

# Microsoft Corp

## Azure deals supporting growth

### UNITED STATES | SOFTWARE | 4Q22 RESULTS

29 July 2022

### BUY (Maintained)

CLOSING PRICE	USD 268.74
FORECAST DIV	USD 2.60
TARGET PRICE	USD 332.00
TOTAL RETURN	24.5%

#### COMPANY DATA

Bloomberg CODE:	MSFT US
O/S SHARES (MN) :	7,464
MARKET CAP (SGD bn / USD bn) :	2770 / 2006
52 - WK HI/LO (USD) :	349.67 / 241.51
3M Average Daily T/O (mn) :	31.24

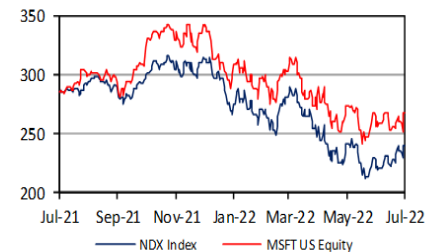
#### MAJOR SHAREHOLDERS

Vanguard Group Inc	8.2%
BlackRock Inc	6.7%

#### PRICE PERFORMANCE (%)

	1M TH	3M TH	YTD
MICROSOFT CORP	1.5	(4.9)	(19.7)
NASDAQ	5.0	(2.9)	(22.4)

#### PRICE VS. NASDAQ



Source: Bloomberg, PSR

#### KEY FINANCIALS

Y/E Jun, USD (bn)	FY21	FY22	FY23e	FY24e
Revenue	168.1	198.3	221.1	250.4
EBITDA	81.6	97.8	108.1	123.9
Net Profit	61.3	72.7	76.5	87.7
EPS (USD)	8.1	9.6	10.3	11.9
P/E (X)	33.4	27.9	26.2	22.6
ROE	43.2%	43.7%	37.7%	35.4%
ROA	18.4%	19.9%	18.8%	18.9%

Source: Company, PSR

#### VALUATION METHOD

Discounted Cash-Flow, WACC 7.1%, g 4.0%

**Phillip Research Team** (+65 6212 1849)  
 research@phillip.com.sg

- 4Q22 results were in line with expectations. FY22 revenue/PATMI was at 99% of our forecasts. Total revenue grew 12% YoY to US\$51.9bn in 4Q22, mainly due to Productivity and Business Processes and Intelligent Cloud revenues. PATMI was only up 2% YoY as margins contracted due to investments in cloud engineering and FX headwinds (4% of 4Q22 PATMI).
- Azure revenue grew 46% YoY in constant currency in 4Q22 driven by continued demand for cloud computing. Office 365 Commercial revenue grew 19% YoY due to higher volumes and prices.
- We maintain a BUY recommendation with a lower DCF target price of US\$332 (WACC 7.1%, g 4%), down from US\$338. This is mainly because we reduced our FY23e revenue/PATMI by 3%/4% to account for headwinds from a stronger USD and slowing sales of PCs. Overall, we believe that Microsoft will be a long-term beneficiary of continued shift to the cloud, businesses reopening, cybersecurity upgrades, and price increases at renewals.

#### Results at a glance

US\$ mn	4Q22	4Q21	YoY	Comments
Revenue	51,865	46,152	12.4%	
- Productivity & Business Processes	16,600	14,691	13.0%	Higher ARPU and user growth
- Intelligent Cloud	20,909	17,375	20.3%	
- Azure YoY % growth in CC*	46.0%	45.0%		High consumption of cloud services
- More Personal Computing	14,356	14,086	1.9%	Weakness for Windows, PCs and Search Ads
Gross profit	35,436	32,161	10.2%	
Operating expenses	-14,902	-13,066	14.1%	
PATMI	16,740	16,458	1.7%	
Operating margin	39.6%	41.4%	-1.8%	

Source: Company, PSR \*Note – Azure revenue amount is not disclosed; CC (Constant Currency)

#### The Positives

**+ Demand for Azure remains strong.** In 4Q22, Azure and other cloud services revenue grew 46% YoY in constant currency vs 45% in 4Q21. Growth came from a record number of contracts worth more than US\$100mn and US\$1bn as customers made larger and longer-term Azure commitments. The strength in Azure and the continued shift to the cloud offerings helped drive solid growth in the Intelligent Cloud segment revenue, which grew 20% YoY to US\$20.9bn in 4Q22.

**+ Office 365 is another solid growth area.** Office commercial products and cloud services revenue increased 9% YoY, driven by strong Office 365 commercial growth of 15% YoY (19% YoY in constant currency), which continues to be a key driver of success for the Productivity and Business Processes segment. Microsoft reported Office 365 Commercial user growth of 14% YoY, led by ongoing momentum in small and medium businesses, frontline worker offerings and expansion of average revenue per user (ARPU) due to strong adoption of E5 license. Dynamics 365 revenue grew 31% YoY while LinkedIn revenue grew 26% YoY.

**+ Strong demand for cybersecurity drives E5 momentum.** In 4Q22, the number of E5 users increased by 60% YoY and now accounts for 12% of the Office 365 commercial installed base. The upgrade to this higher-end tier was because of the robust demand for advanced security capabilities amid rising cybersecurity attacks.

### The Negatives

- **FX headwinds impacting revenue growth.** Microsoft's total revenue growth of 12% YoY in 4Q22 was the slowest since 2020. In 4Q22, the unfavorable foreign exchange rate movement negatively impacted revenue by US\$595mn (or 4% of 4Q22 PATMI) and EPS by US\$0.04 (or 2%). The FX impact was guided to decrease revenue growth in 1Q23 by 5%, while lowering the total cost of goods sold and operating expenses growth by 3%.

- **Russia/Ukraine war and production shutdowns in China.** With the ongoing Russia/Ukraine war, Microsoft has significantly reduced its business operations in Russia. As a result, the company's operating expenses in 4Q22 increased by US\$126mn related to bad debt expenses and asset impairments. Microsoft also witnessed a US\$300mn in negative impact to Windows OEM revenue due to production shutdowns in China and slowing sales of PCs.

### Outlook

For FY23e, Microsoft expects double-digit revenue and operating income growth in both USD and constant currency despite a worsening macroeconomic environment. Operating margins are estimated to be roughly flat as the benefit from extending the depreciable useful life for cloud infrastructure will be offset by FX headwinds. In 1Q23, Azure revenue is expected to be sequentially lower by just 3% on a constant currency basis, driven by continued strength in consumption of cloud computing services. Reopening of the economy will continue to drive user growth for Office 365 Commercial. We expect Microsoft to manage costs efficiently and invest aggressively to grow the business.

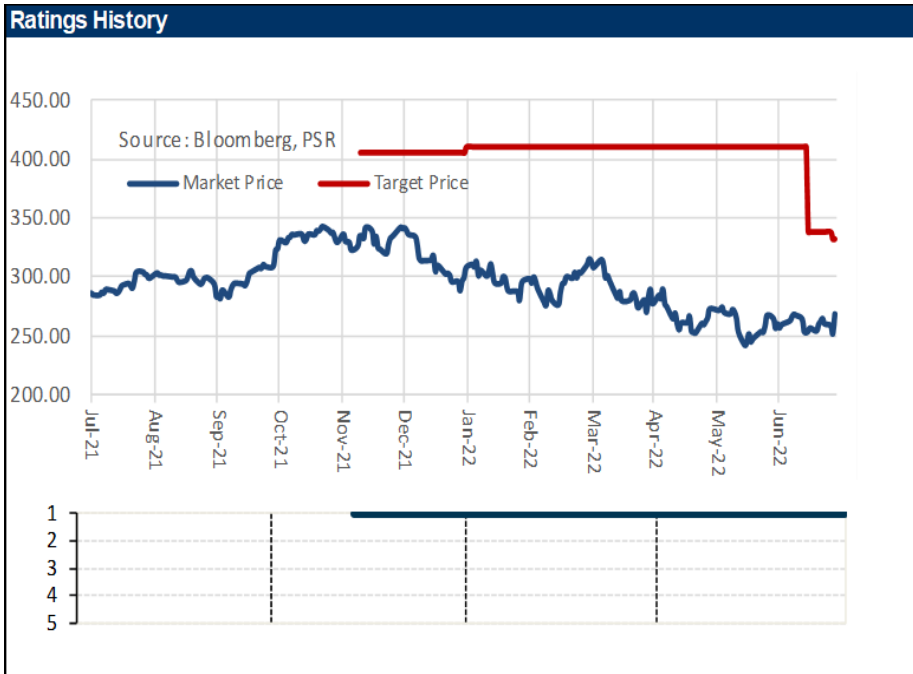
Figure 1: Microsoft 1Q23 guidance summary

Category	Metric	Microsoft	
		1Q22 Actual	1Q23 Guidance
Revenue	US\$ bn	45.3	49.25 to 50.25
- Productivity and Business Processes	US\$ bn	15.0	15.95 to 16.25
- Intelligent Cloud	US\$ bn	17.0	20.3 to 20.6
- More Personal Computing	US\$ bn	13.3	13.0 to 13.4
Cost of goods sold	US\$ bn	13.6	14.9 to 15.1
Operating expense	US\$ bn	11.4	13.3 to 13.4
Tax	% of PBT	0.1%	19%

The significant increase in the tax rate for 1Q23 was mainly due to US\$3.3bn net income tax benefit in 1Q22 related to the transfer of intangible assets.

### Maintain BUY with lower TP of US\$332.00 (prev. US\$338.00)

We reduced our FY23e revenue/PATMI by 3%/4% to account for unfavorable foreign currency movements and slowing sales of PCs. We maintain BUY with a lower target price of US\$332.00. Valuations are based on DCF with a WACC of 7.1% and terminal growth of 4.0%. We believe that Microsoft will be a long-term beneficiary of the continued shift to the cloud, businesses reopening, cybersecurity upgrades and price increases at renewals.



### PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
< -20%	Sell	5

### Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

## Financials

### Income Statement

Y/E Jun, USD mn	FY20	FY21	FY22	FY23e	FY24e
<b>Revenue</b>	<b>1,43,015</b>	<b>1,68,088</b>	<b>1,98,270</b>	<b>2,21,097</b>	<b>2,50,405</b>
Gross profit	96,937	1,15,856	1,35,620	1,51,919	1,72,327
<b>EBITDA</b>	<b>65,755</b>	<b>81,602</b>	<b>97,843</b>	<b>1,08,063</b>	<b>1,23,851</b>
Depreciation & amortisation	(12,796)	(11,686)	(14,460)	(14,880)	(17,265)
<b>EBIT</b>	<b>52,959</b>	<b>69,916</b>	<b>83,383</b>	<b>93,184</b>	<b>1,06,587</b>
Other Income (Expense), Net	77	1,186	333	345	308
Profit before tax	53,036	71,102	83,716	93,529	1,06,894
Taxation	(8,755)	(9,831)	(10,978)	(17,017)	(19,240)
<b>PATMI</b>	<b>44,281</b>	<b>61,271</b>	<b>72,738</b>	<b>76,512</b>	<b>87,654</b>

### Per share data (USD)

Y/E Jun	FY20	FY21	FY22	FY23e	FY24e
EPS	5.8	8.1	9.6	10.3	11.9
DPS	2.0	2.2	2.4	2.6	2.8
BVPS	15.4	18.7	22.1	27.2	33.6

### Cash Flow

Y/E Jun, USD mn	FY20	FY21	FY22	FY23e	FY24e
<b>CFO</b>					
<b>Profit after tax</b>	<b>44,281</b>	<b>61,271</b>	<b>72,738</b>	<b>76,512</b>	<b>87,654</b>
Adjustments	17,877	16,405	15,851	18,313	23,057
WC changes	(1,483)	(936)	446	6,116	5,478
<b>Cashflow from ops</b>	<b>60,675</b>	<b>76,740</b>	<b>89,035</b>	<b>1,00,941</b>	<b>1,16,189</b>
<b>CFI</b>					
CAPEX, net	(15,441)	(20,622)	(23,886)	(26,806)	(29,891)
Others	3,218	(6,955)	(6,425)	(1,390)	(8,890)
<b>Cashflow from investments</b>	<b>(12,223)</b>	<b>(27,577)</b>	<b>(30,311)</b>	<b>(28,196)</b>	<b>(38,781)</b>
<b>CFF</b>					
Loans, net of repayments	(5,518)	(3,750)	(9,023)	(475)	(475)
Dividends	(15,137)	(16,521)	(18,135)	(19,417)	(20,534)
Repurchase of common stock	(22,968)	(27,385)	(32,696)	(30,334)	(32,931)
Others	(2,408)	(830)	978	1,785	2,024
<b>Cashflow from financing</b>	<b>(46,031)</b>	<b>(48,486)</b>	<b>(58,876)</b>	<b>(48,441)</b>	<b>(51,917)</b>
Net change in cash	2,220	648	(293)	24,304	25,491
<b>CCE, end</b>	<b>13,576</b>	<b>14,224</b>	<b>13,931</b>	<b>38,235</b>	<b>63,726</b>

Source: Company, Phillip Securities Research (Singapore) Estimates

### Balance Sheet

Y/E Jun, USD mn	FY20	FY21	FY22	FY23e	FY24e
<b>ASSETS</b>					
Trade and other receivables	32,011	38,043	44,261	46,452	52,610
Cash & cash equivalents	13,576	14,224	13,931	38,235	63,726
Inventories	1,895	2,636	3,742	3,499	3,949
<b>Total current assets</b>	<b>1,81,915</b>	<b>1,84,406</b>	<b>1,69,684</b>	<b>1,97,370</b>	<b>2,31,915</b>
PPE & IA	51,189	67,515	85,696	97,622	1,10,249
Others	68,207	81,858	1,09,460	1,11,146	1,20,928
<b>Total non-current assets</b>	<b>1,19,396</b>	<b>1,49,373</b>	<b>1,95,156</b>	<b>2,08,768</b>	<b>2,31,177</b>
<b>Total assets</b>	<b>3,01,311</b>	<b>3,33,779</b>	<b>3,64,840</b>	<b>4,06,138</b>	<b>4,63,092</b>

### LIABILITIES

Accounts payable	12,530	15,163	19,000	16,563	18,694
Short-term borrowings	3,749	8,072	2,749	2,749	2,749
Deferred revenue	36,000	41,525	45,538	55,476	67,054
<b>Total current liabilities</b>	<b>72,310</b>	<b>88,657</b>	<b>95,082</b>	<b>1,04,374</b>	<b>1,19,347</b>
Long-term borrowings	59,578	50,074	47,032	46,557	46,082
Operating lease liabilities	7,671	9,629	11,489	11,489	11,489
Others	43,448	43,431	44,695	40,928	38,408
<b>Total non-current liabilities</b>	<b>1,10,697</b>	<b>1,03,134</b>	<b>1,03,216</b>	<b>98,974</b>	<b>95,979</b>
<b>Total liabilities</b>	<b>1,83,007</b>	<b>1,91,791</b>	<b>1,98,298</b>	<b>2,03,348</b>	<b>2,15,326</b>

### Equity

Additional paid-in capital	80,552	83,111	86,939	66,092	43,948
<b>Shareholder equity</b>	<b>1,18,304</b>	<b>1,41,988</b>	<b>1,66,542</b>	<b>2,02,790</b>	<b>2,47,766</b>

### Valuation Ratios

Y/E Jun	FY20	FY21	FY22	FY23e	FY24e
P/E (X)	46.6	33.4	27.9	26.2	22.6
P/B (X)	17.5	123.8	111.7	103.2	96.5
EV/EBITDA (X)	32.2	25.6	21.1	18.6	15.9
Dividend yield	0.7%	0.8%	0.9%	1.0%	1.0%

### Growth & Margins

<b>Growth</b>					
Revenue	13.6%	17.5%	18.0%	11.5%	13.3%
EBITDA	20.3%	24.1%	19.9%	10.4%	14.6%
EBIT	23.3%	32.0%	19.3%	11.8%	14.4%
Net profit, adj.	12.8%	38.4%	18.7%	5.2%	14.6%
<b>Margins</b>					
Gross margin	67.8%	68.9%	68.4%	68.7%	68.8%
EBITDA margin	46.0%	48.5%	49.3%	48.9%	49.5%
EBIT margin	37.0%	41.6%	42.1%	42.1%	42.6%
Net profit margin	31.0%	36.5%	36.7%	34.6%	35.0%

### Key Ratios

ROE	37.4%	43.2%	43.7%	37.7%	35.4%
ROA	14.7%	18.4%	19.9%	18.8%	18.9%
Net Gearing	42.1%	30.9%	21.5%	5.5%	CASH
Net Debt/EBITDA (X)	0.8	0.5	0.4	0.1	CASH

Contact Information (Research Team)		
<b>Head of Research</b> Paul Chew – <a href="mailto:paulchewkl@phillip.com.sg">paulchewkl@phillip.com.sg</a>	<b>Research Admin</b> Qystina Azli - <a href="mailto:qystina@phillip.com.sg">qystina@phillip.com.sg</a>	
<b>Construction   Industrial   Conglomerates</b> Terence Chua – <a href="mailto:terencechuatl@phillip.com.sg">terencechuatl@phillip.com.sg</a>	<b>Banking &amp; Finance</b> Glenn Thum – <a href="mailto:glenthumjc@phillip.com.sg">glenthumjc@phillip.com.sg</a>	<b>US Technology Analyst (Internet)</b> Jonathan Woo – <a href="mailto:jonathanwookj@phillip.com.sg">jonathanwookj@phillip.com.sg</a>
<b>US Technology Analyst (Software/Services)</b> Ambrish Shah – <a href="mailto:amshah@phillipcapital.in">amshah@phillipcapital.in</a>	<b>Credit Analyst</b> Shawn Sng – <a href="mailto:shawnsngkh@phillip.com.sg">shawnsngkh@phillip.com.sg</a>	

#### Contact Information (Regional Member Companies)

<p><b>SINGAPORE</b>  <b>Phillip Securities Pte Ltd</b>            Raffles City Tower            250, North Bridge Road #06-00            Singapore 179101            Tel +65 6533 6001            Fax +65 6535 6631            Website: <a href="http://www.poems.com.sg">www.poems.com.sg</a></p>	<p><b>MALAYSIA</b>  <b>Phillip Capital Management Sdn Bhd</b>            B-3-6 Block B Level 3 Megan Avenue II,            No. 12, Jalan Yap Kwan Seng, 50450            Kuala Lumpur            Tel +603 2162 8841            Fax +603 2166 5099            Website: <a href="http://www.poems.com.my">www.poems.com.my</a></p>	<p><b>HONG KONG</b>  <b>Phillip Securities (HK) Ltd</b>            11/F United Centre 95 Queensway            Hong Kong            Tel +852 2277 6600            Fax +852 2868 5307            Websites: <a href="http://www.phillip.com.hk">www.phillip.com.hk</a></p>
<p><b>JAPAN</b>  <b>Phillip Securities Japan, Ltd.</b>            4-2 Nihonbashi Kabuto-cho Chuo-ku,            Tokyo 103-0026            Tel +81-3 3666 2101            Fax +81-3 3666 6090            Website: <a href="http://www.phillip.co.jp">www.phillip.co.jp</a></p>	<p><b>INDONESIA</b>  <b>PT Phillip Securities Indonesia</b>            ANZ Tower Level 23B,            Jl Jend Sudirman Kav 33A            Jakarta 10220 – Indonesia            Tel +62-21 5790 0800            Fax +62-21 5790 0809            Website: <a href="http://www.phillip.co.id">www.phillip.co.id</a></p>	<p><b>CHINA</b>  <b>Phillip Financial Advisory (Shanghai) Co Ltd</b>            No 550 Yan An East Road,            Ocean Tower Unit 2318,            Postal code 200001            Tel +86-21 5169 9200            Fax +86-21 6351 2940            Website: <a href="http://www.phillip.com.cn">www.phillip.com.cn</a></p>
<p><b>THAILAND</b>  <b>Phillip Securities (Thailand) Public Co. Ltd</b>            15th Floor, Vorawat Building,            849 Silom Road, Silom, Bangkok,            Bangkok 10500 Thailand            Tel +66-2 6351700 / 22680999            Fax +66-2 22680921            Website <a href="http://www.phillip.co.th">www.phillip.co.th</a></p>	<p><b>FRANCE</b>  <b>King &amp; Shaxson Capital Limited</b>            3rd Floor, 35 Rue de la Bienfaisance 75008            Paris France            Tel +33-1 45633100            Fax +33-1 45636017            Website: <a href="http://www.kingandshaxson.com">www.kingandshaxson.com</a></p>	<p><b>UNITED KINGDOM</b>  <b>King &amp; Shaxson Capital Limited</b>            6th Floor, Candlewick House,            120 Cannon Street,            London, EC4N 6AS            Tel +44-20 7426 5950            Fax +44-20 7626 1757            Website: <a href="http://www.kingandshaxson.com">www.kingandshaxson.com</a></p>
<p><b>UNITED STATES</b>  <b>Phillip Capital Inc</b>            141 W Jackson Blvd Ste 3050            The Chicago Board of Trade Building            Chicago, IL 60604 USA            Tel +1-312 356 9000            Fax +1-312 356 9005            Website: <a href="http://www.phillipusa.com">www.phillipusa.com</a></p>	<p><b>AUSTRALIA</b>  <b>Phillip Capital Limited</b>            Level 10, 330 Collins Street            Melbourne, Victoria 3000, Australia            Tel +61-03 8633 9803            Fax +61-03 8633 9899            Website: <a href="http://www.phillipcapital.com.au">www.phillipcapital.com.au</a></p>	<p><b>CAMBODIA</b>  <b>Phillip Bank Plc</b>            Ground Floor of B-Office Centre, #61-64,            Norodom Blvd Corner Street 306, Sangkat            Boeung Keng Kang 1, Khan Chamkamorn,            Phnom Penh, Cambodia            Tel: 855 (0) 7796 6151/855 (0) 1620 0769            Website: <a href="http://www.phillipbank.com.kh">www.phillipbank.com.kh</a></p>
<p><b>INDIA</b>  <b>PhillipCapital (India) Private Limited</b>            No.1, 18th Floor, Urmi Estate            95, Ganpatrao Kadam Marg            Lower Parel West, Mumbai 400-013            Maharashtra, India            Tel: +91-22-2300 2999 / Fax: +91-22-2300 2969            Website: <a href="http://www.phillipcapital.in">www.phillipcapital.in</a></p>	<p><b>TURKEY</b>  <b>PhillipCapital Menkul Degerler</b>            Dr. Cemil Bengü Cad. Hak Is Merkezi            No. 2 Kat. 6A Caglayan            34403 Istanbul, Turkey            Tel: 0212 296 84 84            Fax: 0212 233 69 29            Website: <a href="http://www.phillipcapital.com.tr">www.phillipcapital.com.tr</a></p>	<p><b>DUBAI</b>  <b>Phillip Futures DMCC</b>            Member of the Dubai Gold and            Commodities Exchange (DGEX)            Unit No 601, Plot No 58, White Crown Bldg,            Sheikh Zayed Road, P.O.Box 212291            Dubai-UAE            Tel: +971-4-3325052 / Fax: + 971-4-3328895</p>

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