

Microsoft Stock Valuation: Bundling Leads to Dominance



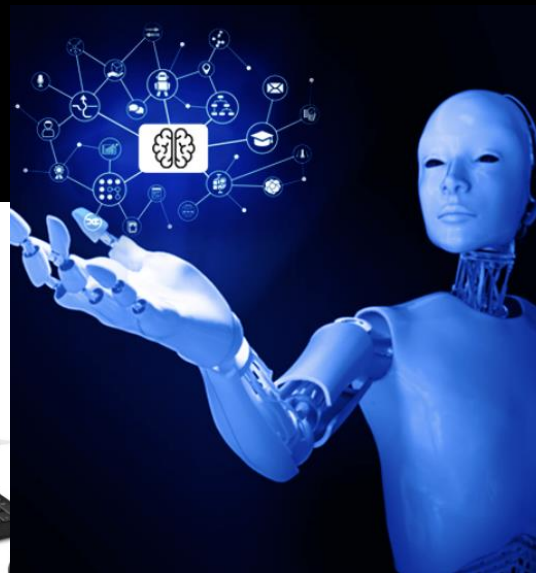
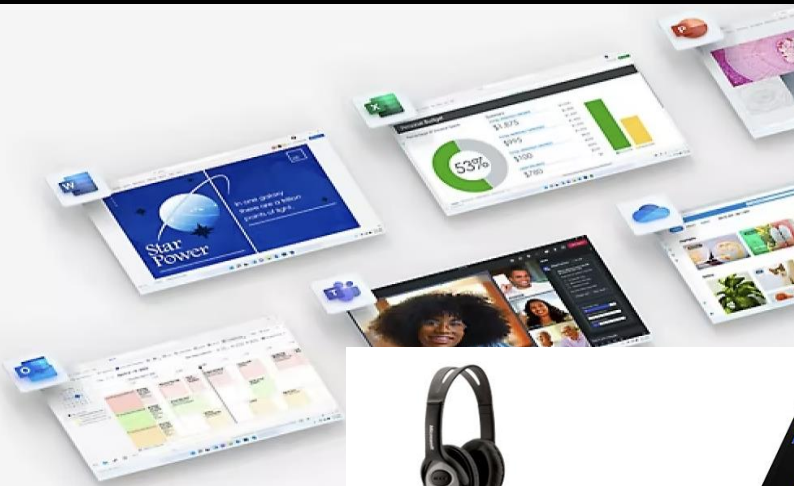
CASE STUDY
VALUATION MASTER CLASS

by

A. Stotz INVESTMENT
RESEARCH



Microsoft



Microsoft Stock Valuation: Bundling Leads to Dominance



This is not a recommendation
or investment advice.

- 🌐 What is the company's background?
- 🌐 What is its competitive strategy?
- 🌐 Does that strategy lead to a competitive advantage?
- 🌐 What does the valuation look like?

As of August 2024, Microsoft is the 3rd largest company in the world by market cap

Rank	Company	Exchange	Mcap (US\$bn)
1	Apple	USA	3,466
2	NVIDIA	USA	3,155
3	Microsoft	USA	3,076
4	Alphabet	USA	2,035
5	Amazon	USA	1,816
6	Saudi Aramco	S. Arabia	1,795
7	Meta Platforms	USA	1,313
8	Berkshire Hathaway	USA	993
9	TSMC	Taiwan	884
10	Eli Lilly	USA	859
11	Broadcom	USA	751
12	Tesla	USA	668
13	JPMorgan Chase	USA	626

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An American multinational technology giant

- ★ Bill Gates and Paul Allen founded Microsoft in 1975 and revolutionized early computing with the DOS and later Windows operating systems
- ★ Windows has over 72% of the market share
- ★ If you've ever used a computer, you've used Microsoft products!

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The distinct segments, each contribution nearly equally

Revenue (US\$bn)	2022	2023	Chg	% Chg	% of TTL
Productivity and Bus. Processes	63.4	69.3	5.9	9.3	32.7
Intelligent Cloud	75.0	87.9	12.9	17.3	41.5
More Personal Computing	59.9	54.7	(5.2)	(8.7)	25.8
Total	198.3	211.9	13.6	6.9	100.0



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More personal computing is shrinking and has lowest and falling gross profit

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Gross profit (US\$bn)	2022	2023	Chg	% Chg	% of TTL
Productivity and Bus. Processes	29.7	34.2	4.5	15.2	38.6
Intelligent Cloud	33.2	37.9	4.7	14.1	42.8
More Personal Computing	20.5	16.5	(4.0)	(19.7)	18.6
Total	83.4	88.5	5.1	6.2	100.0



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More Personal Computing gross margin is lowest and fell by 4ppts



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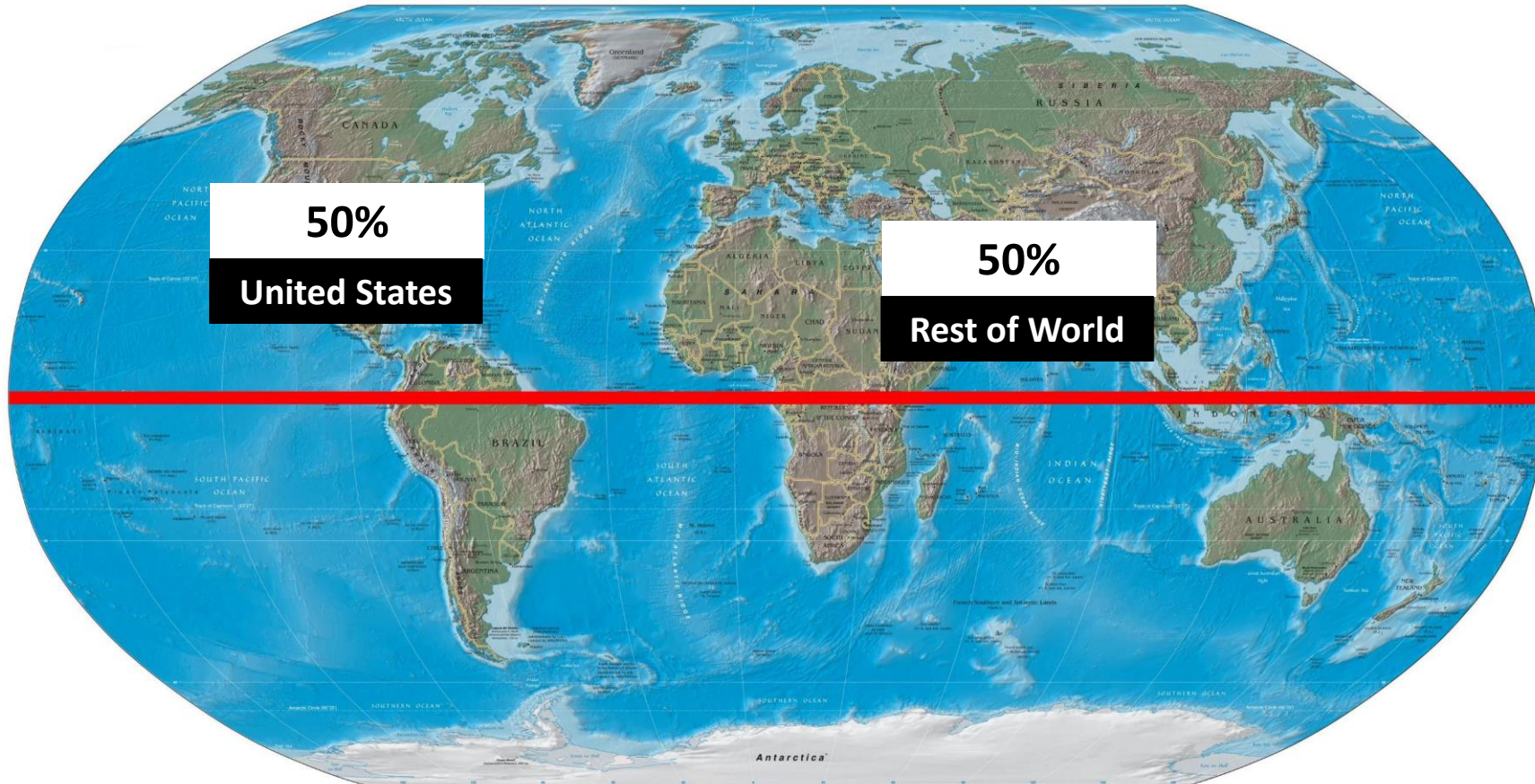
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Gross profit margin (%)	2022	2023	Chg
Productivity and Bus. Processes	46.9	49.4	2.5
Intelligent Cloud	44.3	43.1	(1.2)
More Personal Computing	34.2	30.1	(4.1)
Total	42.1	41.8	(0.3)

2023 Revenue with US dominated, global market evenly poised, generated US\$212bn

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- 🌐 No sales to a country other than US accounted for more than 10% of revenue in the fiscal year 2023

More than 70% of 2023 revenue comes from top 3 products



Server products and
cloud services
US\$80bn, 38%

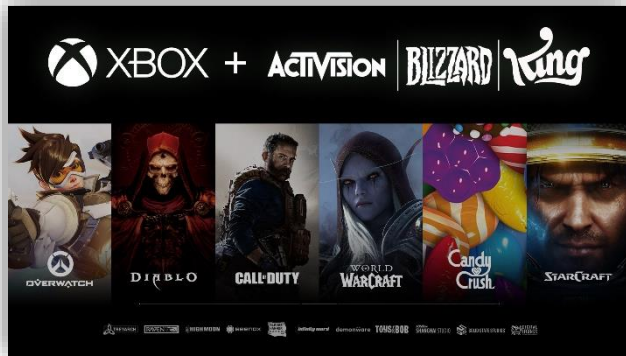


Office products and
cloud services
US\$49bn, 23%



Windows
US\$22bn, 10%

3 other categories has integrated into various aspects of our lives



Gaming
US\$48bn, 7%

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LinkedIn
US\$15bn, 7%



Search and news
advertising
6%

Early Microsoft timeline

- ★ 1980-81: Launched MS-DOS for IBM PC
- ★ 1983: I graduated from high school in Ohio
 - **MSFT released Word for MS-DOS; Lotus 1-2-3 launched and became the #1 spreadsheet**
- ★ 1985: Launched Windows 1.0 and Excel for Macintosh; Steve Jobs pushed out of Apple
- ★ 1986: IPO created many millionaires
- ★ 1987: Released Excel for Windows and Windows 2.0 with improved graphics

In 1988 I bought a secondhand IBM computer for about US\$750 using my credit card



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Source: https://en.wikipedia.org/wiki/IBM_Personal_Computer_XT#/media/File:IBM_PC_XT_5160.JPG

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🌐 I learned to use Lotus 1-2-3

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Source: https://en.wikipedia.org/wiki/IBM_Personal_Computer_XT#/media/File:IBM_PC_XT_5160.JPG

Early Microsoft timeline

- ★ 1989: Lotus 1-2-3 version 3.0 was released, but Excel began catching up. Introduced Office, bundling Word, Excel, and PowerPoint
 - **I graduated from Cal State Long Beach and stood out at Pepsi by making charts with Lotus 1-2-3**
- ★ 1990: Windows 3.0 was a major success, selling over 10 million copies. Windows NT was launched as a secure, stable OS for businesses

1993: I started as a stock market analyst in Thailand using Excel on a slow Windows PC



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Early Microsoft timeline

- ★ 1995: IBM acquired Lotus, but 1-2-3 was already in decline, beaten by Excel and Office
- ★ 1997: Steve Jobs returned to Apple. Microsoft invested \$150 million in non-voting Apple stock, helping Apple regain stability and committing to Office for Mac and Internet Explorer as the default browser
 - **The Asian Financial Crisis struck in Bangkok**

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Microsoft – United States - Founded 1975

Info. Tech. sector, 221,000 employees, US\$212bn revenue

Main segments/products

- Microsoft Azure
- Microsoft 365
- Windows operating system

Its competitive advantage

Competitive advantages through ecosystem integration, continuous innovation and market dominance

How it achieved its competitive advantage

By tightly interlinking its products, maintaining high switching cost, heavily investment in technologies and building strong ties with corporate clients



Under CEO Satya Nadella, Microsoft has excelled in cloud computing and AI

- ★ Satya Nadella replaced Steve Ballmer as the third CEO of Microsoft in 2014
- ★ He has shifted the company away from a falling mobile strategy and focused on cloud computing and AI segments

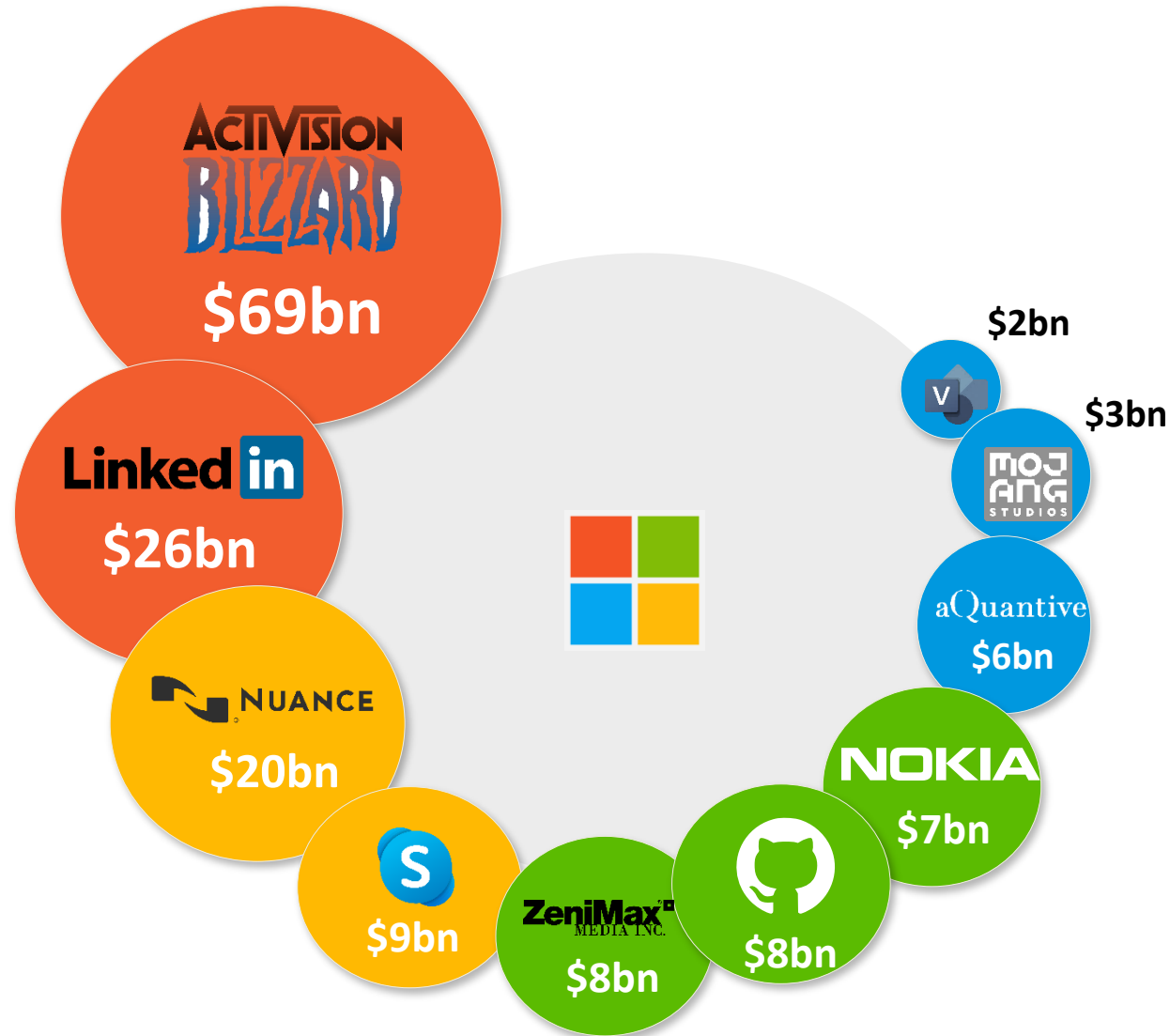


Microsoft has invested US\$13bn in OpenAI for further partnership

- ★ With a recent valuation of nearly US\$80bn, OpenAI has become one of the most valuable tech startups in the world
 - **Structured as a "minority economic interest" to gain profits, but not control to avoid the regulatory scrutiny**
- ★ With this partnership, Microsoft is integrating technology powered by ChatGPT into Bing, GitHub coding tools, Microsoft 365, and Azure Cloud



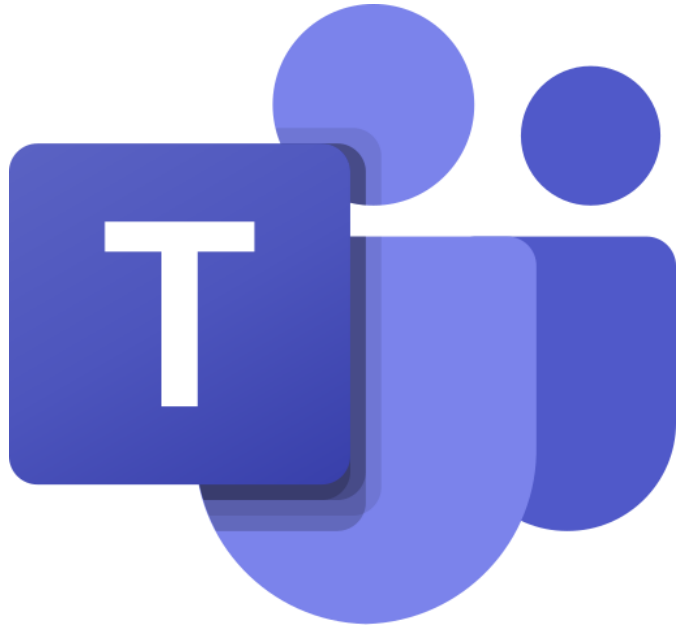
Top 10 Acquisitions by deal value, Microsoft keeps integrating new offering into its ecosystem



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- 🌐 The Activision-Blizzard deal alone almost equal to the next 5 acquisition combined
- 🌐 Most of them happened after Nadella started the role as CEO

Microsoft launched Teams in 2016 to compete with Slack



slack

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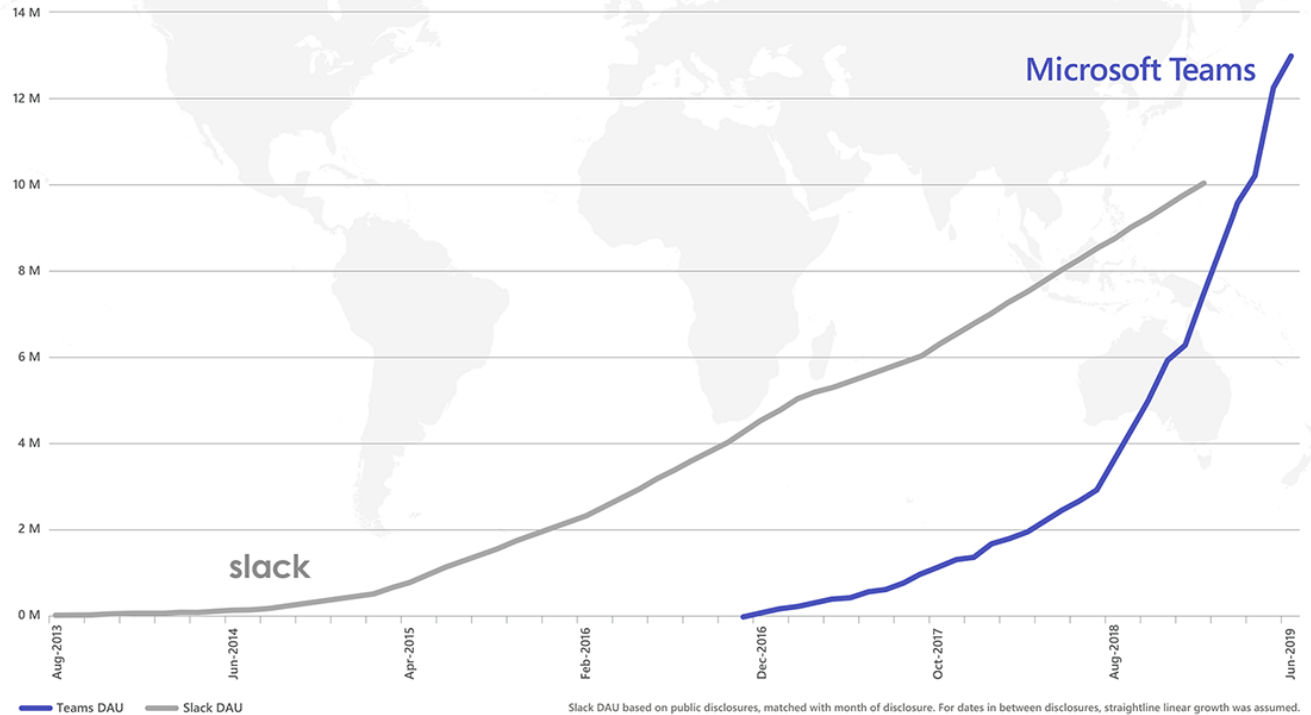
- 🌐 It also integrated Skype which MSFT bought in 2011
- 🌐 Many argue Slack is the better product of the two

It took Microsoft less than 2 years to beat Slack in terms of daily active users



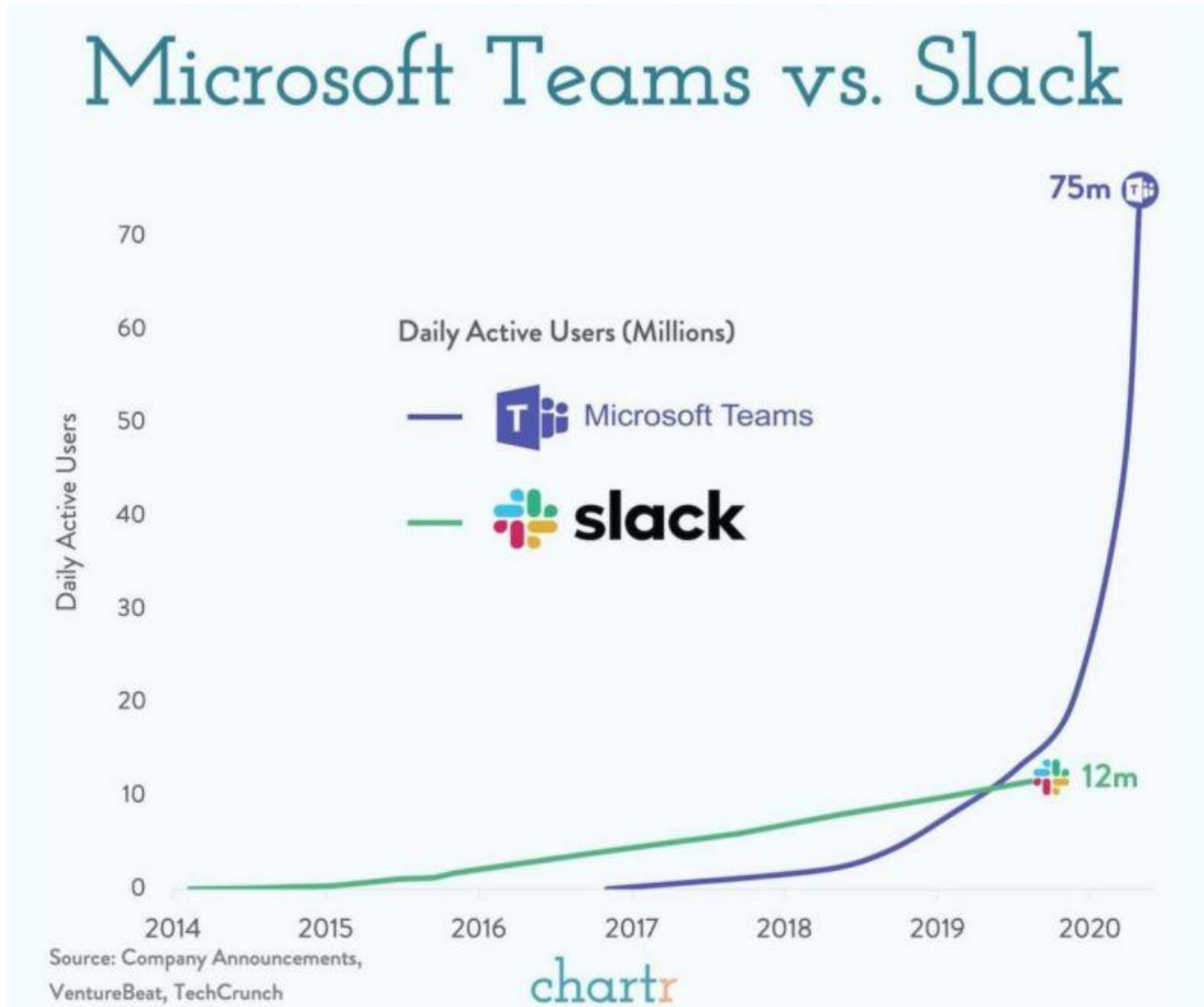
13+ million

daily active users



Slacks DAU based on public disclosures, matched with month of disclosure. For dates in between disclosures, straightline linear growth was assumed.

Microsoft Teams saw exponential growth in users, while Slack has seen linear growth



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- While Slack targeted SMEs, Microsoft Teams was designed for larger enterprises
- Microsoft could leverage its expertise and customer base within enterprise solutions

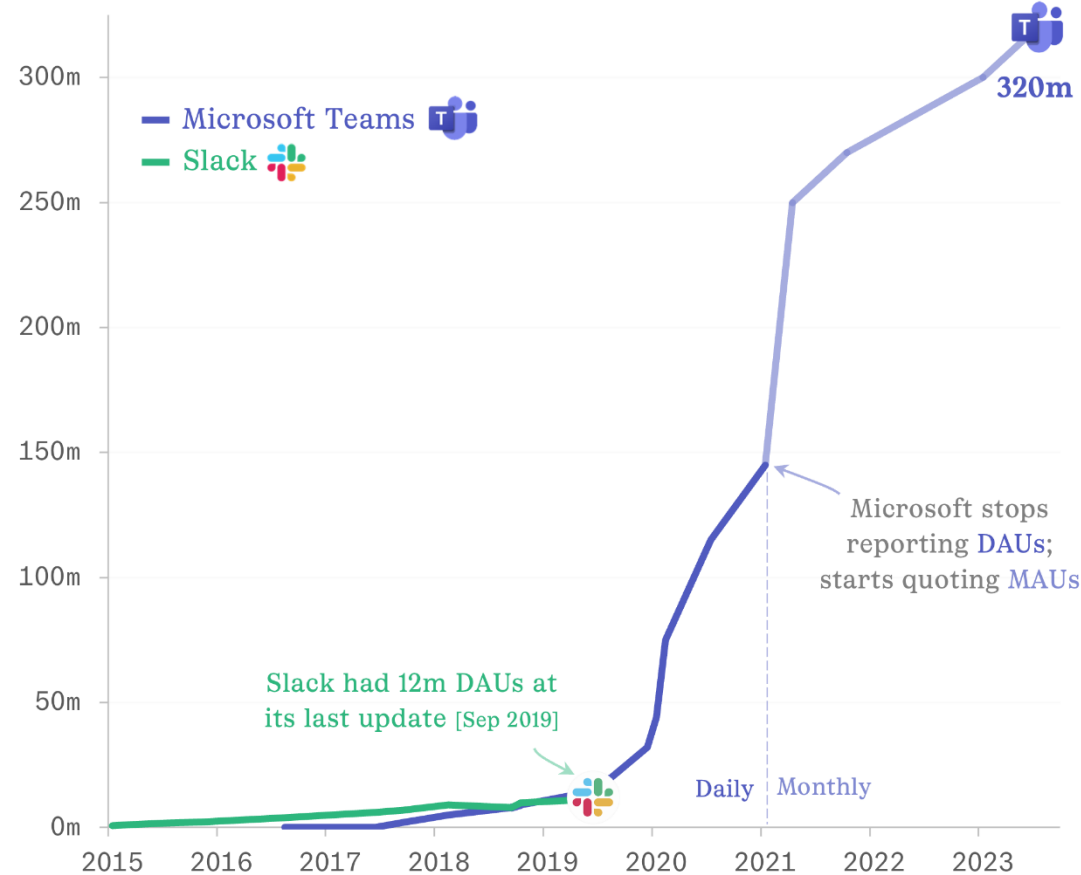
Microsoft Teams have 320 million monthly active users today



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CUTTING SLACK Microsoft's Office Bundle Turbocharged Teams

Daily / Monthly Active Users [Millions]



CHARTR

Source: Company reports

This is not a recommendation or investment advice.

Sources: Chartr, Sherwood.news

- By bundling Teams with Office 365, users basically got Teams for free
- It's hard to beat free
- Microsoft also understands they're selling to the end buyer, not the end user

Microsoft tries to do the same to other apps

- ★ **Microsoft Tasks** tries to overtake Trello
- ★ **Microsoft Lists** tries to overtake Monday.com
- ★ **Microsoft To Do** tries to overtake every personal task management app
- ★ By bundling and leveraging its enterprise clients, Microsoft has a good chance to become the dominant app in terms of users
- ★ It is currently integrating Copilot AI into its ecosystem

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**Is the company
financially world class?**



I use my **World Class Benchmarking** scorecard to measure if a company has a **competitive advantage**



I developed this scorecard ten years ago; here's how we construct it



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- ★ My team gathers the yearly and quarterly financial data of 26,000 companies worldwide
- ★ We then calculate each company's **Profitable Growth** score
 - Which is a composite measure of both profitability and growth

I developed this scorecard ten years ago; here's how we construct it

- ★ After that, we rank the company relative to sector peers of similar size
 - A decile ranking of 1 or 2 is financially world class, while 10 is the worst
- ★ We assess the company's performance over the prior four years and the past 12 months (PTM)



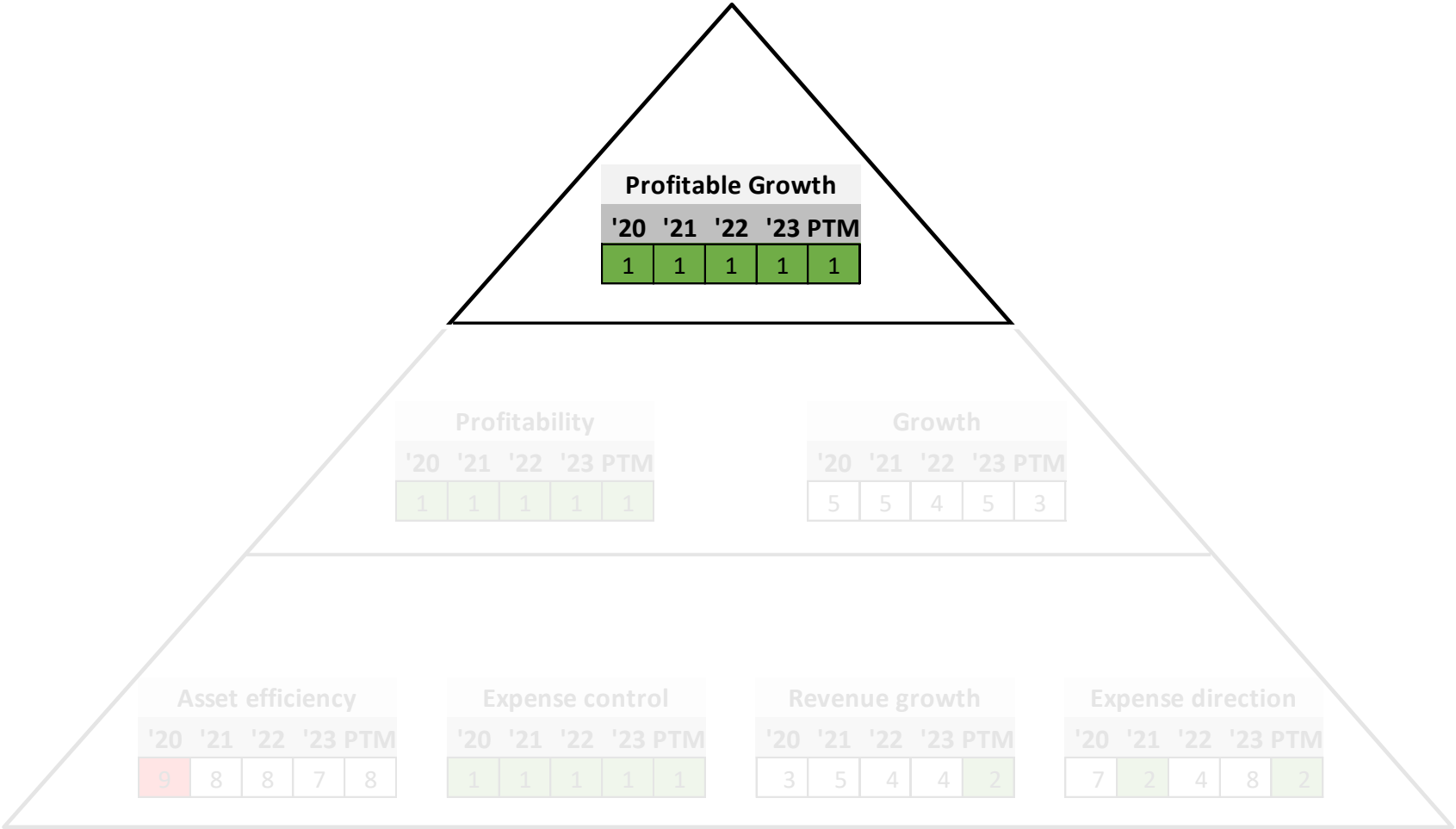
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**Is the company
financially
world class?**

Microsoft: A. Stotz Profitable Growth



Andrew Stotz, PhD, CFA



Benchmarked against 640 large Info Tech companies worldwide.

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Source: A. Stotz Investment Research. Notes: 1 = top ranking and 10 = worst. Most recent year's data is based on the past 12 months (PTM) of published data.

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I use my **FVMR** methodology
to determine the
attractiveness of the
company



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Net profit margin (NPM)

Return on assets (ROA)

MANAGEMENT

EARNINGS

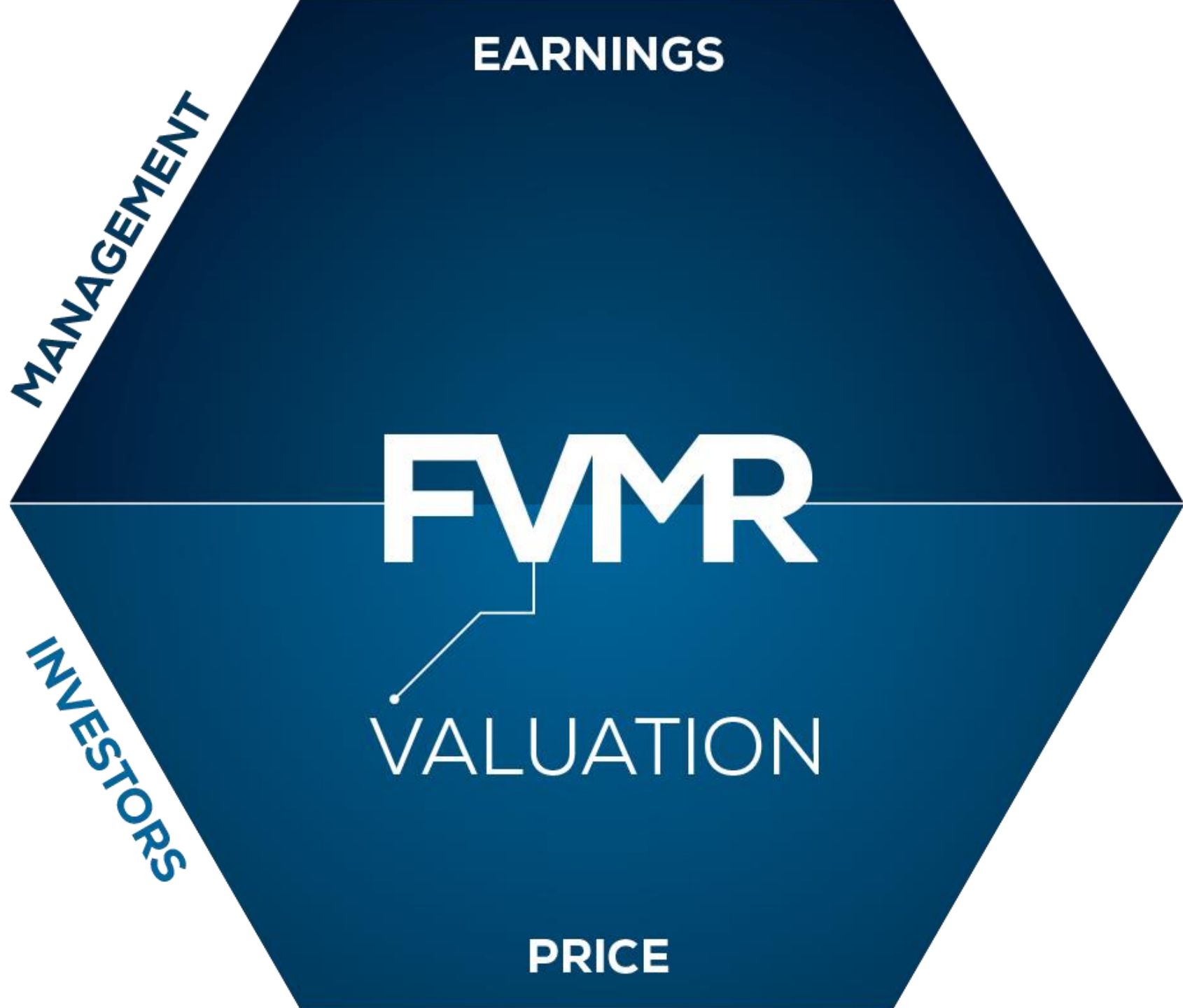
FUNDAMENTALS

FVMR

INVESTORS

PRICE





EARNINGS

MANAGEMENT

FVMMR

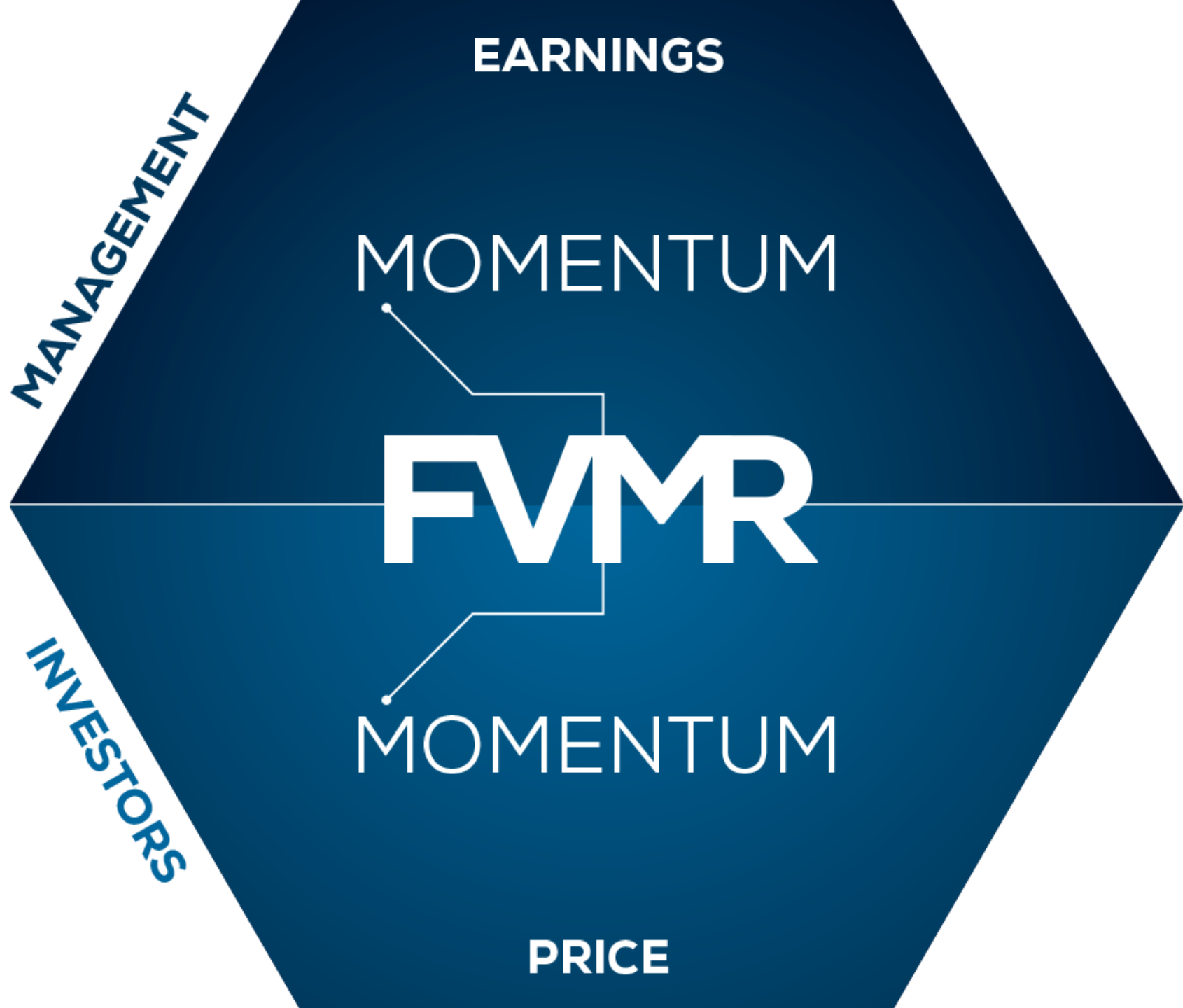
VALUATION

PRICE

INVESTORS

Price-to-earnings (PE)

Price-to-book value (PB)



EPS growth (EPS)

% Price change (Price*)

EARNINGS

MOMENTUM

FVMMR

MOMENTUM

PRICE

MANAGEMENT

INVESTORS

MANAGEMENT

EARNINGS

RISK

FVMR

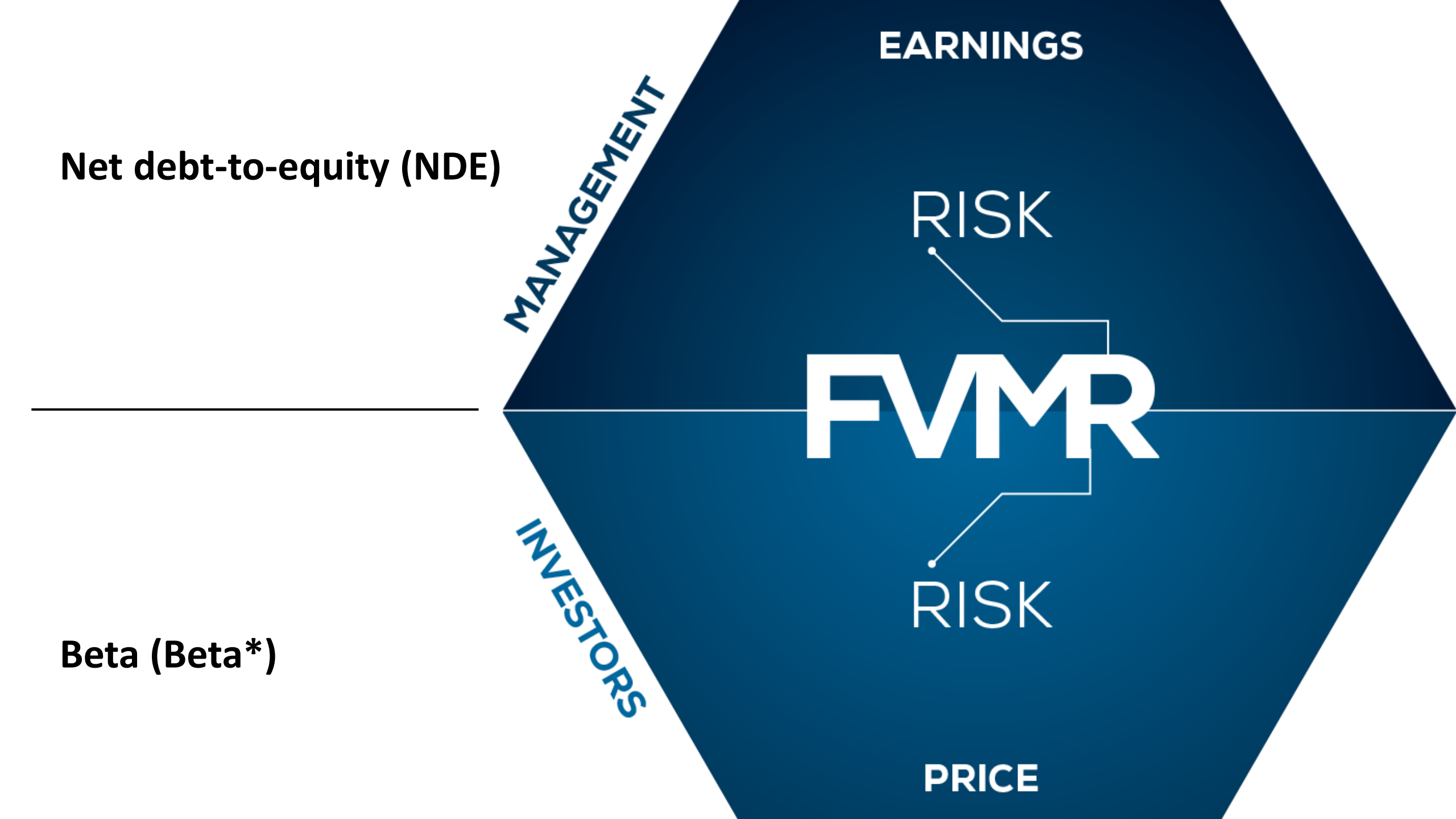
RISK

INVESTORS

PRICE

Net debt-to-equity (NDE)

Beta (Beta*)



Abbreviated FVMR Scorecard




A. Stotz FVMR Methodology - Info. Tech.: Software & Services

Company	Exchange	Mcap US\$bn	ADV US\$m	Fund. (%)		Valuation (x)		Momo (% chg)		Risk (x)		FVMR rank
				NPM	ROA	PE	PB	EPS	Price*	NDE	Beta*	
Info. Tech.: Software & Services		5,293	6,059	28.0	16.8	33.7	12.5	18.3	2.1	5.5	1.0	
Microsoft	USA	3,098	3,016	36.0	20.6	34.7	11.0	20.1	(2.4)	(0.2)	1.0	5
Oracle	USA	384	278	19.8	7.8	24.3	31.8	9.6	12.2	76.7	1.6	11
SAP	Germany	267	301	8.1	3.7	47.3	5.3	(3.7)	7.9	0.1	1.1	9
Salesforce	USA	256	416	15.3	5.8	28.7	4.1	40.9	(5.2)	(0.0)	1.3	7
Adobe	USA	248	539	24.9	18.0	31.6	16.4	15.9	15.5	(0.1)	1.0	3
Accenture	USA	209	287	10.8	13.9	27.9	7.4	2.9	8.9	(0.3)	0.5	4
Tata Consultancy Servs.	India	194	120	19.2	31.3	0.4	17.4	9.9	14.7	(0.5)	0.5	1
IBM	USA	181	213	13.5	6.4	19.6	7.1	6.0	14.9	1.9	0.6	2
Intuit	USA	173	338	18.2	10.2	36.2	9.2	19.2	(6.4)	0.2	1.0	8
ServiceNow	USA	171	219	11.5	7.6	64.8	18.6	39.2	9.2	(0.4)	0.9	10
Palo Alto Networks	USA	114	332	32.1	16.4	61.3	21.5	32.1	12.6	(0.1)	1.5	6

Source: A. Stotz Academy, Refinitiv. Sector data is market cap weighted. *Price change and beta over the past three months.

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 Click the link in the description to download this PDF and get the Abbreviated FVMR Scorecard for the world's top 500 companies

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