

US EQUITY RESEARCH

11 Nov 2024

Microsoft Corp

Intelligent Cloud + Gaming led growth

Company Overview

Microsoft Corp (MSFT) develops, manufactures, licenses, & supports a wide range of software products. It has transformed from a component driven (PC, server) to one driven by the need for cloud capacity. Its Azure platform is thriving & is placed 2nd in public cloud in terms of market share. MSFT has three businesses - Productivity & Business Processes (Office, LinkedIn, Dynamics), Intelligent Cloud (Server Products & Cloud Services, Azure, and Enterprise Services) & More Personal Computing (Windows, Devices, Gaming, Search).

Investment Overview

MSFT is the market leader in the productivity software market. Microsoft Corporation (MSFT) is the market leader in productivity software enjoying certain key competitive advantages over its peers such as an industry-leading product range, widespread market presence, and deep C-level relationships. According to Research and Markets, the cloud-based office productivity software market is expected to grow at a 25.3% CAGR to USD52bn by 2026. Consensus forecasts revenue CAGR of 16% over FY24-26F (June YE) for MSFT's productivity and business process segment which includes (Office, LinkedIn, and Dynamics).

Azure is the key growth driver although weak macro may moderate near-term growth. Consensus expects Intelligent Cloud which includes Azure to deliver a revenue CAGR of 17% over FY24-26F contributing 46% to FY26F group revenue (43% in FY24). MSFT holds a 26% market share in the cloud followed by GOOGL at 10% (both behind Amazon Web Service's 31%) as of Dec 23, according to Canalys. Operating margin for the cloud stood at 47% in FY24 vs 31% margin in the personal computing (PC) segment (25% of group revenue). MSFT is likely to see an uplift in its margins when customers switch from its on-premises install bases (e.g. Windows and Gaming) to its cloud platform. We expect higher revenue driven by the AI launch of Copilot Wave 2 in 1Q25, known as Copilot Pages or BizChat, for Microsoft 365 subscribers, allowing AI-driven collaboration. This integrates into Excel, PowerPoint, Outlook, and OneDrive, enhancing tasks like data analysis, presentations, summarizing meeting content, highlighting important emails, improving file search, and content analysis. Despite macro uncertainty, we see further upside potential in its cloud segment with MSFT as the market share gainer.

Activision acquisition boosts the relatively underperforming PC segment. MSFT's acquisition of Activision contributed a net impact of c.3 points to revenue growth. MSFT projects PC segment 1Q25F revenue to be in the range of USD14.9bn – USD15.3bn, a 9%-12% y/y increase, considering the impact of the acquisition of Activision. This acquisition has increased gaming revenue by 44% y/y and Xbox content and services revenue by 61% y/y, slightly ahead of guidance.

BUY MSFT with a higher TP of USD531 (Prev TP USD465). Our TP for MSFT is based on 41x 12m-forward blended earnings of USD96.2bn (prev USD91.2bn). Higher TP is due to (i) rolling forward of 12m earnings (ii) consensus upward revision in FY24F/25F earnings by 3% each and (iii) rise in peer-premium from 5% to 25% in terms of price-to-earnings ratio (PER). The higher premium is due to i) rising dominance in the cyber security space, ii) stronger presence in cloud services, iii) investments in AI at scale. This should lead MSFT to easily exceed consensus earnings CAGR of 16% vs the peer average of 14% over FY24F-26F.

Risks

Enterprise application spending is cyclical, given the more discretionary nature of applications projects. During an economic slowdown, when firms are faced with shrinking IT budgets, projects involving application upgrades, migrations or new installations are often deferred. This could present a higher degree of risk for Microsoft, in the event of an economic slowdown. Slower-than-expected commercial cloud growth, slowing cloud spend, foreign currency risk, negative economic conditions, inability to hire, increasing competition, and PC or Server market decelerate faster than expected are also some downside risks for MSFT.

Analyst

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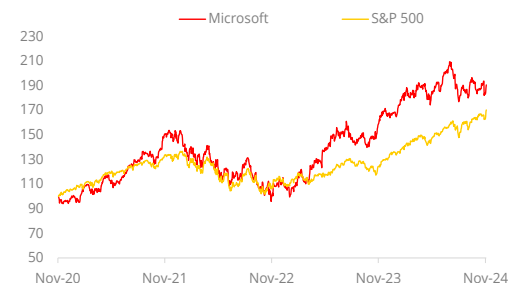
Key Financial Data

Bloomberg Ticker	MSFT US
Sector	Information Technology
Share Price (USD)	425.43
DBS Rating	BUY
12-mth Target Price (USD)	531.0
Market Cap (USDbn)	3,163.0
Volume (mn shares)	19.9
Free float (%)	100.0
Dividend yield (%)	0.7
Net Debt to Equity (%)	8.3
Fwd. P/E (x)	32.5
P/Book (x)	11.0
ROE (%)	35.6

Closing Price as of 7 Nov 2024

Source: Bloomberg, DBS

Indexed Share Price vs Composite Index Performance



Source: Bloomberg

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Financial Summary (USD MN)

FY Dec	FY2021A	FY2022A	FY2023A	FY2024F	FY2025F
Sales					
% y/y					
Gross Profit					
% y/y					
EBITDA					
% y/y					
Net Profit (Loss)					
% y/y					
FCF					
CAPEX					
EBITDA Margin (%)					
Net Margin (%)					
ROA (%)					
ROE (%)					
Tax Rate (%)					

Source: Refinitiv

Valuation Metrics

FY Dec	FY2021A	FY2022A	FY2023A	FY2024F	FY2025F
P/E					
P/B					
Dividend Yield					
EV/EBITDA (x)					
FCF Yield %					

Source: Refinitiv

Credit & Cashflow Metrics

FY Dec	FY2021A	FY2022A	FY2023A	FY2024F	FY2025F
Debt / Equity					
Net Debt / Equity					
Debt / Assets					
Net Debt / Assets					
EBITDA / Int Exp					
Debt / EBITDA					
ST Debt / Total Debt (%)					
[Cash + CFO] / ST Debt					
Receivables Days					
Days Payable					
Inventory Days					

Source: Refinitiv

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Target Price & Ratings History



#	Date of Report	Closing Price	12-m Target Price	Rating
1	01 Dec'23	374.51	437.00	BUY
2	08 Jan'24	374.69	445.00	BUY
3	30 Jan'24	408.59	465.00	BUY
4	02 Apr'24	421.44	531.00	BUY

Source: DBS
Analyst: Sachin Mittal

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STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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