



Microsoft Corp. (MSFT)

Updated January 31st, 2024, by Aristofanis Papadatos

Key Metrics

Current Price:	\$407	5 Year CAGR Estimate:	2.7%	Market Cap:	\$3.0 T
Fair Value Price:	\$276	5 Year Growth Estimate:	10.0%	Ex-Dividend Date:	2/14/24
% Fair Value:	147%	5 Year Valuation Multiple Estimate:	-7.5%	Dividend Payment Date:	3/14/24
Dividend Yield:	0.7%	5 Year Price Target	\$445	Years Of Dividend Growth:	22
Dividend Risk Score:	A	Retirement Suitability Score:	C	Rating:	Sell

Overview & Current Events

Microsoft Corporation, founded in 1975 and headquartered in Redmond, WA, develops, manufactures, and sells software and hardware to businesses and consumers. Its offerings include operating systems, business software, software development tools, video games and gaming hardware, and cloud services. Microsoft's market capitalization is \$3.0 trillion, compared to annual underlying earnings power of \$73 billion.

On October 13th, 2023, Microsoft acquired Activision Blizzard, a leader in video game content, for \$68.7 billion.

In late January, Microsoft reported (1/30/24) financial results for the second quarter of fiscal 2024 (its fiscal year ends June 30th). The company accelerated its performance and grew its revenue 18% over last year's quarter. Growth came from Intelligent Cloud and Productivity & Business Processes, which grew 20% and 13%, respectively. Sales of Azure, Microsoft's high-growth cloud platform, grew 30%. As a result, earnings-per-share grew 26%, from \$2.33 to \$2.93, and exceeded the analysts' consensus by \$0.16. Microsoft has exceeded the analysts' consensus in 20 of the last 22 quarters. Thanks to solid business momentum and enthusiasm over the potential of Microsoft in artificial intelligence, the stock has rallied 68% in 12 months. Given accelerated sales growth, we have raised our annual forecast from \$11.30 to \$11.50.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$2.63	\$2.65	\$2.79	\$3.08	\$3.88	\$4.75	\$5.76	\$7.97	\$9.21	\$9.81	\$11.50	\$18.52
DPS	\$1.12	\$1.24	\$1.44	\$1.56	\$1.68	\$1.80	\$1.99	\$2.19	\$2.42	\$2.66	\$3.00	\$4.58
Shares¹	8,239	8,027	7,808	7,708	7,677	7,643	7,571	7,608	7,506	7,467	7,400	7,000

After years of solid growth, Microsoft had a hard time growing its profits during 2011-2015. After a change in its management and a strategic shift towards cloud computing and mobile, Microsoft has reinvigorated growth. The tech giant has grown its earnings-per-share at a 15.8% average annual rate over the last decade.

Microsoft's cloud business is growing at a rapid pace thanks to Azure, which has been growing tremendously. The Office product range, which had been a low-growth cash cow for years, is showing strong growth rates as well after Microsoft changed its business model towards the Office 365 software-as-a-service (SaaS) system. Due to low variable costs, the company should be able to maintain a solid earnings growth rate for the foreseeable future. Buybacks are an additional growth driver, although this form of capital allocation becomes less attractive with an elevated valuation.

The markets Microsoft addresses continue to grow, with cloud computing being the most compelling. This means that Microsoft will most likely be able to grow its top line even without any market share gains. Given also margin expansion, we expect 10% average annual growth of earnings-per-share over the next five years.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	14.0	17.0	18.1	20.2	22.1	23.7	27.4	28.3	32.2	27.3	35.4	24.0
Avg. Yld.	3.0%	2.7%	2.9%	2.5%	2.0%	1.6%	1.3%	1.0%	0.8%	1.0%	0.7%	1.0%

¹ In millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Microsoft is marked by several very distinct valuation periods. In the 1990's and early 2000's, it was not uncommon to see shares trade north of 30- or 40-times earnings. From 2003 through 2008 shares regularly traded in the 20 to 25 times earnings range. From 2009 through 2014, a 10 to 15 multiple was typical. And lately, 20 times earnings and above has once again become the norm, as growth has picked up extensively. Our view is that an above average multiple of 24.0 is warranted for the business, especially considering the strong balance sheet. The stock is now trading at a 10-year high price-to-earnings ratio of 35.4. If it trades at fair valuation level in 2029, it will incur a -7.5% annualized drag.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	43%	47%	52%	51%	43%	38%	35%	27%	26%	27%	26%	25%

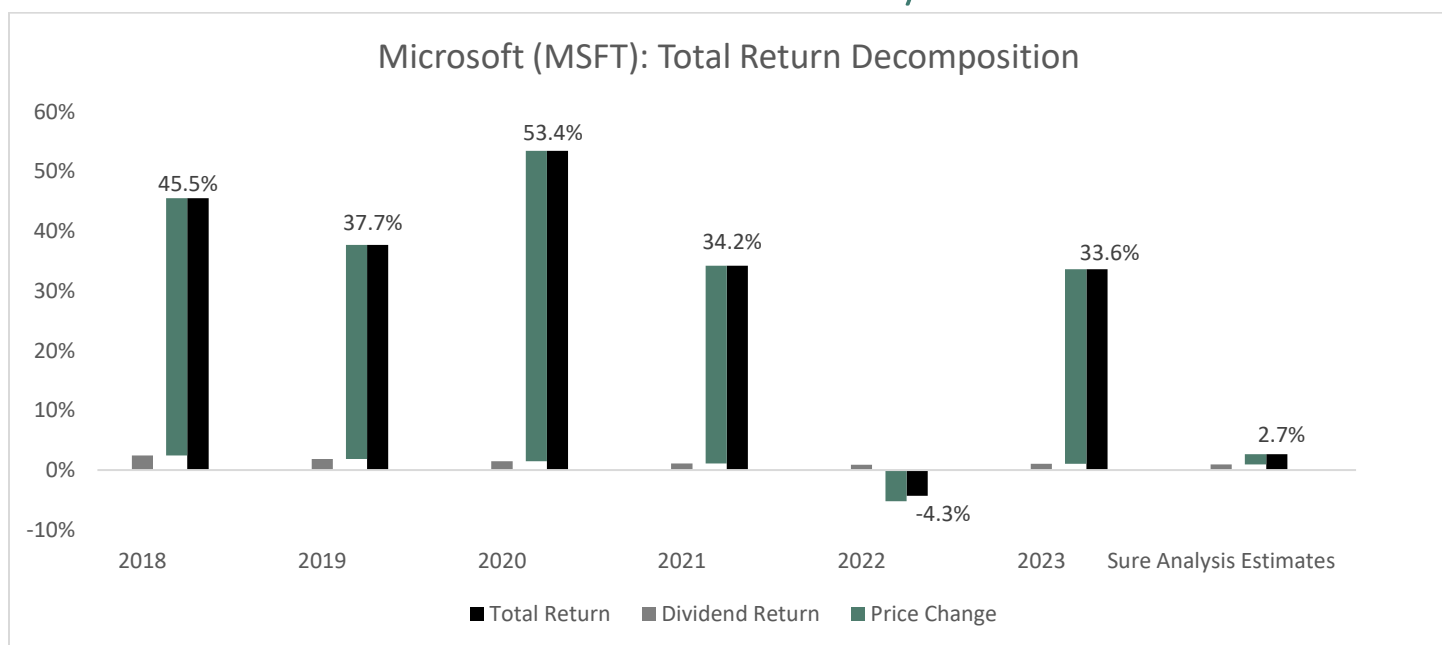
Microsoft has been a solid income investment throughout the last decade. The dividend payout ratio has never risen substantially above 50%, and the fact that Microsoft has one of the strongest balance sheets in the world means that the dividend is very safe. However, the below-average yield makes Microsoft less suitable as an income stock today.

Microsoft has a wide moat in the operating system & Office business units and a strong market position in cloud computing. It is unlikely that the company will lose market share with its older, established products, whereas cloud computing is such a high-growth industry that there is enough room for growth for multiple companies. Microsoft has a renowned brand and a global presence, which provides competitive advantages. The company is relatively resilient against recessions, and its AAA-rated balance sheet makes it a low-risk business.

Final Thoughts & Recommendation

Microsoft had been a low-growth cash cow throughout the majority of the last decade, but a focus on cloud computing and mobile has reinvigorated its growth. With that said, the stock has rallied 68% in 12 months, partly thanks to enthusiasm of the market over the potential of artificial intelligence. As a result, Microsoft could now offer just a 2.7% average annual return over the next five years, as its 10.0% earnings growth and its 0.7% dividend may be partly offset by a -7.5% valuation headwind. While the short-term momentum is strong for the company and the stock price, we are reluctant to recommend the stock at its nosebleed valuation level and rate it as a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	86833	93580	91154	96571	110360	125843	143015	168090	198270	211915
Gross Profit	59755	60542	58374	62310	72007	82933	96937	115860	135620	146052
Gross Margin	68.8%	64.7%	64.0%	64.5%	65.2%	65.9%	67.8%	68.9%	68.4%	68.9%
SG&A Exp.	20488	20324	19198	19942	22223	23098	24709	25220	27725	30334
D&A Exp.	5212	5957	6622	8778	10261	11682	12796	11690	14460	13861
Operating Profit	27886	28172	27188	29331	35058	42959	52959	69920	83383	88523
Op. Margin	32.1%	30.1%	29.8%	30.4%	31.8%	34.1%	37.0%	41.6%	42.1%	41.8%
Net Profit	22074	12193	20539	25489	16571	39240	44281	61270	72738	72361
Net Margin	25.4%	13.0%	22.5%	26.4%	15.0%	31.2%	31.0%	36.5%	36.7%	34.1%
Free Cash Flow	27017	23724	24982	31378	32252	38260	45234	56120	65149	59475
Income Tax	5746	6314	5100	4412	19903	4448	8755	9831	10978	16950

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets (\$B)	172	174	193	250	259	287	301	334	365	411
Cash & Equivalents (\$B)	9	6	7	8	12	11	13.6	14.2	13.9	34.7
Acc. Receivable (\$B)	20	18	18	22	26	30	32.0	38	441	48.7
Inventories (\$B)	3	3	2	2	3	2	1.9	2.6	3.7	2.5
Goodwill & Int. (\$B)	27	22	22	45	44	50	50.4	57.5	78.8	77.3
Total Liab. (\$B)	83	94	121	163	176	184	183.0	191.8	198.3	205.8
Accounts Payable (\$B)	7	7	7	7	9	9	12.5	15.2	19	18
Long-Term Debt (\$B)	23	35	53	86	76	72	63.3	58.2	49.8	47.2
Total Equity (\$B)	90	80	72	88	83	102	118.3	142	167	206
D/E Ratio	0.25	0.44	0.74	0.98	0.92	0.71	0.54	0.41	0.30	0.23

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	14.0%	7.0%	11.2%	11.5%	6.5%	14.4%	15.1%	19.3%	20.8%	18.6%
Return on Equity	26.2%	14.4%	27.0%	31.9%	19.4%	42.4%	40.1%	47.1%	47.2%	38.8%
ROIC	21.3%	10.7%	17.1%	17.0%	10.0%	23.5%	24.9%	32.1%	34.9%	30.8%
Shares Out.	8,239	8,027	7,808	7,708	7,677	7,643	7,683	7,608	7,540	7,472
Revenue/Share	10.34	11.34	11.38	12.33	14.16	16.23	18.61	22.09	26.30	28.36
FCF/Share	3.22	2.87	3.12	4.01	4.14	4.93	5.89	7.38	8.64	7.96

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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