MICROSOFT (MSFT)

Business Model

Microsoft develops and licenses consumer and enterprise software. It is known for its Windows operating systems and Office productivity suite. The company is organized into three equally sized broad segments: productivity and business processes (legacy Microsoft Office, cloud-based Office 365, Exchange, SharePoint, Skype, LinkedIn, Dynamics), intelligence cloud (infrastructure and platform-as-a-service offerings like Azure, Windows Server OS, SQL Server), and more personal computing (Windows Client, Xbox, Bing search, display advertising, and Surface laptops, tablets, and desktops).

The Company in a Nutshell

- MSFT's strength is in the many businesses using its services (Windows, software, servers, services, etc.).
- Azure is prone to several years of growth.
- Microsoft can sustain a double-digit dividend growth rate for the next decade.

Investment Thesis

Microsoft is one of the oldest and newest tech companies, all at the same time. While it benefits from a strong core business model that generates cash flow through subscriptions, management has proven its ability to develop other growth vectors. Its most recent success is with Azure, which is No. 2 in public cloud services. Azure is on the path to strong growth over the coming years. Cloud services will also be integral to the future of many businesses, and this segment is already exhibiting tremendous growth. MSFT recently acquired a player in artificial intelligence (Nuance) for $19.7B. This will mesh well with MSFT's business portfolio and open the door to healthcare solutions. We would also like to mention MSFT's acquisition of Activision, which may bring with it some tailwinds. Finally, if you have been waiting for an entry point with MSFT, the downtrend in the tech sector could be bringing us to that potential entry point.

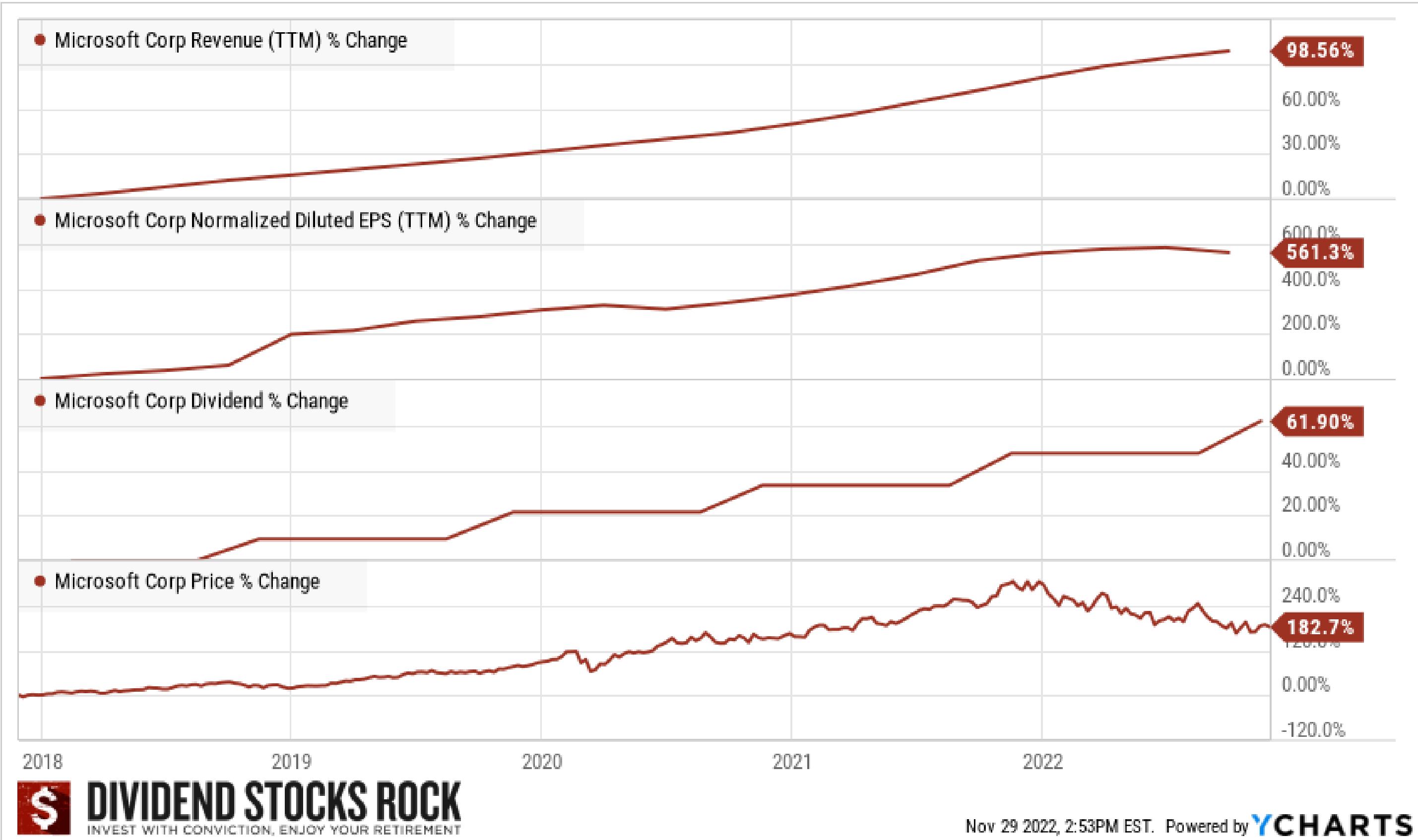
VALUATION

Dividend Growth Rate Years 1-10: 10.00% **Terminal Dividend Growth Rate:** 7.00%

	Discount Rate (Horizontal)		
Margin of Safety	**8.00%**	**9.00%**	**10.00%**
20% Premium	$375.32	$185.83	$122.75
10% Premium	$344.04	$170.35	$112.52
Intrinsic Value	$312.77	**$154.86**	$102.29
10% Discount	$281.49	$139.38	$92.06
20% Discount	$250.21	$123.89	$81.83

DSR STOCK CARD

11/26/2022



Potential Risks

Microsoft has several dark clouds hovering over it: the first is evidently the Windows desktop OS. Desktops are often replaced by smartphones, tablets, or 2-in-1 solutions, where Windows isn't a major player. Desktops won't disappear soon, but there won't be much growth from them either. Microsoft is also seeing a slowdown in growth from its subscription business. Most of its product suites (Windows, Office) are mature products, which are good for cash flow generation, but won't keep the market excited (as it is right now!). While Microsoft can count on Azure and Dynamics to ensure growth, both products are not leaders in their respective markets. The tech giant must wrestle with other companies just as large. In the short term, our concerns are the state of the economy and how the tech sector will perform in the coming months.

Dividend Growth Perspective

Microsoft has successfully increased its dividend yearly since 2004. Its yield used to be more attractive at approximately 3%, but the hype surrounding the stock has made it a low-yielding (~1%) stock. Even a double-digit dividend growth rate wasn't enough to compensate for the stock price surge since 2015. Microsoft has a strong dividend triangle, and an investor can expect high-single-digit dividend increases for a while. Even after the 10% dividend increase in Q4 2021, the stock is yielding ~1%. In Q4 2022, the company is set to increase its dividend by a solid 10%.