



Research Analysts:

Jeffrey Owiredo-Yeboah (Jeffrey.owiredo-yeboah@uconn.edu) | Reno Brown II (reno.brown_ii@uconn.edu)
Agasti Mhatre (agasti.mhatre@uconn.edu) | Claudel Larose (claudel.larose@uconn.edu)

Recommendation: **BUY**

UConn Student Managed Fund

Microsoft Corp. (NYSE: MSFT)

October 26th, 2021

Target Price: \$360.87

Current Price: \$323.17

Stop loss: \$258.54

52 Week High/Low: \$199.62/\$311.09

Market Cap (\$B): \$2.3T

Dividend Yield: 0.7946%

Beta: 0.88

ROE: 47.08%

P/E Ratio (TTM): 37.79

EV/EBITDA: 27.15

EBITDA Margin: 49.81%

Gross Margin: 68.93%

Company Overview

MSFT is an American multinational technology corporation which produces computer software, OS, server/client applications, consumer electronics, personal computers, internet/intranet software, gaming systems & other devices. It's an extremely stable, bluechip, conglomerate with an aggressive goal of "empowering every person and organization on the planet to achieve more."

MSFT has a number of income streams generating revenues from different segments & is well positioned to help us reach our portfolio goal for generating alpha against the SPY. The three main segments driving this growth are

- More Personal Computing consists of consumer and enterprise products. Products include
 - Windows including Windows OEM; Devices including Surface and PC accessories
 - Gaming including Xbox hardware and Xbox content and services
 - Search advertising
- Intelligent Cloud consists of public private and hybrid server products and cloud services. Products include
 - Server products and cloud services including Azure, SQL Server, Windows Server and GitHub
 - Enterprise Services including Premier Support Services and Microsoft Consulting
- Productivity and Business Processes consists of products and services representing productivity, communication and information services.
 - Office Products (Commercial and Consumer) include Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance and Skype
 - LinkedIn including Talent Solutions, Marketing Solutions, Premium Subscriptions, Sales Solutions, and Learning Solutions
 - Dynamics include Dynamics 365

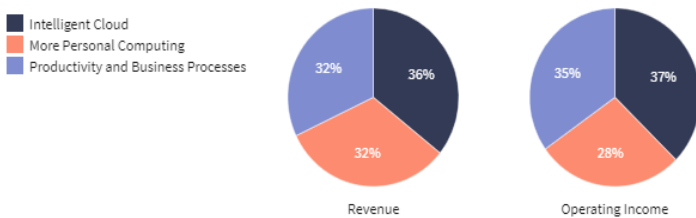
(IaaS) Infrastructure as a service includes the rent for IT infrastructure, services VMs, data storage, backup, hosting, web apps, OS, & pay as you go service. Players in the space include AMZN AWS, MSFT Azure, GOOG GCP. (PaaS) Platform as a Service includes the delivery of services such products include Windows Azure). (SaaS) Software as a service full service includes the others above MSFT Office 365).

The global software industry space is valued at approximately \$600B. There's been generally a historical approximately 20% year over year cloud subscription growth & it's expected to increase. The cloud space represents approximately 37% of the global software industries' revenue leaving approximately 63% of growth to be captured & absorbed. There's an expectation that cloud subscription's revenue could hit 52% of total industry revenue by 2023 with approximately \$300B growth potential. Growth forecasts for total global enterprise software industry to accelerate 3-4% through 2024 driven by cloud subscription growth & partially offset by declining traditional software sales & licenses. Overall subscription revenue has crossed a threshold where it equates to more than 2x license revenue or 70% of total revenue for some industry peers including MSFT & ADBE. Microsoft holds the largest share at 64.7%, Oracle at 17.3%, Salesforce at 8.9%, Adobe at 5.7%, & Intuit at 3.4%. Lastly, Microsoft owns 19.8% share of the global infrastructure as a service (IaaS) space only second to Amazon at 40.8%. and Google at 6.1%.



Microsoft Segment Breakdown

Based on Microsoft's FY 2021 ended June 30, 2021



Industry Outlook

The Covid-19 pandemic has accelerated growth in mainly two areas: cloud migration & digital transformation. There is a tremendous need to achieve the following objectives; lower IT infrastructure costs & enable easy access to applications from a large number of remote users which drives migration to the cloud through 3 levels of computing.

Investment Thesis

- ✓ Strong growth in intelligent cloud segment
- ✓ Increased operating efficiency
- ✓ Low downside risk
- ✓ Increased organic/Inorganic growth

Investment Risks

- Intense competition
- Cybersecurity
- Lack of innovation
- Capital expenditure into cloud-based growth
- M&A Execution

Financial Performance

Breakdown	TTM	6/30/2021	6/30/2020	6/30/2019	6/30/2018
> Total Revenue	168,088,000	168,088,000	143,015,000	125,843,000	110,360,000
Cost of Revenue	52,232,000	52,232,000	46,078,000	42,910,000	38,353,000
Gross Profit	115,856,000	115,856,000	96,937,000	82,933,000	72,007,000
> Operating Expense	45,940,000	45,940,000	43,978,000	39,974,000	36,949,000
Operating Income	69,916,000	69,916,000	52,959,000	42,959,000	35,058,000
> Net Non Operating Interest Inc...	-215,000	-215,000	89,000	76,000	-2,733,000
> Other Income Expense	1,401,000	1,401,000	-12,000	653,000	4,149,000
Pretax Income	71,102,000	71,102,000	53,036,000	43,688,000	36,474,000
Tax Provision	9,831,000	9,831,000	8,755,000	4,448,000	19,903,000
> Net Income Common Stockhold...	61,271,000	61,271,000	44,281,000	39,240,000	16,571,000

Valuation Assumptions & Key Financials

We recommend a BUY rate for MSFT based on a target price of \$360.87 per share. This target price reflects a 17.43% margin of safety based on its closing price of \$309.16 on October 25th, 2021. We calculated WACC as 6.01%, assuming a terminal growth rate of 2% and a 18.01x exit EV/EBITDA.

Perpetuity Growth Method - Value per Share	
Free Cash Flow at year 2025	114,395.80
WACC	6.01%
Perpetuity Growth Rate	2.00%
Perpetuity Value in 5 years	2,910,489.28
Present Value of Perpetuity (@ WACC)	2,238,320.58
(+) Present Value of Free Cash Flows (@ WACC)	384,216.26
(=) Current Enterprise Value	2,622,536.84
(-) Long Term Debt	82,278.00
(+) Cash and Marketable Securities	130,334.00
(=) Equity Value	2,670,592.84
Shares outstanding	7,514.89
Estimated Value per Share (USD)	355.37
Current Price (USD)	309.16
Estimated Upside	46.21

Terminal EBITDA Method - Value per Share	
Terminal EBITDA at year 2025	171,356.82
WACC	6.01%
Exit Enterprise Value / EBITDA	18.01
Terminal Value in 5 years	3,086,136.35
Present Value of Terminal Value (@ WACC)	2,305,153.60
(+) Present Value of Free Cash Flows (@ WACC)	384,216.26
(=) Current Enterprise Value	2,689,369.86
(-) Long Term Debt	82278
(+) Cash and Marketable Securities	130334
(=) Equity Value	2737425.86
Shares outstanding	7514.89
Estimated Value per Share (USD)	364.27
Current Price (USD)	309.16
Estimated Upside	55.11

ESG Considerations

MSFT has a low risk rating because it has the highest rankings in energy management, systemic risk management, employee engagement in diversity and inclusion. MSFT is constantly looking to reduce its carbon footprint & donated \$1.9B to 243k non profits globally. The MSFT Airband Initiative provides broadband access to 2.1million people (15.1m outside US) & has a Global Skills Initiative goal of 25 million learners by 2021.

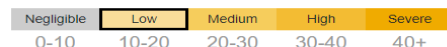
Industry Group: Software & Services

Country: United States

Identifier: NAS:MSFT

ESG Risk Rating

13.3 Low Risk



Ranking

INDUSTRY GROUP

Software & Services

19 out of 930

UNIVERSE

Global Universe

689 out of 14465

Last Update: Jun 15, 2021