

Company Update Report

Microsoft Corporation

Information Technology

Analyst thesis

Our recommendation is based on:

- Microsoft Azure is benefiting from the rapid adoption of multi-cloud strategies, while Azure Local (formerly Azure Stack HCI) and Azure Arc strengthen Microsoft's hybrid control plane across on-premises and cloud environments.
- Microsoft's broad product range drives a strong subscription model with annuity-type revenue and customer loyalty supported by a strong moat (high switching costs, innovation, scale, network effect, and brand). This is evident in the high and stable margins it achieves over the long term.
- While Microsoft shares trade at a premium relative to peers, this valuation is supported by its superior organic revenue growth, strong free cash flow generation, and a leading cloud platform.
- Microsoft is well placed to be a strong benefactor of AI.

As at: 31 August 2025

Latest company and market insights

Key highlights

In this report, we revisit the Q4 FY2025 results for MSFT, released in July 2025, and how this positions our view in context.

Financial results at a glance:

- Productivity and Business Processes revenue of \$32.2 billion projected for September Q1 2026E, slightly below the \$33.1 billion actual in June Q4 2025, indicates typical sequential normalisation but ongoing strong growth driven by Microsoft 365 Commercial and Dynamics 365. This supports our thesis on resilient, high-quality annuity revenue.
- Intelligent Cloud's revenue forecast of \$30.1 billion for September Q1 2026E closely matches June Q4 FY2025 actual of \$29.9 billion, validating our view that Azure and cloud services remain core growth engines powered by AI infrastructure, securing Microsoft's leadership and competitive moat.
- More Personal Computing's expected \$12.9 billion in September Q1 2026E versus \$13.5 billion actual in June Q4 2025 reflects expected consumer market cyclical, but stable contribution from gaming and advertising reinforces diversification.
- Overall, the consistency between forecast and actual results aligns with our investment thesis of durable cloud and productivity momentum offsetting cyclical consumer pressures. It bolsters confidence in Microsoft's sustainable growth, strong free cash flow, and market-leading AI positioning underpinning the "Undervalued" rating and further upside potential.

Management's outlook:

Microsoft's Q1 FY26 revenue guidance strongly supports our investment thesis focused on cloud and AI-driven growth, subscription resilience, and diversified revenue streams: Expected 2-point FX boost adds near-term upside to organic growth. Productivity and Business Processes guidance (\$32.2-\$32.5 billion) reflects sustained strength in Microsoft 365 Commercial and Dynamics 365, driving high-margin recurring revenues, a core thesis pillar. Intelligent Cloud forecast (\$30.1-\$30.4 billion), including Azure's 37% constant currency growth despite capacity constraints, validates leadership in scalable cloud infrastructure and AI, fuelling long-term growth. More personal computing guidance (\$12.4-\$12.9 billion), with expected Windows OEM and Devices softness, aligns with cyclical consumer dynamics, offset by gaming and advertising diversification reducing volatility.

Sector outlook:

The technology sector outlook for 2026 is highly positive, driven by rapid AI advancements, cloud computing growth, and broad digital transformation across industries. Accelerated AI adoption is propelling demand for enhanced computing power and innovative applications, which are becoming central to enterprise strategies. Cloud services maintain strong double-digit expansion as firms shift workloads to scalable platforms, fuelling growth in key segments like software-as-a-service (SaaS) and infrastructure-as-a-service (IaaS).

This dynamic environment reinforces our investment thesis that companies leading in AI-enabled cloud infrastructure and digital innovation are best positioned to capture sustained revenue and profit growth. The sector's expansion supports confidence in durable earnings, structural industry tailwinds, and robust free cash flow generation, which underpin attractive valuations and long-term upside potential for leading technology players.

Ticker	MSFT-US
Share price	\$507
Intrinsic value	\$585
Upside/(Downside)	15%
Recommendation	Undervalued

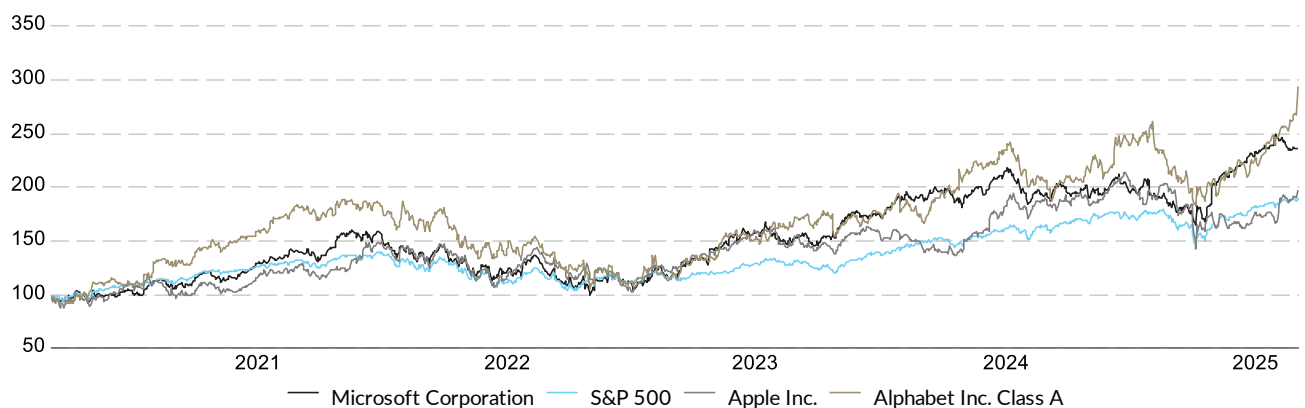


Table 1: Qualitative summary

Factor	Rating	Description
Growth	★★★★☆	<ul style="list-style-type: none"> Expected three-year revenue CAGR is 14.7% and expected three-year EPS CAGR is 16.7% We expect earnings growth over the next three years to be driven by: Continued investments in AI infrastructure and data centers, supporting scalability and competitiveness. Accelerated integration and monetisation of AI technologies within Microsoft 365, Azure, Dynamics 365, and related platforms, fuelling high margin recurring revenue growth through enhanced productivity and cloud services.
Valuation	★★★★☆	The share price has 15% upside to the IV. Current NTM P:E of 32.5x is trading at a 4% discount to the five-year average P:E of 34x
Dividend	★★★★☆	LTM dividend yield 0.66%. NTM dividend yield 0.7%.
Issuance	★★★★☆	Shares issued have decreased by 2% in the past five years.
Catalyst		<ul style="list-style-type: none"> Investments in AI infrastructure and cloud data centers to sustain scalability, innovation, and competitive advantage. Expansion of Microsoft Azure, benefiting from strong multi-cloud adoption and AI integration. Solid subscription and licensing business with strong pricing power.
Quality of earnings	★★★★★	Five-year average ROE 40.7%. Five-year average operating margin 43.3%. Nine of the past 10 years had both positive earnings with growth. Supported by subscription-based services like Microsoft 365, Azure, and Dynamics 365.
Moat	★★★★☆	Microsoft's broad range of products across cloud, productivity software, gaming, and professional networking (LinkedIn) with a strong network effect moat. High recurring revenue and customer loyalty from Microsoft 365, Dynamics 365, and cloud services with extremely high switching costs for customers. A trusted brand with proven enterprise-grade security and compliance, critical in regulated industries.
Management and governance	★★★★★	Microsoft's management is defined by strong leadership under CEO Satya Nadella, driving cloud and AI growth. The governance framework promotes accountability, transparency, and shareholder alignment, supported by an independent, diverse board. Oversight is maintained through specialized committees and ongoing evaluations. This structure ensures long-term value creation and effective risk management.
Balance sheet	★★★★★	Net debt/EBITDA ratio 0.0x, interest coverage ratio 53.9x. Debt/assets ratio 18.1%. The Net debt/EBITDA reflects a net cash position, demonstrating strong financial flexibility and the company's ability to comfortably meet its debt obligations without leverage concern.
Risks		<ul style="list-style-type: none"> Microsoft products remain a prime target for cyberattacks due to their widespread use. High investment levels of research and development in AI not translating to profitable growth. Microsoft relies heavily on Azure. Service outages or security breaches can significantly impact reputation and compliance. Regulation: Regulatory complexity around AI, partner relationships, data privacy, and cybersecurity requires Microsoft to continuously adapt. Antitrust regulations risk forcing changes like product unbundling, license revisions, or limits on AI partnerships, which could impact growth and profitability.

Source: FactSet

Graph 1: Five-year price (Indexed to 100)



Source: FactSet

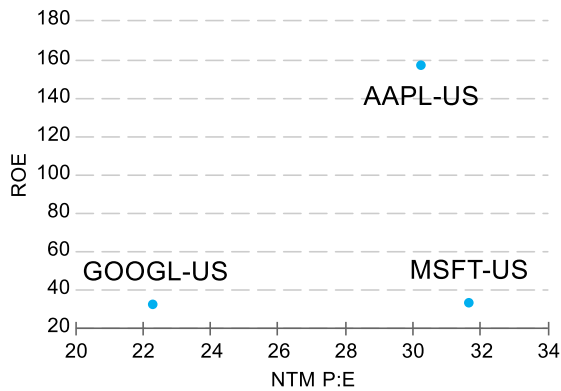


Table 2: Price performance versus benchmark and peers

Period	YTD	MTD	3M	6M	1Y	2Y	3Y	5Y	10Y
MSFT-US	20.5%	0.3%	9.5%	30.7%	24.2%	54.6%	98.4%	137.1%	1092.1%
AAPL-US	-4.2%	3.3%	18.2%	1.6%	8.6%	26.6%	53.9%	98.2%	777.8%
GOOGL-US	22.7%	9.1%	38.2%	35.9%	48.5%	71.2%	115.4%	193.8%	638.7%
MSCI world	10.4%	0.5%	7.4%	10.6%	16.5%	38.4%	57.8%	78.8%	166.5%

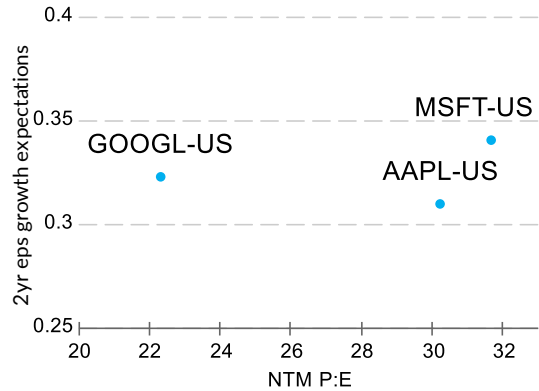
Source: FactSet

Graph 2: P:E vs 2Y average ROE



Source: FactSet

Graph 3: P:E vs consensus EPS 2Y CAGR forecast



Source: FactSet

Valuation

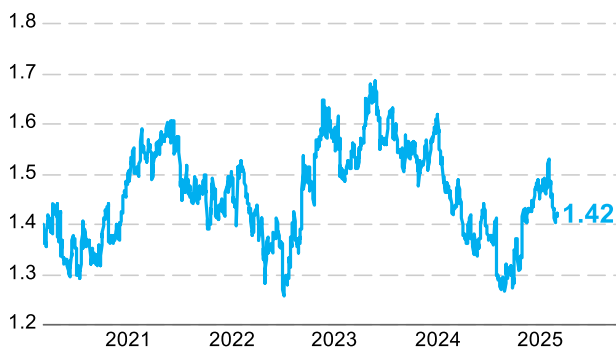
Microsoft's valuation was conducted using a DCF model with forecasts to 2030. Free cash flows are discounted using WACC, with terminal value based on EV/EBITDA exit multiples of 15x (bear), 18x (base), and 22x (bull).

- Bear case (10%): Slower growth from regulatory risks or weaker AI adoption.
- Base case (60%): Steady growth driven by cloud, AI, and diversification.
- Bull case (30%): Rapid AI and cloud expansion under favourable conditions.

Table 3: Valuation summary

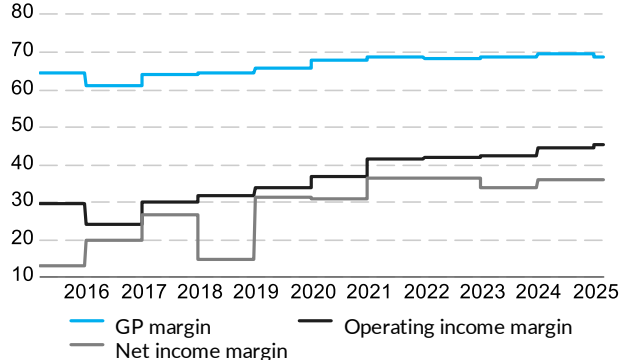
Valuation Probabilities			
	Bear	Base	Bull
Exit Multiple	15x	18x	22x
Probability	10%	60%	30%
Share price	\$477	\$560	\$671
Share Price Value	\$585		
Upside/(Downside)	15%		

Graph 4: NTM P:E. relative to benchmark



Source: FactSet

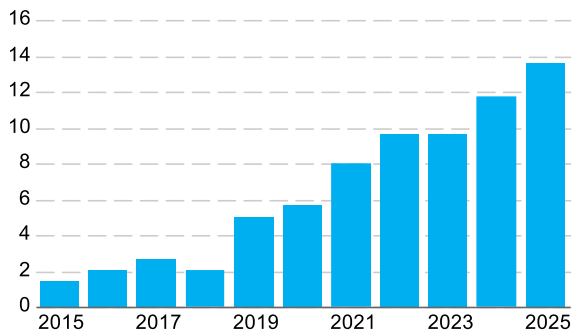
Graph 5: Profit margins (%)



Source: FactSet

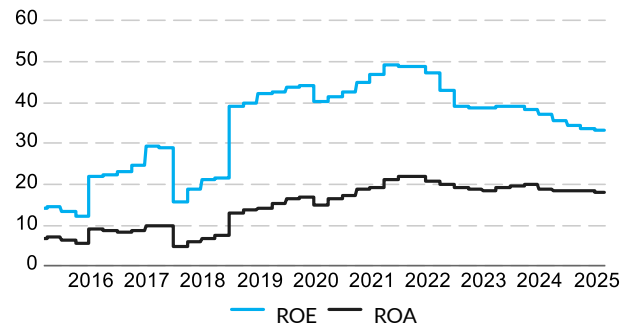


Graph 6: 10Y EPS Y/Y growth (%)



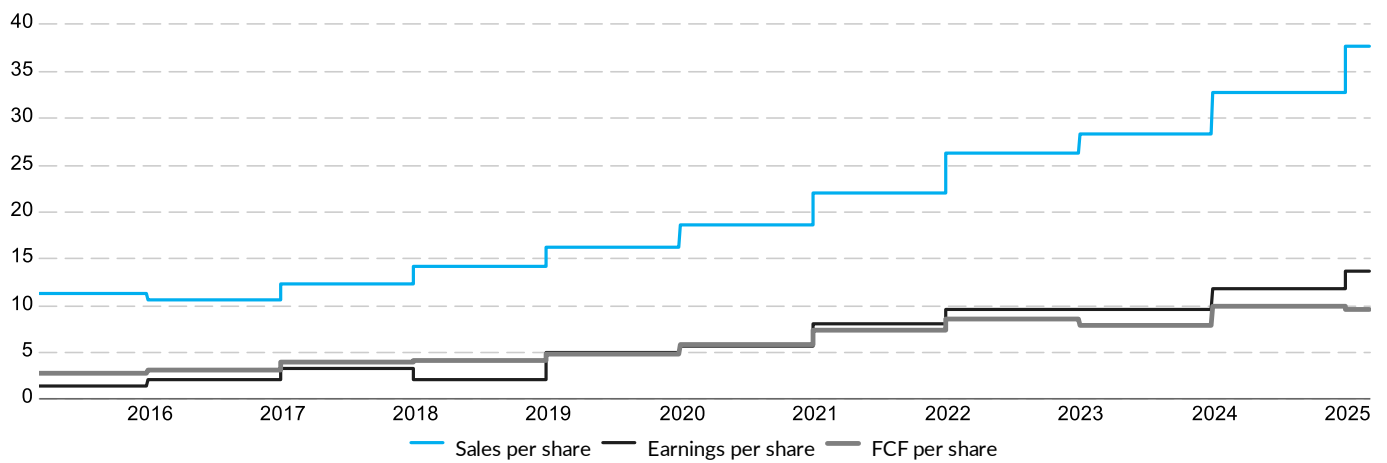
Source: FactSet

Graph 7: ROE and ROA (%)



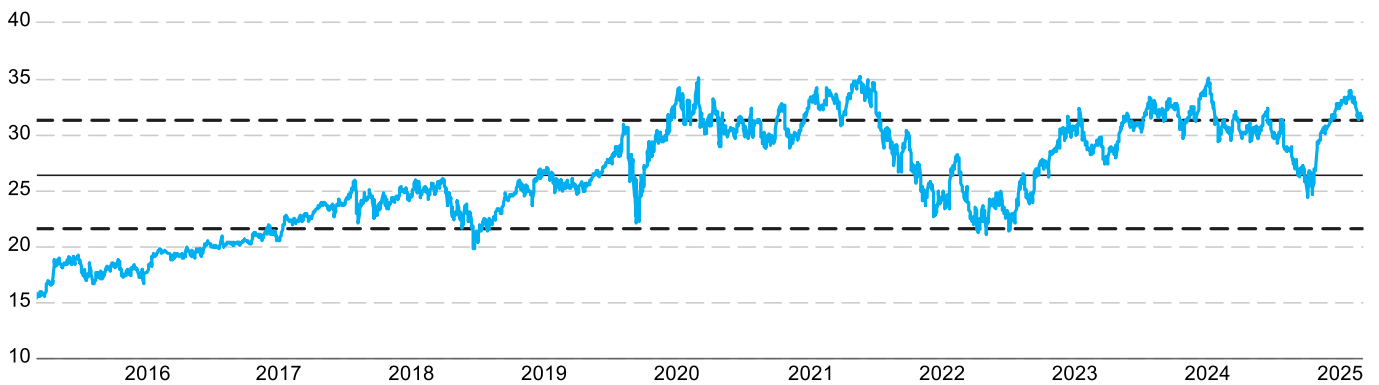
Source: FactSet

Graph 8: Sales, earnings and FCF per share (USD)



Source: FactSet

Graph 9: NTM P:E



Source: FactSet



Table 4: Financials and ratios

Income statement (\$Mn)	Jun 21	Jun 22	Jun 23	Jun 24	Jun 25	1Y Growth	3Y CAGR	5Y CAGR
Revenue	168 088	198 270	211 915	245 122	281 724	15%	12%	15%
Cost of sales	52 232	62 650	65 863	74 114	87 831	19%	12%	14%
Gross income	115 856	135 620	146 052	171 008	193 893	13%	13%	15%
EBIT	69 916	83 383	89 723	109 433	128 528	17%	16%	19%
EBITDA	80 816	97 843	103 584	131 720	162 681	24%	18%	20%
Net income	61 271	72 738	72 361	88 136	101 832	16%	12%	18%
EPS (USD)	8	10	10	12	14	16%	12%	19%
Balance sheet (\$Mn)	Jun 21	Jun 22	Jun 23	Jun 24	Jun 25	1Y Growth	3Y CAGR	5Y CAGR
Total assets	333 779	364 840	411 976	512 163	619 003	21%	19%	15%
Total shareholders equity	141 988	166 542	206 223	268 477	343 479	28%	27%	24%
Total liabilities	191 791	198 298	205 753	243 686	275 524	13%	12%	9%
Ratios	Jun 21	Jun 22	Jun 23	Jun 24	Jun 25	5Y Avg		
Net debt/EBITDA	-0.7	-0.4	-0.5	0.0	0.0	-0.3		
Interest coverage	29.8	40.4	45.6	37.3	53.9	41.4		
Debt/assets	24.7	21.5	19.3	19.1	18.1	20.5		

Source: FactSet

Table 5: Standard finance and investment abbreviations

Abbreviation	Definition
MSFT	Microsoft Corporation
EBITDA	Earnings before interest, tax, depreciation and amortisation
EBIT	Earnings before interest and tax
CAGR	Compounded annual growth rate
EPS	Earnings per share
NTM	Next twelve months (also known as forward)
LTM	Last twelve months (also known as trailing)
ROE	Return on equity
ROA	Return on assets
DCF	Discounted Cash Flow
YTD	Year to date
MTD	Month to date
M	Month
Y/y	Year(s)
P:E.	Price to earnings
GP	Gross profit
FCF	Free cash flow
FY	Financial year
USD	United States Dollar
FX	Foreign Exchange
IaaS	Infrastructure as a Service
SaaS	Software as a Service



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