



UConn Student Managed Fund

Microsoft (NASDAQ: MSFT)

November 11, 2020

Target Price: \$286.86
Current Price:
Stop loss:
52 Week High/Low: \$232.86/\$132.52

Market Cap (\$T): \$1.7
Dividend Yield: 1.0%
Beta: 0.92
ROE: 42.4%

P/E Ratio (TTM): 36.0x
EV/EBITDA: 23.0x
Debt/Equity: 0.67
Profit Margin: 31.2%

Company Overview

Microsoft Corporation is a technology company. The Company develops, licenses, and supports a range of software products, services and devices. The Company's segments include Productivity and Business Processes, Intelligent Cloud and More Personal Computing. The Company's products include operating systems; cross-device productivity applications; server applications; business solution applications; desktop and server management tools; software development tools; video games, and training and certification of computer system integrators and developers. It also designs, manufactures, and sells devices, including personal computers (PCs), tablets, gaming and entertainment consoles, phones, other intelligent devices, and related accessories, that integrate with its cloud-based offerings. It offers an array of services, including cloud-based solutions that provide customers with software, services, platforms, and content, as well as solutions support and consulting services.

Industry Outlook

We see continued revenue growth and margin expansion in the software industry, especially for cloud providers and legacy software companies that have completed their transitions to the cloud. The Covid-19 pandemic and the related telecommuting trend likely accelerates the transition to cloud computing. Therefore, we strongly believe that cloud migration will continue to be a key driver for growth.

Investment Thesis

Wide Economic Moat: Microsoft's diverse business portfolio presents a wide range of economic moats that we expect to directly impact the company's margins. The firm experiences both a network effect as well as high switching costs for its Windows OS, Window server, and database management systems (DBMS). The Company also has a scalability advantage in the cloud service segment (Azure) serving 95% of the Fortune 500 companies. Lastly, Microsoft experiences pricing power for its Office 365 offerings as it is a standardized productivity solution deployed across corporate America.

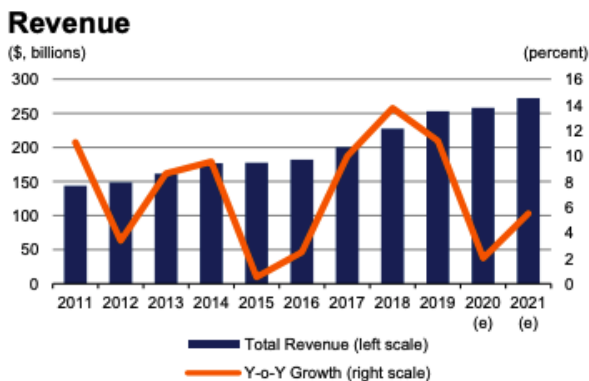
Continued Growth of Cloud Services: Microsoft is well positioned to capture additional cloud market share. The IaaS segment of the cloud industry is expected to grow 27% through 2022 according to a recent Gartner report. Microsoft currently makes up 18% of the total IaaS cloud services market share, and we expect continued grow given the company's competitive advantage, scalability factors, and broad presence in company IT infrastructure. Many of the largest companies in the world have their IT infrastructure built on top of Microsoft's Windows server and DBMS, which we view as a key advantage for organizations to leverage while migrating to the cloud.

Investment Risks

COVID-19: As a result of the coronavirus lockdowns, Microsoft experienced a sharp decline in foot traffic to their brick and motor stores, and as a result had to cease operations for 83 of their 87 retail locations. Additionally, with ad spending reduced, Microsoft's LinkedIn and search engines business has been adversely affected. COVID-19 remains a headwind for growth in consumer-related endeavors.

Cybersecurity: Microsoft remains a main target of cybercrime given its broad exposure and involvement within IT infrastructure across the world. Any cybersecurity incident poses immense reputational harm to both Microsoft and its brand.

M&A Execution: With several high-profile flops such as Nokia and aQuantive, Microsoft has a reputation of embarking on unsuccessful ventures that have a direct impact on their bottom line. This requires increased scrutiny of Microsoft's judgement associated with future acquisitions.



e-Estimated.

Source: CFRA, S&P Global Market Intelligence

Company Financials Fiscal year ending Jun 30										
Per Share Data (USD)	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
Tangible Book Value	8.97	6.88	5.08	5.51	6.45	7.26	7.61	7.35	5.93	5.22
Free Cash Flow	5.94	4.99	4.19	4.05	3.15	2.90	3.26	2.93	3.49	2.90
Earnings	5.76	5.06	2.13	3.25	2.56	1.48	2.63	2.58	2.00	2.69
Earnings (Normalized)	4.31	3.47	2.73	2.22	2.04	2.11	2.05	2.04	2.06	2.01
Dividends	2.04	1.84	1.68	1.56	1.44	1.24	1.12	0.92	0.80	0.64
Payout Ratio (%)	34.00	35.00	77.00	46.00	54.00	81.00	40.00	34.00	38.00	22.00
Prices: High	204.40	138.40	102.69	72.89	56.85	50.04	42.29	35.78	32.95	29.46
Prices: Low	130.78	93.96	68.02	50.39	39.72	40.12	30.84	26.26	23.79	22.73
P/E Ratio: High	35.50	27.40	48.20	22.40	22.20	33.80	16.10	13.90	16.50	11.00
P/E Ratio: Low	22.70	18.60	31.90	15.50	15.50	27.10	11.70	10.20	11.90	8.40
Income Statement Analysis (Million USD)										
Revenue	143,015	125,843	110,360	96,571	91,154	93,580	86,833	77,849	73,723	69,943
Operating Income	52,959	42,959	35,058	29,331	27,188	28,172	27,886	27,497	27,956	27,161
Depreciation + Amortization	12,300	11,600	9,900	7,800	5,878	5,400	4,245	3,339	2,758	2,537
Interest Expense	2,591	2,686	2,733	2,222	1,243	781.00	597.00	429.00	380.00	295.00
Pretax Income	53,036	43,688	36,474	29,901	25,639	18,507	27,820	27,052	22,267	28,071
Effective Tax Rate	16.50	10.20	54.60	14.80	19.90	34.10	20.70	19.20	23.80	17.50
Net Income	44,281	39,240	16,571	25,489	20,539	12,193	22,074	21,863	16,978	23,150
Net Income (Normalized)	33,128	26,900	21,247	17,386	16,320	17,388	17,239	17,283	17,488	17,248
Balance Sheet and Other Financial Data (Million USD)										
Cash	136,492	133,832	133,664	132,901	113,041	96,391	85,146	76,410	62,044	51,371
Current Assets	181,915	175,552	169,662	162,696	139,660	122,797	114,246	101,466	85,084	74,918
Total Assets	301,311	286,556	258,848	250,312	193,468	174,472	172,384	142,431	121,271	108,704
Current Liabilities	72,310	69,420	58,488	55,745	59,357	49,647	45,625	37,417	32,688	28,774
Long Term Debt	59,578	66,662	72,242	76,073	40,557	27,808	20,645	12,601	10,713	11,921
Total Capital	200,414	188,785	170,226	183,238	126,538	115,467	112,987	95,234	79,138	70,221
Capital Expenditures	15,441	13,925	11,632	8,129	8,343	5,944	5,485	4,257	2,305	2,355
Cash from Operations	60,675	52,185	43,884	39,507	33,325	29,668	32,502	28,833	31,626	26,994
Current Ratio	2.52	2.53	2.90	2.92	2.35	2.47	2.50	2.71	2.60	2.60
% Long Term Debt of Capitalization	38.00	41.90	48.10	45.80	32.70	24.10	18.30	13.20	13.50	17.00
% Net Income of Revenue	31.00	31.20	15.00	26.40	22.50	13.00	25.40	28.10	23.00	33.10
% Return on Assets	11.26	9.85	8.61	8.26	9.24	10.15	11.07	13.03	15.20	17.43
% Return on Equity	40.10	42.40	19.40	31.90	27.00	14.40	26.20	30.10	27.50	44.80

Valuation Assumptions

We give a BUY recommendation for Microsoft based on a target price of \$286.86 per share. This target price reflects a 28.2% margin of safety based on its closing price of \$224.02 on November 6, 2020. We used the company's WACC of 6.5% to discount our projected cash flows. We assumed a terminal growth rate of 3.5% and a 23.0x exit EV/EBITDA while computing the Perpetuity Growth and terminal EV/EBITDA valuation method, respectively.

Terminal Growth (Intrinsic Share Price)

286	2.50%	3.00%	3.50%	4.00%	4.50%
7.5%	180	196	217	242	277
7.0%	199	220	246	282	331
6.5%	224	250	286	336	412
6.0%	255	291	342	419	547
5.5%	296	348	426	556	816

	Perpetuity	EBITDA	Weight	Value
Bull	311.37	315.62	20%	313.92
Base	286.30	293.36	60%	290.53
Bear	241.98	253.33	20%	248.79
Intrinsic Value				286.86
MOS				28.22%

EBITDA Multiple (Intrinsic Share Price)

293	21	22	23	24	25
7.5%	261	271	282	292	303
7.0%	266	277	287	298	309
6.5%	272	282	293	304	315
6.0%	277	288	299	311	322
5.5%	283	294	306	317	329

ESG Considerations

MSCI gives Microsoft a AAA rating for their initiatives towards mitigating climate change and leveraging their Azure platform towards creating sustainable solutions.

Industry: Software & Services
Country/Region: United States of America

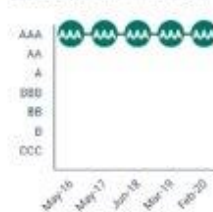
MSCI
ESG RATINGS

AAA

CCC B BB BBB A AA **AAA**

ESG Rating history

MSCI ESG Rating history data over the last five years or since records began.



ESG Rating distribution

Universe: MSCI ACWI Index constituents software & services, n=141.

