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Microsoft Corporation

NASDAQ: MSFT

BUY

Recommendation: BUY, 13, \$2,146.82

Intrinsic Value: \$216

Executive Summary

We recommend that the CSUF SMIF Portfolio re-initiate a 3% position in MSFT for the following reasons: As a position held previously, we've identified an opportunity to obtain MSFT again at a significant discount, they have a plenty of cash on hand, as well as increased volume in customers using their cloud services. MSFT has an intrinsic value of \$216 per share which is a 30% upside from its current price of \$165.14. This opportunity exists for MSFT as a result of COVID-19's negative impact on the global economy, they are positioned well as a leader in their industry due to businesses and individuals relying heavily on their software and devices. MSFT will serve as a defensive and value investment in CSUF's broader portfolio.

Company Name	Market Data			Financial Data				Valuation			
	Price	Market Cap.	EV	Sales	EBITDA	EBIT	Earnings	EV/Sales	EV/EBITDA	EV/EBIT	P/E
Microsoft Corporation	\$ 149.70	1.139T	1.13T	134.25B	61.26B	52.48B	44.32B	8.4x	1.8x	2.2x	27.7x
Apple Inc.	\$ 247.74	1.084T	1.13T	267.68B	78.12B	71.22B	57.53B	4.2x	1.4x	1.6x	19.57x
Oracle	\$ 49.83	157.143B	185.01B	39.77B	16.37B	14.17B	10.76B	4.7x	11.3x	13.1x	15.67x
IBM	\$ 108.03	95.975B	159.58B	77.15B	16.84B	11.50B	9.43B	2.1x	9.5x	13.9x	10.1x
Average								4.85x	6x	7.7x	18.26x
Median								4.45x	5.65x	7.65x	17.62x

Company Overview

Microsoft Corporation participates in the development and support of services, devices, and solutions. They have three operating segments that include Productivity and Business Processes, Intelligent Cloud, and More Personal Computing. Based out of Seattle, Washington with over 150,000 employees globally, they are a leader in their industry due to having one of the most commonly used operating systems and popular computing devices. MSFT additionally sells various products such as the Xbox line and is easily recognized for their Bing search engine.

Investment Thesis

We recommend the repurchase of Microsoft Corporation (MSFT). Over the last three months Microsoft has lost almost 22% of its equity value since mid-February. Although a decline in the stock value is warranted due to the overall uncertainty in the economy and COVID-19. Microsoft has a market share of 24.8% within the Software and Services industry and a 42.1% market share in Database, Storage and Backup Software Publishing in the US. With the move from office-work to home-work due to COVID-19, Microsoft can expect an increase in cloud computing and services. Demand for services such as Zoom has put stress on companies' infrastructure, but Microsoft's cloud computing and Windows Virtual Desktop has already taken on increased volume swiftly. We recommend a BUY on Microsoft (MSFT). A 3.00% holding in Microsoft would equate to roughly 12 shares at a current price of \$165.14. The funding for this purchase would come from our current cash holdings.

Valuation, Recommendation, & Risks

Valuation:

Through a DCF model, we found Microsoft to have an intrinsic value of \$216 per share (Appendix, pg. 7). Although, over the past few years Microsoft has shown impressive growth rates and improving financial condition, we mostly used their historical growth rate averages while also utilizing some estimates given by FactSet in order to project out the cash flows. Even if Covid-19 forces a longer contractionary period, Microsoft's business segments such as productivity and business processes, intelligent cloud, and personal computing should still be able to grow if not thrive in this work-from-home environment. For this reason, we still have MSFT's top line growing, although at a slower rate than recently, in our model. When calculating the terminal value, we used the growth in perpetuity method and incorporated a modest 3% growth rate. Upon completion of the model, we found an intrinsic value of \$216. Compared to the current stock price of \$165, this reveals a potential upside of 30.5%.

Industry Outlook:

The Database, Storage and Backup Software Publishing industry in the U.S. is in its growth stage of its economic life cycle as software becomes more innovative, cost-effective and user-friendly. Incentivized adoption is expected to grow in new users as they continue with ongoing trends within their industry (IBISWorld). Over the next five years these trends will result in robust industry growth as revenue is expected to increase at an annualized rate of 5.8% to 2024. Coincidentally, the COVID-19 virus has increased demand for cloud, wireless, and data storage services among the public and private sector. The major players in this industry can expect continued user adoption as their market share, wide popularity, and convenience dominate this industry.

Catalyst:

Microsoft has three segments of revenue that are nearly evenly distributed with Intelligent Cloud making up roughly 32% of their total revenue. The consistent rise of database software is seen by increased use of digital technology across a wider range of the economy. As the pandemic keeps people isolated due to social-distancing measures, Microsoft's cloud computing has already seen an 800% increase in usage. Microsoft's Azure cloud platform has been significant in the growth of this segment, as they integrate into healthcare and government services. Their Azure platform has gained adoption in the automobile industry as companies like Ford, Renault-

Nissan, and Toyota utilize their services to improve their insight on safety, real-time information to drivers, and vehicle maintenance.

Risk:

Microsoft's largest revenue segment comes from More Personal Computing, making up about 36% of their total revenue. It is the only segment they have lowered their guidance on for Q3 FY20 due to an increased amount of time for their supply chain to return to normal operations. Mitigation: If their supply chain takes longer than anticipated to return to normal, they can acquire alternate chips from another major supplier but risk bearing increased costs or potentially further delayed deliveries.

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Appendix

Microsoft Corporation (MSFT) - DCF							
Free Cash Flow Buildup							
<i>\$mm</i>	Projected Annual Forecast						
	2018A	2019A	2020P	2021P	2022P	2023P	2024P
Sales	\$ 110,360	\$ 125,843	\$ 141,361	\$ 156,975	\$ 173,670	\$ 187,722	\$ 223,761
COGS	38,353	42,910	45,646	52,052	57,510	61,068	69,970
Gross Income	72,007	82,933	95,715	104,923	116,160	126,654	153,791
Expenses	36,949	39,974	43,630	48,438	53,477	56,644	67,704
EBIT (non-GAAP)	\$ 35,058	\$ 42,959	\$ 52,085	\$ 56,485	\$ 62,683	\$ 70,010	\$ 86,087
EBIT Margin	31.8%	34.1%	36.8%	36.0%	36.1%	37.3%	38.5%
Tax Rate	17%	11%	17%	17%	17%	17%	17%
NOPAT (EBIT x (1-T))	29192	38438	43310	46868	51935	58108	71452
+ Depreciation	10261	11682	12443	13683	15061	17259	19105
- Capex	11632	13925	15435	17891	20363	24646	25121
- Change NWC	20467	3866	5000	5000	5000	5000	5000
= Free Cash Flow	\$ 7,354	\$ 32,329	\$ 35,318	\$ 37,660	\$ 41,634	\$ 45,721	\$ 60,436
Discounted Cash Flows			\$ 33,230	\$ 33,338	\$ 34,677	\$ 35,831	\$ 44,562
Sum of present values of FCFs	\$ 181,637.9						
WACC							
Beta(3y Adj.)	1.1						
10yr Risk Free Rate	0.73%						
Equity Risk Premium	5.27%						
Cost of Equity	6.53%						
Weight of Equity	94.84%						
After Tax Cost of Debt	1.81%						
Weight of Debt	5.16%						
WACC =	6.28%						
Terminal Value							
Growth in perpetuity method:							
Long term growth rate	3.0%						
WACC	6.3%						
Free cash flow (t+1)	\$ 64,233.8						
Terminal Value	\$ 1,956,173.4						
Present Value of Terminal Value	\$ 1,442,364.8						
Enterprise Value to Equity Value							
Enterprise Value	\$ 1,624,002.7						
-Debt	86,458						
+Cash	133,820						
=Equity Market Value	1,671,365						
/shares outstanding	7,753						
=Intrinsic Value/share	216						