

Disnat GPS Report

Microsoft (MSFT, US\$64.00)



February 10, 2017

Company Description

Microsoft is one of the largest and most robust companies on the planet.

It has an extremely impressive portfolio of products (Microsoft Windows, Microsoft Office, Xbox, Azure Cloud, the Surface product line, etc.).

That said, and despite the weakness of the traditional computers sector, the supply of IT products and services for the commercial sector remains limited. Microsoft's business clients should therefore continue to use traditional products (Windows and Office) for a long time, either in their traditional form or in cloud form, providing some stability to the company's revenues.

In this respect, however, history teaches us to adopt a cautious attitude and to look out for companies which have a large part of their business linked to a changing sector.

This caution is even more important when you see that, in the field of new technologies, the champions of yesterday - Polaroid, Kodak and BlackBerry - are no more than a shadow of their former selves!

Disnat GPS Portfolio Strategist Comments

Saying that Microsoft is a large company is an understatement. With a market capitalization of approximately \$500 billion, the business is worth more than the five major Canadian banks combined.

Currently, the steady decline in personal computer sales over the last several years is a concern.

However, the strong adoption of Windows 10 (both by companies and individuals), strategic investments in the development of cloud computing solutions, the positioning of Xbox and the new appeal of the Surface product line (tablets and soon phones) allow us to maintain confidence in the future of the company.

Notwithstanding, companies in transition remain a riskier investment.

Despite these fears, we are of the opinion that Microsoft, second to Amazon in terms of cloud computing solutions and still dominant in business services, should continue its favorable performance.

Other Disnat GPS reports available : Apple, Disney, Nike, Cisco.

Financial Health

| Fiscal Year | 2014 | 2015 | 2016 |
|--|------|------|------|
| Long term debt (in billions of dollars) | 21 | 28 | 41 |
| Debt/equity ratio | 0.23 | 0.35 | 0.57 |

Microsoft's financial health is one of the strongest around.

Official figures show a debt of more than \$40 billion and a debt to equity ratio of more than 0.55, but Microsoft's situation is actually much better than these figures indicate: at the moment, the company has about \$100 billion in cash!

However, much of this cash is held abroad. This is important because if Microsoft decides to bring these profits back to the United States, the amount would be taxed as profit made in the United States at a rate of 20% to 35%.

Although there are too many unknowns to allow for a precise calculation, even at a rate of 35% Cisco would benefit from an influx of funds that would still be much greater than its debt.

It can therefore be said that Microsoft has no net debt and has a very favorable cash position, which should be taken into account in our evaluations.

Growth

| Compound Yield | 1 year | 3 years | 5 years | 10 years |
|--------------------|--------|---------|---------|----------|
| Revenue | - 8% | 3% | 4% | 6% |
| Earnings per share | 42% | - 6% | - 5% | 6% |

The growth of Microsoft's revenues and earnings per share over the past five or ten years shows that the company has experienced a period of relatively difficult growth.

This slow growth is mainly due to sales of personal computers (and even sales to businesses) that have slowed over several years.

Although this situation is worrying and in many cases such weakness in traditional business is a very bad sign, we believe that Microsoft seems to have avoided the worst of it by choosing to take the cloud computing route.

In addition, despite more compelling offers than ever from the competition (Apple, Android, etc.), many consumers prefer the Microsoft-Windows environment and wish to pursue this business relationship, both personally and professionally.

While growth in personal computer sales will remain weak, we believe that cloud computing and new technologies have brought Microsoft back on the path to growth.

Valuation

| Key Ratios | Microsoft | Microsoft (5 yr avg) | S&P 500 |
|------------------------|-----------|----------------------|---------|
| Price/earnings | 30,1 | 20.5 | 20.6 |
| Forward price/earnings | 21.6 | n.a. | 18.7 |
| Dividend yield | 2.3% | n.a. | 2.6% |

Microsoft's current evaluation, while looking a little high given the figures above, is actually relatively fair.

In terms of price/earnings ratios and future price/earnings, Microsoft's stock is currently trading at a premium compared to its own history as well as to the index.

It should be remembered, however, that with net cash of approximately \$50 billion, the financial ratios in the above table are greater than they would be if this cash was used to reduce the outstanding number of shares.

Including this cash, the stock would therefore trade at a discount to the S&P 500.

We do not agree with the idea that more than 250 companies in the S&P 500 have a better future outlook than Microsoft.

At Disnat GPS, we believe that the market is evaluating Microsoft slightly below its fair value. We are therefore very satisfied to hold a superior company at a fair price!

Governance

| Fiscal Year | 2012 | 2013 | 2014 | 2015 | 2016 |
|-----------------------------|-------|-------|-------|-------|-------|
| Earnings per share (\$) | 2.00 | 2.58 | 2.63 | 1.48 | 2.10 |
| Dividend (\$) | 0.76 | 0.89 | 1.07 | 1.21 | 1.39 |
| Number of shares (millions) | 8,506 | 8,470 | 8,399 | 8,254 | 8,013 |

In 2013, Microsoft introduced a dividend that it has grown each year since, and we trust it will do so for many years to come.

The company regularly buys a portion of its outstanding shares. Over the last five years, Microsoft has bought back more than 5% and it maintains a share repurchase program, which it continues to apply when the situation permits.

Historically, Microsoft is not a company that engages in large acquisitions, and we believe that this philosophy will continue to apply.

As for internal investments, in addition to its cloud computing activities, few new products or services could create a strong and rapid impact on the profits of a company the size of Microsoft. We appreciate, however, the efforts made in the development of Surface products.

As many consumers prefer the Microsoft environment, we support the company in the development and promotion of its related products.

Explanatory Notes

Disnat GPS reports contain five separate sections, each followed by comments from the Disnat GPS Portfolio Strategist regarding the following:

1. Company Description
2. Financial Health
3. Growth
4. Valuation
5. Governance

At Disnat GPS, we believe that the topics, ratios and other financial figures presented here are particularly important.

However, for reasons of space, we can not publish all available data. We therefore invite you to read the additional financial information on the Disnat website.

Furthermore, this report is an analysis of the condition of a company today, with a medium to long term view. It is in no way an adequate tracking of daily activities of the stock market in general or of this particular company.

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