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, and it provides solution support and consulting services.

**Revenue**

![Revenue Graph]

Source: CFRA, S&P Global Market Intelligence

Company Overview

We see continuing revenue growth and margin expansion in the software industry, especially for cloud providers and legacy software companies that have largely 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 contributing to growth in future years.

Investment Thesis

**Wide Economic Moat:** Microsoft’s diverse business portfolio presents a wide range of moats that we expect to directly impact the company’s margins. The firm experiences both a network effect and a high switching cost for its Windows OS, Windows server, and database management systems (DBMS). The company also have a scalability advantage in the cloud service segment (Azure) serving 95% of the Fortune 500 companies. Finally, but not least, Microsoft experiences pricing power for its Office 365 offerings as it is a standardized solution for productivity 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 at a CAGR of 27% through 2022 according to a study completed by Gartner. Microsoft’s currently have 18% of the IaaS cloud services market share and we expect it to grow given the company’s competitive advantage in terms of scalability and its presence in major corporation’s 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 motive for those organization to leverage Azure during its migration 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. This poses immense brand reputation as well as potential loss and harm related to technical infrastructure.

**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.
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.

ESG Considerations

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