

Analyst: Omid Omarkhil
Sector: Technology
Rating: BUY
Target Price: \$532.89
Current Price: \$483.16
Upside Potential: 10.3%

Microsoft Equity Report

Company Overview

Microsoft Corporation (listed on NASDAQ as MSFT) is a global tech giant that has transformed from a leading software supplier to the most complete and integrated cloud and productivity company in the world. Founded in 1975 and headquartered in Redmond, Washington, the company used to be a dominant PC operating system provider, namely their iconic Windows operating system. Now, under the leadership of CEO Satya Nadella, the company has become one of the world's largest cloud, AI and productivity software platforms. Microsoft is now a vital component of the global digital economy, integrating its services into all levels of consumer and business technology. Its ecosystem has roots and ties across many enterprises, governments and consumers all around the world.

The company operates through 3 primary business segments: productivity and business processes, intelligent cloud and more personal computing. They thrive in all three segments which reflects in their high share price and market capitalisation. Their current share price (as of 5/12/25) is \$483.16 and their market cap is \$3.58988 trillion.

Microsoft's current strategy is to accelerate AI development and integration to get ahead of the rest of the tech world. Microsoft's AI integration is primarily branded under the umbrella term "Microsoft Copilot", with this it has become a foundational player in the global AI race having several long term development levers and enduring competitive advantages.

Executive Summary & Investment Thesis

Microsoft has been dominating the technology industry for many decades as shown by its high profitability, fantastic return on capital and having a variety of different revenue streams. Based on my discounted cash flow (DCF) analysis, I derived a target price of \$532.89 per share. With the fiscal year end price being \$483.16 per share, the return on investment would be 10.3%. Thus my recommendation is a strong buy.

Microsoft's revenue split is such that: 42.9% comes from intelligent cloud, 37.7% comes from productivity and business processes and 19.4% from more personal computing. The current trends in AI advancement and digital transformation only indicate that

Microsoft will continue to thrive in this current market. Microsoft has had a steady return on invested capital over the last 5 years between 29% and 35% per year with the 2020 ROIC being 29.72%.

Microsoft's business movements are on the level of its competitors like Apple, Amazon and Google and it even has higher operating margins and sales growth. The future of Microsoft is very bright as its business movements will only be better and innovative with the advancements of AI. With a steady revenue return. Microsoft's stock is seen by many as a low-risk and favourable investment.

Industry and Market Analysis

Microsoft is a part of and a main contributor to the technology and cloud computing industry. Rapid innovation, intense competition, and changing demand dynamics are characteristics of the global technology sector. Microsoft has heavy involvement in multiple industries including: cloud computing, artificial intelligence, enterprise software & productivity and personal computing & gaming.

The global computing market gets larger every single year due to evolving IT systems and increasing use of data worldwide. Microsoft Azure (which is Microsoft's cloud computing platform) is the second biggest cloud service only behind Amazon's AWS. Azure's main allure is its integration with Microsoft's web and software ecosystem. In this market Microsoft is the second biggest player and many users who use Microsoft's other products prefer it.

AI continues being the main talking point of the world. The race to optimise and integrate AI is the goal of every tech giant in the world. Rapid growth in AI requires high performance cloud services which Microsoft can provide (as mentioned previously.) Microsoft has a partnership with AI's biggest player OpenAI which shows how deeply involved it is in this industry. Microsoft's own AI, Copilot, works brilliantly with Microsoft's other products and services such as Collab and Excel. In this market, Microsoft is a main beneficiary of any AI innovations due to its large investment in AI giants and its own AI model evolving.

Microsoft is the leader of the enterprise and productivity software industry. They have a subscription based model that brings in consistent monthly/yearly revenue. Microsoft office and 365 are by far the largest in the market and are industry standards. This

report was made on word and data was extracted to excel which are Microsoft's most iconic software. There are almost no viable substitutes since Microsoft has already captured the majority of the market so other companies don't see a good reason to invest into this market. More and more firms are adopting a hybrid work schedule so the demand for Microsoft 365 and Teams is at an all time high. Google workspace is slowly growing but it is still no real competitor to Microsoft and won't be for the foreseeable future.

In the gaming industry, Microsoft's main competitors are Sony, Tencent and Nintendo. In terms of gaming hardware such as the Xbox, Microsoft is beaten by Sony and Nintendo. Instead of competing more in terms of hardware, Microsoft has chosen to prioritise their subscription based gaming model through Xbox game pass. This model provides a more stable cash flow compared to unit sales they were previously focused on.

Microsoft of course faces many risks and problems being involved in so many industries. Cloud infrastructure is being innovated and priced aggressively by AWS and Google Cloud. Microsoft faces regulatory scrutiny, the main issue being data sovereignty laws which affects global cloud supply. Investigations into their bundling strategies are also prominent. Macroeconomic sensitivity is another factor to identify, the main problem being currency volatility. Just over half of Microsoft's sales are from overseas so any change in global currency rates could lead to a lower return on capital.

Overall, Microsoft holds leadership or very strong positions in all these markets. Their well intertwined ecosystem, global trust, familiarity with software and innovation in AI provide Microsoft a competitive edge. Microsoft's diversified product portfolio bode well to capture long term growth and navigate future markets.

Historical Financial Performance

Refer to the Excel sheet attached for all the data mentioned

Metric	2020	2021	2022	2023	2024	2025
Revenue	\$143,01 5M	\$168,08 8M	\$198,270 M	\$211,915 M	\$245,12 2M	\$281,72 4M
Stock Price (At FY End)	\$203.51	\$270.90	\$258.63	\$340.54	\$446.95	\$497.41
YoY Growth %	13.65%	17.53%	17.96%	6.88%	15.67%	14.93%

Microsoft has had a compound annual growth of about 14.5%. The revenue growth in 2023 was significantly lower at only 6.88%. This could be due to macroeconomic obstacles and the slowdown/decline in the personal computing and productivity sector of Microsoft. The slowdown was caused by low demand post pandemic that affected the industry as a whole. As shown, 2024 was a return to form and the market returned to normal as the world moved on from the pandemic.

Microsoft's stock price reflects its consistent revenue growth as it also increases year on year. In 2022, the stock price was lower as the market in this year was shifting away from tech stocks and Microsoft was facing backlash about its customer facing business.

Metric	2020	2021	2022	2023	2024	2025
Cost of Revenue	\$46,078 M	\$52,232 M	\$62,650 M	\$65,863 M	\$74,114 M	\$87,831 M
Gross Profit	\$96,937 M	\$115,85 6M	\$135,620 M	\$146,05 2M	\$171,00 8M	\$193,89 3M
Gross Margin %	67.78%	68.93%	68.40%	68.92%	69.76%	68.82%

Gross profit has increased from \$99,937M to \$193,893M, which is a 100% increase in just 5 years, showing that Microsoft keeps on expanding and will do so for the

foreseeable future. Cost of revenue increases every year, with a 90% increase over the last 5 years, this is because inflation and all round price increases forces Microsoft to spend more money. Also for Microsoft to expand its business it must spend more money year on year to outcompete its industry rivals. Gross margin is very consistent, steady at around 68%. This reflects how safe Microsoft is as an investment and also shows that it is a definitive market leader. 2024 had the highest gross margin which is largely thanks to Azure's operating scale advantages.

Metric	2020	2021	2022	2023	2024	2025
Operating Income	\$52,959M	\$69,916M	\$83,383M	\$88,523M	\$109,433M	\$128,528M
Interest and Dividends Income	\$2,680M	\$2,131M	\$2,094M	\$2,994M	\$3,157M	\$2,647M
Interest Expenses	\$2,591M	\$2,346M	\$2,063M	\$1,968M	\$2,935M	\$2,385M
Other Income	\$77M	\$1,186M	\$333M	\$788M	\$1,646M	\$4,725M
Income Before Taxes	\$53,036M	\$71,102M	\$83,716M	\$89,311M	\$107,787M	\$123,627M
Provision for Income Taxes	\$8,755M	\$9,831M		\$10,978M	\$16,950M	\$19,651M
Net Income	\$44,281M	\$61,271M	\$72,738M	\$72,361M	\$88,136M	\$101,832M
Effective Tax Rate	16.50%	13.80%	13.10%	19%	18.20%	17.60%
Current Taxes	\$8,744M	\$9,981M		\$16,680M	\$23,009M	\$24,389M
EBITDA	\$68,423M	\$85,134M	\$100,239M	\$105,140M	\$133,009M	\$160,165M
Net Operating Profit After Tax	\$44,221M	\$60,268M	\$72,156M	\$71,704M	\$89,516M	\$105,907M

Operating income has increased 3x since 2020 showing how efficient Microsoft's main operations have become. Tripling over 5 years indicates: consistent revenue growth,

improved pricing and revenue outpacing growing costs. This signals durability in the market for investors and a higher return on investment .

Interest and dividend income has fluctuated over the years with no consistent trend. Over the last 3 years, it has averaged to \$2,900M. Microsoft's interest revenue has grown dramatically in recent years as a result of rising interest rates applied to its substantial cash and investment holdings. Despite supporting reported earnings, this income is non-core and subject to interest rate fluctuations. Profitability is not significantly impacted by dividend income.

From 2020-2023, Microsoft's interest expenses showed a steady decline. This is because as Microsoft's revenue costs have grown more and more, they have less need for borrowed funds so the monetary cost of these debts decrease. However in 2024 the expenses increased significantly by \$1M. This is primarily due to higher interest rates on its existing debt rather than aggressive new borrowing or a deterioration in credit quality.

Other income includes all non-operating activities that don't include Microsoft's main business segments. In 2025 they had a dramatic increase in this section increasing over \$3M. This significant increase is thanks to changes in the foreign exchange market. Since Microsoft generates 50% of their income from overseas, any positive change in the strength of the US dollar will be favorable for the company. This positive change happened in 2024 reflecting the inflated other income.

Income before tax and provision for income tax will naturally increase over the years since the revenue has increased every single year. Increased revenue reflects the increased income before tax. As Microsoft's revenue increases they will of course be made to pay more tax, reflecting in the provision and current tax provided in the table . Subtracting the provision for taxes from income before tax gives you the company's net income which also lines with the increase over the years. An anomaly is in 2023 where the net income was lower than the previous year. This was because of a large one time charge related to mass layoffs and restructuring costs.

Effective tax rate shows a decline over the years with a significant jump in 2023 followed by a return to trend. The jump in 2023 was caused mainly by the discontinuation of full R&D expense deductibility (section 174) in the US tax code. Another reason is that their large one time tax benefits expired in 2023. Microsoft's lower NOPAT in 2023 is reflected by the higher tax rate.

Metric	2020	2021	2022	2023	2024	2025
Earnings Per Share (Diluted)	\$5.76	\$8.05	\$9.65	\$9.68	\$11.80	\$13.64
Cash Dividend Per Share	\$2.04	\$2.24	\$2.48	\$2.72	\$3	\$3.32
Shares Outstanding	\$7,610M	\$7,547M	\$7,496M	\$7,446M	\$7,431M	\$7,433M
Market Capitalisation	\$1,548,635M	\$2,044,482M	\$1,938,690M	\$2,535,660M	\$3,321,285M	\$3,697,248M
Enterprise Value	\$1,598,386M	\$2,088,404M	\$1,974,540M	\$2,548,193M	\$3,347,907M	\$3,710,157M
Operating Margin	37%	41.60%	42.10%	41.80%	44.64%	45.62%
Net Margin	31%	36.45%	36.69%	34.15%	35.96%	36.15%

Earning per share increases proportionate to the increase in revenue. An average increase of \$2 per year shows a consistent growth that investors like to see. Microsoft's EPS growth was muted in FY2023 due to operating margin compression from increased investment spending, a higher effective tax rate, and slight share dilution. FY2023 should be viewed as a year of normalisation rather than a sign of diminishing underlying profitability. Cash dividend per year showed a consistent increase of about \$0.30 per share. There are no outliers this time and dividend payouts continue to increase over the years which surges more investors and retail traders. A gradual decrease in shares outstanding over the years is good for the investors since it means the value of existing shares increases.

A general shift away from growth stocks and valuation multiple compression in the face of rising interest rates were the primary causes of Microsoft's market capitalisation decline in 2022. The decline was caused by macroeconomic issues rather than a deterioration in the business's operating fundamentals. This year was an anomaly and the typical increase occurs throughout due to the increasing share price per year % outweighing the decreasing shares outstanding %. Evidently, the same trend follows enterprise value.

Operating margin acts as a profitability ratio which is increasing over the years since Microsoft has become more profitable every year and revenue has increased.

Microsoft's net margin fell in FY2023 as a result of slower post-pandemic revenue growth, higher investment and restructuring expenses, and a higher effective tax rate. The compression is a normalisation from exceptionally high prior year profitability rather than a drop in underlying earnings power.

Metric	2020	2021	2022	2023	2024	2025
Research & Development Expenses	\$19,269M	\$20,716M	\$24,512M	\$27,195M	\$29,510M	\$32,488M
Sales & Marketing Expenses	\$19,598M	\$20,117M	\$21,825M	\$22,759M	\$24,456M	\$25,654M
General & Administrative Expenses	\$5,111M	\$5,107M	\$5,900M	\$7,575M	\$7,609M	\$7,223M

Expenses in all sectors of Microsoft have increased every single year. Microsoft's spending increases are a result of a number of factors, including short-term restructuring and acquisition related costs, deliberate investments in cloud and AI infrastructure, and higher compensation costs. Although these factors affected short-term profitability, they promoted long-term scalability and competitive positioning.

Metric	2020	2021	2022	2023	2024	2025
Balance Sheet:						
Assets:						
Short-term Investments	\$122,95M	£116,11M	\$90,826M	\$76,558M	\$57,228M	\$64,323M
Cash and Cash Equivalents	\$13,576M	\$14,224M	\$13,931M	\$34,704M	\$18,315M	\$30,242M
Total Current Assets	\$181,91M	\$184,40M	\$169,684M	\$184,25M	\$159,73M	\$191,13M
Property & Equipment, Net	\$44,151M	\$59,715M	\$74,398M	\$95,641M	\$135,59M	\$204,96M

	\$43,351	\$49,711	\$67,524	\$67,886	\$119,22	\$119,50
Goodwill	M	M	M	M	0M	9M
					\$27,597	\$22,604
Intangible Assets	\$7,038M	\$7,800M	\$11,298M	\$9,366M	M	M
	\$301,31	\$333,77	\$364,840	\$411,97	\$512,16	\$619,00
Total Assets	1M	9M	M	6M	3M	3M
Liabilities & Equity:						
	\$72,310	\$88,657	\$95,082	\$104,14	\$125,28	\$141,21
Total Current Liabilities	M	M	M	9M	6M	8M
	\$59,578	\$50,074	\$47,032	\$41,990	\$42,688	\$40,152
Long-term Debt	M	M	M	M	M	M
	\$63,327	\$58,146	\$49,781	\$47,237	\$44,937	\$43,151
Total Debt	M	M	M	M	M	M
	\$183,00	\$191,79	\$198,298	\$205,75	\$243,68	\$275,52
Total Liabilities	7M	1M	M	3M	6M	4M
	\$118,30	\$141,98	\$166,542	\$206,22	\$268,47	\$343,47
Total Shareholder's Equity	4M	8M	M	3M	7M	9M
	\$110,31	\$130,14	\$154,265	\$186,38	\$237,35	\$305,97
Average Shareholder's Equity	7M	6M	M	3M	0M	8M
					\$1,246	
Inventories	\$1,895M	\$2,636M	\$3,742M	\$2,500M	M	\$938M
					\$1,873	\$1,092
Average Inventories	\$1,979M	\$2,266M	\$3,189M	\$3,121M	M	M
	\$32,011	\$38,043	\$44,261	\$46,688	\$56,924	\$69,905
Accounts Receivable	M	M	M	M	M	M
	\$168,05	\$185,91	\$202,482	\$218,75	\$295,09	\$356,38
Invested Capital	5M	0M	M	6M	9M	8M

Microsoft has almost doubled its asset base while reducing leverage and tripling equity which is a good indicator for a powerful firm.

Short term investments declined 48% since money was redeployed into operations. Microsoft's short term investments fell by more than \$19 billion in fiscal year (FY) 2024,

from \$76,558 million to \$57,228 million. This was the intended result of the company making two significant strategic capital deployments with its sizable cash reserves. The primary cause was the completion of the \$68.7 billion Activision Blizzard acquisition in October 2023, which required a large cash outlay and is shown by the concurrent, massive increase in both goodwill and intangible assets on the balance sheet.

Cash and cash equivalents increased 122% showing strong cash generation. 2023 and 2025 show up as anomalies standing at around \$30,000 million while the rest of the years was at around \$15,000 million. These 2 standouts are because: in 2023 Microsoft strategically raised liquidity in anticipation of the major acquisition of Activision Blizzard and the 2025 was because of the substantial cash generation from AI demand.

Accounts receivable increased 118%, using standard terms of payment to increase business sales. Inventories decreased 51% showing great inventory management and a shift from hardware to software requiring less inventory space.

Net property and equipment increased at a substantial 364%. This is driven by the accelerated growth from 2023-2025 in data center expansions to help optimise its Azure platform. AI growth also requires more equipment and servers to function optimally.

Goodwill increased 176% but the main statement is the massive jump in 2024. Goodwill nearly doubled which is mainly due to the acquisition of Activision Blizzard. As shown in the other sections as well, this acquisition is behind many outliers and jumps in money and will be throughout this report. Again it's shown by the jump in intangible assets as well.

Total debt and long term debt decreased 32% and 33% respectively. Showing a consistent deleveraging despite the yearly growth in revenue. Microsoft's large operating income helps it pay off its interest expenses easily giving them great interest coverage. Shareholder's equity rose 190% with debt to equity ratio dropping to 0.13 in 2025. The company is financially healthy and stable shown by its very low reliability on debt.

	\$44,281		\$72,738	\$72,361	\$88,136	\$101,83
Net Income	M	\$61,271	M	M	M	2M
Depreciation & Amortisation	M	M	M	M	M	M
Stock-Based Compensation	\$5,289M	\$6,118M	\$7,502M	\$9,611M	M	M
Working Capital	\$109,605M	\$95,749M	\$74,602M	\$80,108M	\$34,448M	\$49,913M
Changes in Working Capital	\$3,473M	6M	M	\$5,506M	0M	M
Operating Cash Flow (OCF)	\$60,675M	\$76,740M	\$89,035M	\$87,582M	\$118,54M	\$136,16M
Capital Expenditures (CapEx)	\$15,441M	\$20,622M	\$23,886M	\$28,107M	\$44,477M	\$64,551M
Free Cash Flow (OCF - CapEX)	\$45,234M	\$56,118M	\$65,149M	\$59,475M	\$74,071M	\$71,611M
Dividend Payments	\$15,137M	\$16,521M	\$18,135M	\$19,800M	\$21,771M	\$24,082M
Share Repurchases	\$22,968M	\$27,385M	\$32,696M	\$22,245M	\$17,254M	\$18,420M
Net Change in Cash	\$2,220	\$648M	\$293M	M	M	M
			\$20,773	\$16,389	\$11,927	

Overall, Microsoft has more than doubled its operating cash flow while free cash flow has seen a more halted growth since Microsoft has taken such a big change in their main industry switching from PC products to software.

Microsoft has a strong OCF every year and it outweighs net income by about 1.3-1.4x. This is a strong positive signal since it shows that the company successfully turns gains into cash. Depreciation and amortisation increased almost 3x, this growing asset base being depreciated shows the companies good long term health and financial capability. Stock based compensation increased 126% showing Microsoft is willing to pay in accordance with its growing revenue. Workers are paid more relative to how well the company performs and grows which increases worker incentive. The significant drop in working capital from 2024 is directly caused by two strategic business actions that have

an impact on the balance sheet: a deliberate increase in short-term liabilities and a large capital investment for acquisitions and infrastructure.

Capital expenditure has grown substantially over the last 2 years at 130%. This increase is thanks to the increasing development of Azure cloud capacity, AI investments and gaming service development. Share repurchases have fallen over the years due to the prioritisation of capital expenditures as more cash is used for them.

Dividend payments are very stable but have slowly increased at 59%. This is a good sign for investors as dividend payments are usually a good motive for investors and for retail traders to buy a large amount of shares to maximise the dividend payout.

Microsoft is going through a strategic shift, sacrificing short-term FCF in order to build long-term infrastructure advantages, according to the company's cash flow statement. The quality of cash generation is still exceptional, and the capital allocation is strict, despite the substantial reinvestment requirements. The foundation being built seems strategically sound for the AI/cloud era, but investors must wait patiently for the investment phase to yield returns.

Financial Health Metrics:

Metrics	2020	2021	2022	2023	2024	2025
Liquidity & Efficiency:						
Current Ratio	2.52	2.08	1.79	1.77	1.27	1.35
Quick Ratio	2.49	2.05	1.75	1.75	1.27	1.35
Days Sales Outstanding	81.7	82.61	81.48	80.41	84.76	90.57
Inventory Turnover	72.27	74,186	2.17	67.9	130.87	257.99

The current ratio is a crucial liquidity ratio that evaluates a company's ability to satisfy its short term obligations with its short-term assets, in short current assets / current liabilities. A current ratio of 1.5 is optimal for a tech giant like Microsoft. In 2024 the ratio dropped below 1.5 mainly thanks to: liabilities outgrowing current assets, deferred revenue growth and an increase in accrued expenses. In 2025 the ratio is slowly

returning to the 1.5 level with the future looking bright and another increase should take it to around 1.44 in 2026. Quick ratio is similar to the current however it subtracts inventories from current assets. Since inventories are almost negligible, the ratio is almost no different to current ratio especially in 2024 and 2025 where there is no change since these are the years where Microsoft shifted their inventory costs to software and data centers.

Days sales outstanding quantifies how quickly customers pay. The industry standard is 82 days. A significant increase has occurred in the last 2 years jumping up to 90.57 days. The reason for this is because the company has shifted towards large enterprises. Azure and 365 are sold to enterprises and governments which means higher payments which require longer contracts to pay off. This is a concern for the company as 90 days is too high especially for a software prominent company.

Inventory turnover is how fast inventory is sold and replaced. It has increased 97% over the last 5 years showing a remarkable improvement. The shift to software and cloud services is the largest contributor to this. The heavy reduction in inventory is reflected in the higher turnover since there is less inventory to sell. Revenue growth has increased year on year while inventory has decreased so it is also replaced faster.

Metrics	2020	2021	2022	2023	2024	2025
Leverage Ratios:						
Debt-to-Equity Ratio	0.54	0.41	0.3	0.23	0.17	0.13
Debt-to-EBITDA	0.93	0.68	0.5	0.45	0.34	0.27
Interest Coverage Ratio	21.47	31.3	41.58	46.38	37.72	54.5

The Debt-to-Equity (D/E) Ratio is a solvency ratio that evaluates a company's risk and financial leverage by comparing its total debt to its shareholder equity (total debt / total shareholder's equity). Debt to equity ratio decreased every year, explained by factors mentioned previously in this report. Total debt decreased by 32% while shareholder equity increased by 190%. Equity far outpaces debt which is reflected in the decreasing ratio. The average in the tech industry is 0.5-0.7 so with Microsoft having a ratio of 0.13 it is an industry pioneer in this and is among the lowest in the market. Similar

explanation for the debt to EBITDA ratio. EBITDA has increased 134% so its growth drives the ratio down. A ratio of 0.27 is the best in the industry, same as debt to equity.

Interest coverage ratio is calculated by EBIT / interest expense, the higher the ratio the better. It was already very strong in 2020 and showed steady improvement every year. The dip in 2024 was caused by a big increase in interest expense this year (which was explained earlier). The substantial increase in 2025 was caused by a further increase in operating income while interest expenses lower back to normal levels. This new high is also the best in the industry.

Microsoft's leverage ratios are the best in the industry which shows that they are leaders when it comes to minimising and managing debt while keeping interest expenses as low as possible.

Metrics	2020	2021	2022	2023	2024	2025
Valuation Multiples:						
P/E Ratio (TTM)	35.33	33.65	26.8	35.18	37.88	36.47
Forward P/E	27.32	28.97	24.28	28.86	33.11	28.92
Price/Sales	10.83	12.16	9.78	11.97	13.55	13.12
Price/Book	13.09	14.4	11.64	12.3	12.37	10.76
EV/EBITDA	23.36	24.53	19.7	24.24	25.17	23.16
P/FCF (Price to Free Cash Flow)						
	34.24	36.43	29.76	42.63	44.84	51.63
Dividend Yield	1%	0.83%	0.96%	0.80%	0.67%	0.67%

The P/E ratio is reasonable for steady growth. The current ratio of 36.47 higher than the average due to advancements in AI which Microsoft reaps a large reward of since it holds a leadership position. The success of the transition to a cloud service also helps. The ratio is calculated by: stock price/EPS. The anomaly in 2022 is caused by the decrease in stock price combined with the significant increase in EPS compared to the previous year. (The reason for the decrease in stock price was explained earlier).

Forward P/E is the same but estimated forward EPS is used instead of actual EPS. Since this is a prediction based ratio the outcome isn't as important as the actual trailing P/E. Similar trends are shown which reflects that the overall prediction of EPS was actually quite accurate with only 2021 underestimating the EPS. A 21% decrease in 2025 implies a strong expected growth in EPS next year.

Price/sales measures market cap / revenue. This number is usually increasing since the maker values revenue more as the business diversifies their portfolio which Microsoft has done this decade. Since revenue is increasing every year, any anomalies are caused by a decrease in market cap from the previous year. The significant decrease in 2022 was caused by a typical market adjustment, where the denominator (revenue) grew faster than the numerator (market capitalisation), greatly compressing the valuation multiple. A similar thing happened in 2025 but to a much smaller extent. The 2025 ratio of 13.12 is pretty high in the industry but is justified by the high increase in gross and net margins.

Price/book measures stock price / book value per share. The slow increase shows that the stock price lagged equity growth, which implies that the market prefers earning potential over asset base. The dips in 2022 and 2025 were caused by exceptional equity growth combined with market cap growth in these 2 years. In comparison to its underlying asset base, the company is less expensive in these years despite a rising stock price.

EV/EBITDA measures enterprise value / EBITDA. The rising numbers indicate consistent expansion and cash flow valuation. 2025 was a moderation year where it is slightly below the average but still at a good level comparatively to the rest of the industry. The large decrease in 2022 was brought about by a potent combination of an increase in EBITDA (the denominator) and a slight decrease in enterprise value (the numerator). Excluding the anomaly, Microsoft is stable at around 23-25x.

P/FCF measures stock price / FCF per share, which increased 50.8% over the last 5 years. This implies that the market anticipates future FCF growth and is willing to pay a premium. The risk that comes with this is that it adds more reliability on capital expenditure yield returns being positive every year. The stock market as a whole saw a significant correction in 2022 due to rising inflation and interest rates, particularly in the technology sector. Consequently, the ratio's stock price component (Microsoft's market capitalisation) fell. A lowering numerator instantly reduces the ratio. The most significant reason for the anomaly was that Microsoft's FCF increased massively this year too which brings the number down.

Dividend yield measures: dividend per share / stock price. There is an overall decline of 33% indicating that stock price growth outpaced dividend growth which is also reflected in the data collected. The yield is the same for 2024 and 2025 which shows stability and an easy to predict 2026 yield. The industry average lies at around 1.4% but Microsoft is a growing company and its stock is still growing year on year so there is no cause for concern.

To conclude the financial health analysis, Microsoft stands as an industry leader and the best in the market when it comes to liquidity and efficiency largely thanks to their low overall debt. Liquidity and efficiency is affected largely by the company shift to cloud services so a return to industry highs is expected for the remainder of the decade. 2022 is an outlier in many of these numbers thanks to a macro level shift in the tech market.

DCF Valuation

See attached excel file

A discounted cash flow (DCF) valuation determines a company's intrinsic value by projecting its future free cash flows and reducing them to present value using an appropriate discount rate. My model predicts an equity value per share of \$532.89, with the current share price being \$483.16, this is a 10.3% increase.

I used data from 2023-2025 (shown as year -2 to year 0) to predict the income statement of Microsoft over the next 5 years. I assumed Microsoft would maintain its current double digit revenue growth every year throughout the forecast period and I used a 4% terminal value to imply a perpetual growth rate. Higher revenue trends also follow higher EBITDA and in turn higher tax depreciation every year for the next 5 years. Subtracting tax depreciation from EBITDA gives operating profit which is increasing over the years since the growth in EBITDA is far larger than the growth in tax depreciation. I predicted a declining COGS and SG&A, the reasoning for this is operating leverage will continue to be provided by AI efficiency and cloud scale advantages, and tax rates will return to the industry average. Since the structural mechanisms (low-tax foreign centres and U.S. tax amortisation benefits) that lower Microsoft's ETR are still largely in place, I predicted a declining tax rate of 0.2% per year. The steps to calculate NOPAT, unleveled cash flow and total cash flow were

shown in the Excel file in the DCF sheet. These calculations required the data I predicted.

The 8.5% discount rate used is accurate because it closely resembles a well-calculated weighted average cost of capital (WACC) for a blue-chip company with exceptionally low financial risk because it illustrates the minimal return that investors (both debt and equity holders)need to be compensated for the risk associated with the company's future cash flows, the WACC is the standard discount rate for DCF. My research into other DCF valuations also justified it as many other reports were made using an 8.5% discount rate. I used a terminal value of 17.5 which is in line for a mature tech leader. 17.5x is a conservative but premium multiple when compared to the typical large cap, superior technology sector, it achieves a balance between quick short-term growth and sustainable long term growth.

The result of \$532.89 per share implies that the stock has an intrinsic value which is higher than its current price meaning that Microsoft is currently undervalued when considering its leadership position in AI, clean balance sheet, consistent year on year growth and a successful business transition to cloud services. The valuation reflects sustained growth, margin expansion, heavy reinvestment and a durable competitive advantage.

Risks include a dependence on a high terminal value, however the buy rating will still hold even with a lower assumption such as 16x. The DCF model also fails to model macroeconomic factors and it's hard to quantify potential technological advances. Most of the assumptions in the Excel data are also linear through the next 5 years which is highly unlikely and since the whole model is based on these assumptions, some investors might not agree with them and thus the valuation result.

My DCF supports a strong buy rating with a \$532.89 price target but investors should monitor this valuation's sensitivity to changes in growth assumptions and discount rates. This outcome is very probable and it aligns with the general market consensus.

Risks

Like all investments, there are risks that should be taken into account when thinking of investing into Microsoft.

Starting with the high risk categories, competition is one of the main risks. In terms of cloud services Microsoft is beaten by Amazon's AWS which dominates the market, this being Microsoft's main market that it has transitioned into, it can be worrying for investors. Google cloud is also providing competitive pricing and is slowly catching up to Microsoft's 2nd place in the industry. The AI market is a winner takes all industry, so Microsoft lacking behind its competitors is unfavourable. Competition in the software industry is a non factor since Microsoft dominates this market.

Another big risk is regulatory and legal risks. There are still current investigations into compliance issues within the digital markets from the EU. Unfavourable regulatory decisions may lead to the unbundling of services, which would impact MSFT's earnings. Microsoft is heavily intertwined with global governments, any changes in political leaderships and parties can affect government contracts which is a major part of Microsoft's revenue. A lengthy legal dispute between the company and the IRS over historical transfer pricing (prior to 2014) could result in billions of dollars in back taxes, penalties, and interest. A loss would result in a large financial outlay and create a negative precedent, even if the financial impact is small.

There are also medium technological risks that Microsoft faces. AI investment returns are uncertain, since monetisation of AI models may take longer than expected. Microsoft's heavy involvement in the government makes it subject to cybersecurity attacks, which if successful can cause huge reputation damage and a lot of investors and customers will lose faith in the company.

Another medium risk is financial and valuation risks. Since a significant portion of revenue is generated outside of the US, adverse currency fluctuations may have a negative impact on reported sales, profitability, and cash flows. Any growth declaration and rising rates can affect valuation rating, which reflects badly on the company. If the company doesn't meet its anticipated growth in revenue and cash flow, the market will likely compress its valuation multiples (for example, the P/E ratio may decline).

Low risks include geopolitical and environmental risks. Tensions between the US and China, the 2 biggest players in the tech industry, could reduce dependency on advanced chips and other exports.

Because of its strong financial position, diverse business, and successful track record, Microsoft has a better risk profile than most of its IT competitors, even though it is not risk-free. The primary risk of investing is paying too much for growth that might happen more slowly than anticipated or face more competition than expected.

Pay Benchmarking

Refer to pay benchmarking sheet in the Excel file attached

Pay benchmarking is the simple process of collecting compensation (base salary + any bonuses) for numerous job roles in a company and comparing it to market competitors to ensure the company's wage structure is fair and competitive. The peers used in this data are: Google(Alphabet),Facebook(Meta),Amazon,Apple and Netflix, the data for compensation was collected from [levels.fyi](#). My data is presented in GBP (£) but it's using US salaries, this is because this was how the data was structured in levels.fyi. The compensation was calculated by: base salary + variable pay (bonuses) + long term incentives (stocks/yr) which = total direct compensation (TDC). I compared Microsoft's base salary and TDC to its peers and gave a percentage difference, a negative percentage difference shows that Microsoft's pay is below its competitors and a positive percentage implies it is above.

In terms of base salary, Microsoft only exceeds its competitors median in: software engineer II, data science engineer and enterprise account executive. Out of the 11 different job roles I used, Microsoft only outpriced the market in 3 roles which isn't ideal for someone who is looking for a high base salary as a requisite for a job. The most important comparison is TDC, in which Microsoft only exceeded market median in software engineer II and enterprise account executive. The consistent outpricing when it comes to software engineering is very good since this is the most popular role in the market, so a lot of talented applicants will prefer to work at Microsoft over its competitors due to the higher pay. There are huge gaps in TDC median differences in certain roles, mainly principal software engineer which has a substantial 69.3%

decrease and senior product manager which has a 47.8% decrease. Early to mid career roles in Microsoft are competitive with some being above the median.

However, the largest compensation gaps for Microsoft come in senior roles. These differences suggest that, especially when compared to rivals like Google, Meta, and Amazon, Microsoft would struggle to attract or retain top-tier senior employees in highly competitive roles.

Microsoft has great benefits and perks highlighted in every role, once you join Microsoft the perks are very similar no matter the role which gives the employees a community feel.

Senior technical and product leadership roles pay significantly lower salaries compared to the median. Execution and creativity may be impacted, since the senior employees with the most experience are the ones that move the company forward the most, by higher attrition. Microsoft's lower compensation for senior roles could reflect a different corporate culture/environment which focuses more on young talent which in turn encourages more young talent to apply for roles and join the company. This still proposes a risk though since as it currently stands there is no reason for an employee to stay at the company as a senior when they can move and get a higher pay for the same role and job title.

Stock based compensation is Microsoft's biggest bonus/payment outside the base salary, since Microsoft is one of the top companies in the S&P 500 it reflects a large bonus. The heavy dependability on the stock can be seen as a negative since if Microsoft's stock underperforms, the TDC gap will widen even further. This was shown in 2022 where the stock price fell compared to the previous year. However this concern is mostly insignificant since most employees choose the smart decision in withholding the company's stock and selling it way down the line where the value is significantly bigger.

The pay benchmarking analysis reveals a complicated compensation strategy: competitive for early career and sales roles, but potentially underpaying senior technical and product expertise relative to peers. Rather than being an urgent warning sign, this should be seen as a structural factor that could affect Microsoft's long term innovation potential and personnel pipeline.

Conclusion & Valuation

Microsoft cements its position as a premier tech giant with exceptional fundamentals and a clear growth plan with the company successfully transitioning into a dominant integrated cloud and AI platform.

Microsoft has an unmatched competitive position holding #1 or #2 in all 3 of its core segments. It has one of the best financial metrics in the market leading in operating margins, a fantastic debt to equity ratio, exceptional return on equity and a fast growing free cash flow generation. Another core strength is its partnership with OpenAI which gives the company strong leadership in the AI race along with a clear monetisation path.

For a business of Microsoft's size and financial strength, the risks that have been identified, such as cloud competition, regulatory scrutiny, and macroeconomic sensitivity are significant but controllable. While undervaluing the prospective gains from AI monetisation and ongoing cloud migration, the present price seems to fairly reflect these difficulties.

Microsoft Corporation (MSFT) is a better compounder with a fair valuation when compared to its peer group. My discounted cash flow analysis shows an intrinsic value of \$532.89 per share, up 10.3% from the current price of \$483.16.

Microsoft's unrivalled competitive moat, its pivotal role in the AI transformation, and its strong financial foundation all support this valuation. The company's strategic positioning and execution support a path to consistent double-digit earnings growth, despite some risks.

Therefore, I initiate coverage of Microsoft with a BUY rating and a 12-month target price of \$532.89.

