in China that continued through May and a deteriorating PC market in June contributed to a negative impact on Windows OEM revenue of over \$300M. Reductions in advertising spend contributed to a negative impact on LinkedIn as well as Search and news advertising revenue of over \$100M. The company also scaled down its operations in Russia due to the ongoing war in Ukraine and recorded an opex of \$126M related to bad debt and severance. All of this, combined with the inflation/recessionary fears in the market, contributed to a large downward movement in the stock price. However, the share price since has risen 16.93% on the back of strong earnings reported during H1 FY23 and beaten both the indices.

**DCF/Multiples:** To find the target price, we conducted valuations using two methods: EV/EBITDA industry multiples and a 10Y Gordon Growth DCF model. For each method, we used the three-scenario technique - worst case, base case, and best case scenarios. We also considered analysts forecasts to give us a better approximation of our valuation model.

For the industry multiples valuation, we used LTM EBITDA and multiples ranging from 20.7x to 22.8x, which is in line with the observed historical 5Y trend. For the DCF valuation, we forecast revenues and EBITDA values 10 years into the future. We used a discount rate ranging from 9.5% to 10.5%, and a perpetual growth rate ranging from 2% to 3%.

Averaging all the estimated prices from various valuation methods, we find a target price of US \$308 per share, presenting an upside potential of 10.2%.

## Investment Risks

**Competitions and Disruptions:** Maintaining their ability to innovate along with their status as one of the top employers in a highly competitive sector, disruptions to supply of highly sophisticated computer components & foreign exchange risk represent Microsoft's principal business risks.

**Cybersecurity and Data Protection:** As a technology company, Microsoft is subject to cybersecurity risks, including cyber-attacks, data breaches, and other security incidents that could result in financial and reputational harm.

**Regulation and Licensing Landscape:** Microsoft operates in a heavily regulated industry, and changes in laws and regulations could impact its business operations and financial performance.