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|--|---|---|---|
| Company: Microsoft Corporation | Ticker: MSFT Current Price: \$ 330.59 | Industry: Technology | Sub Industry: |
| Target Price: \$456.00 Stop Loss: \$264.47 52 Week High/ Low: \$349.67 / \$ 209.11 | TTM P/E: 39.98 Forward P/E: 35.51 EPS: \$2.27 | Beta: 0.886 Credit Rating: AAA (S&P) Rating Outlook: Stable | Market Cap: \$2.48T Avg Vol (30 Day): 24.59MM Dividend Yield: 0.70% |

Company Background:

Microsoft Corporation is an American multinational technology corporation which produces computer software, consumer electronics, personal computers, and related services. Its best-known software products are the Microsoft Windows line of operating systems, the Microsoft Office suite, and the Internet Explorer and Edge web browsers.

Industry Outlook:

CFRA Research concludes that the outlook for the system software industry is positive. With the forecasted S&P 500 software industry revenue growth to be 16% in 2021, and decelerating slightly to 12% in 2022. The industry is continuing to benefit from covid-19 related spending and the ongoing migration of enterprise applications to the cloud. The S&P 500 systems sub industry is up 19.9% YTD vs. 19.0% of the S&P 500 overall (as of 9/14/2021). With a 36.9x (LTM) P/E, the S&P 500 Systems Software sub-industry looks expensive, especially vs. the overall S&P 500 with a P/E of 28.7x, until one considers that Systems Software's trailing 3-year EPS CAGR is 53%, vs. 9% for the overall S&P 500

Investment Thesis:

Microsoft (MSFT) has had consistent growth in revenue, EBIT Margin, net profit margin, operating income, and net income. Revenue grew 17.5% YoY, with EBIT margin increasing 41.6%, net profit margin increasing. MSFT has seen 11% annualized revenue growth per year over the past five years. With estimated annual rates of revenue growth to continue to rise at 13.5% per year to 2026. MSFT maintains a robust balance sheet with a 2% debt ratio and 98% equity ratio. MSFT continues to dominate the software systems industry, being ranked #1 in the world in terms of software sales in 2020.

Investment Risks:

- 1.) Competition in Technology Sector: Mitigant: Barriers to entry in many product lines are low to Microsoft. Many of the areas in which Microsoft competes evolve rapidly with changing and disruptive technologies, shifting user needs, and frequent introductions of new products and services. Microsoft's ability to remain competitive depends on our success in making innovative products, devices, and services that appeal to businesses and consumers.
- 2.) Cyber Attacks and Security Vulnerabilities: Mitigant: With the increasing sophistication and complexity of cyber-attacks, it may be difficult for a firm like Microsoft to immediately detect and defend against every vulnerability. Which may cause customer data to be leaked and intellectual property to be stolen. However, Microsoft is committed to providing support on detection, tracking, and remediation from cyber-attacks.

3-5 take away from last quarter investor call transcript:

- LinkedIn now has nearly 800 million members. Confirmed hires on the platform increased more than 160% year over year.
- Microsoft Cloud revenue grew 36% and 34% in constant currency to \$20.7 billion, ahead of expectations.
- At a total company level, headcount grew 14% year over year as we continue to invest in key areas such as cloud engineering, sales, customer deployment, and gaming.
- Over the past two years, our Microsoft 365 subscriber base has grown over 50%, reaching \$54.1 million.

Financial Performance:

| In millions* | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | Last 12M |
|--------------------|--------|--------|---------|---------|---------|---------|----------|
| Revenue* | 91,154 | 96,571 | 110,360 | 125,843 | 143,015 | 168,088 | 176,251 |
| Operating Profit* | 27,188 | 29,331 | 35,058 | 42,959 | 53,409 | 69,916 | 74,278 |
| Net Income * | 20,539 | 25,489 | 16,571 | 39,240 | 44,281 | 61,271 | 67,883 |
| Revenue Growth % | -2.59 | 5.94 | 14.28 | 14.03 | 13.65 | 17.53 | |
| EBITDA% | 2.40% | 9.66% | 8.98% | 11.31% | 22.96% | 19.96% | |
| Operating Profit % | 43.59% | 11.30% | 20.79% | 22.54% | 23.28% | 32.02% | |
| Net Income Margin | 22.53% | 26.39% | 15.02% | 31.18% | 30.96% | 36.45% | |
| D/E | 69.46 | 108.9 | 105.79 | 84.49 | 69.41 | 57.95 | |
| EPS | 2.79 | 3.08 | 3.88 | 4.75 | 5.76 | 7.97 | |
| PE Ratio | 19.75 | 22.52 | 26.90 | 28.60 | 35.07 | 34.55 | 39.98 |
| Current Ratio | 2.68 | 2.92 | 2.90 | 2.53 | 2.52 | 2.08 | |
| ROE | 25.17 | 29.85 | 19.45 | 42.41 | 40.14 | 47.08 | |
| ROA | 10.89 | 11.25 | 6.51 | 14.39 | 15.06 | 19.30 | |
| Dividend Per share | 1.44 | 1.56 | 1.68 | 1.84 | 2.04 | 2.24 | |
| FCF | 24,982 | 31,378 | 32,252 | 38,260 | 45,234 | 56,118 | 60,420 |

Discounted Cash Flow

| | 2011-15 | 2016-20 |
|------------------------|---------|---------|
| Avg Revenue growth | 10.0% | 11.0% |
| Avg EBITDA Margin | 11.0% | 18.0% |
| Avg Net Income Margin | 25.4% | 25.2% |
| Avg Debt/Equity | 25.6 | 87.6 |
| Avg FCF / Margin | 33% | 30.2% |
| Cost of Debt | | 3.60% |
| Tax Rate | | 13.83% |
| Cost of Equity | | 5.35% |
| WACC | | 5.30% |
| Perpetuity growth rate | | 3.0% |

Analyst Opinion

| Buy: 42 | Hold: 5 | Sell: 0 |
|-------------------|---------------|----------|
| | Rating | Target |
| S&P Net Advantage | Strong Buy | \$388.00 |
| Morning Star | N/A | N/A |
| Value Line | Timeliness: 1 | N/A |

Relative Valuation

| | Microsoft Corporation (MSFT) | CrowdStrike Holdings Inc. (CRWD) | Oracle Corporation (ORCL) | Servicenow Inc. (NOW) | Industry Avg.* |
|------------------|------------------------------|----------------------------------|---------------------------|-----------------------|----------------|
| P/E | 39.98 | NM | 22.45 | 1,101 | 193.65 |
| P/B | 16.34 | 54.79 | N/A | N/A | 16.24 |
| Dividend Yield | 0.70% | N/A | 1.32% | N/A | 1.5% |
| PEG Ratio | 2.60 | 6.605 | 2.46 | 2.68 | 1.73 |
| EPS | \$2.27 | -\$0.24 | \$0.88 | \$0.34 | \$0.27 |
| Revn Grth | 17.53% | 69.72% | 3.85% | 31.25% | 17.75% |
| NI Grth | 47.59% | -91.87% | 9.15% | 389.97% | 57.24% |
| Operating Margin | 44.66% | -14.04% | 35.23% | 4.89% | 27.7% |
| Debt / Equity | 57.95 | 85.31 | 1,462 | 63.02 | 6.00 |
| Market Cap | \$2.48T | \$49.55BN | \$248.05BN | \$129.21BN | - |
| Revenue TTM | \$176,251 | \$874.4 | \$40,479 | \$5,531 | - |
| Net Income TTM | \$67,883 | -\$185.90 | \$13,953 | \$220.6 | - |
| FCF TTM | \$60,420 | \$363.9 | \$12,564 | N/A | - |

*Industry Avg. NI Grth, Operating Margin, Revenue TTM, FCF TTM includes companies listed.

Total Return

| | MSFT | Industry | S&P 500 |
|--------------|-------|----------|---------|
| YTD | 49.67 | 33.59 | 21.02 |
| 2020 | 40.1 | 41.23 | 26.25 |
| Last 3 Years | 44.83 | 37.48 | 20.34 |
| Last 5 Years | 41.36 | 35.10 | 17.68 |

CSR Characteristics

| | MSFT | Industry |
|--------------------------------|------|----------|
| Governance Disclosure Score | 59 | 18 |
| ESG Disclosure | 58 | 11 |
| Social Disclosure Score | 54 | 8 |
| Environmental Disclosure Score | 63 | 6 |

Prepared by Serge Virvo (Dec 1st, 2021) using Bloomberg, Value Line, S&P Net Advantage, Morning Star, Yahoo Finance