

Microsoft Corporation (MSFT US)

Global Credit Research GCRE098

Maintains a strong balance sheet

- FY23 revenues up 7% y/y to \$211.9bn; Operating income up 6% y/y to \$88.5bn driven by Microsoft Office and cloud services
- Generated \$59.5bn of free cash flows in FY23 and the net cash position was \$64bn
- Outlook positive given the large revenues and a diversified product portfolio, a healthy balance sheet and the proven ability to generate strong free cash flows

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Credit Opinion

We maintain our positive outlook given the large revenues and a diversified product portfolio, a healthy balance sheet and the proven ability to generate strong free cash flows. On the other hand, we noted the sharp drop in revenue growth rate caused by the challenging economic environment (please refer to Chart 1). From an equity perspective, lower growth rates could reduce returns to shareholders and drive the stock price lower in the short term. However from a credit perspective, we don't expect lower growth rates to worsen significantly the credit metrics given Microsoft's robust balance sheet and strong business model.

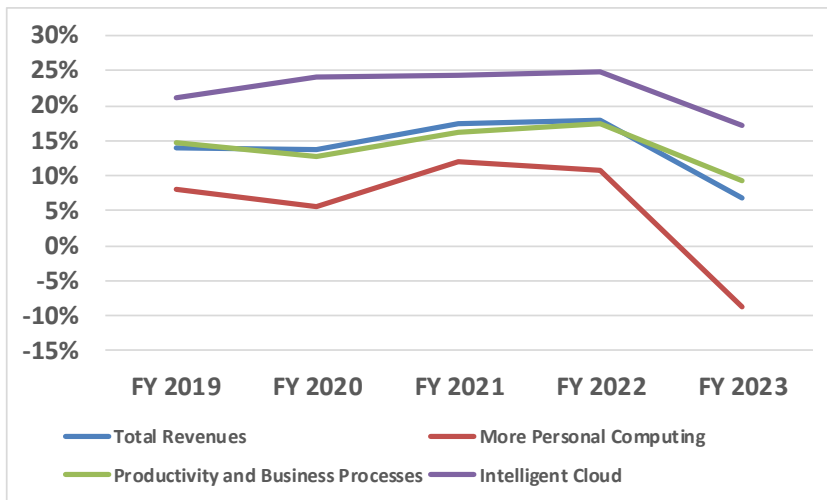
In FY23, Microsoft's revenues increased 7% y/y to \$211.9bn driven by growth in Intelligent Cloud and Productivity and Business Processes. Intelligent cloud revenues continues to grow at double-digits rates, more than offsetting the revenue decline in More Personal Computing segment. We expect headwinds from the challenging economic environment to continue in the short term. However we expect the demand for cloud services to continue to drive growth in medium to long term. Remaining performance obligation (revenue to be recognized in future periods) remains high at \$229bn as of June 30, 2023.

While cloud services are the main growth driver, Microsoft maintains a diversified product portfolio that should provide revenue stability during the economic cycle. As of end of June 2023, Intelligent Cloud had a share of 41%, Productivity and Business Processes had a share of 33% and More Personal Computing had a share of 26% in the total revenues (please refer to Chart 2).

Microsoft maintains a strong balance sheet with a net cash position of \$64bn as of end of June 2023. Equity ratio continues to improve, growing 4.4pp y/y to 50.1% (please refer to Chart 3). We expect that the strong balance sheet should provide enough financial flexibility for Microsoft to follow its growth strategy and to adapt to business environment changes.

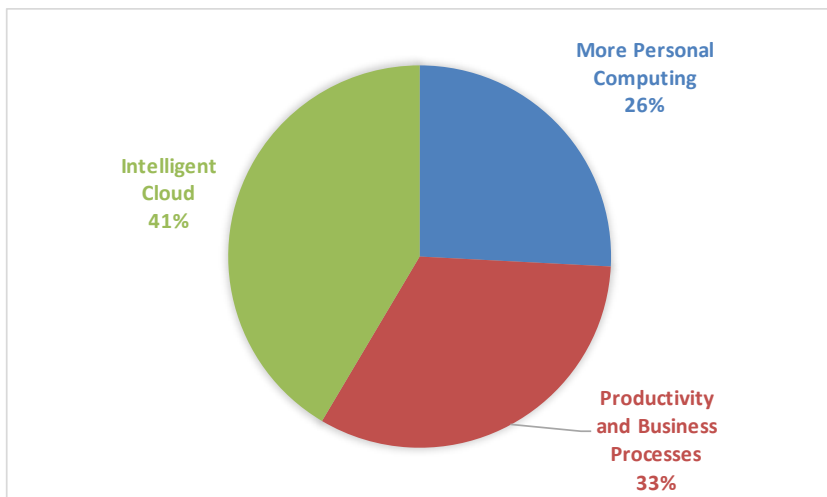
Microsoft generated \$59.5bn of FOCF in FY23. This represents a decline of 9% y/y due to lower cash from operations and increasing in capital spending (CapEx) to support the cloud demand. We expect Microsoft to use its cash flows to finance acquisitions to expand its business ecosystem and to return capital to shareholders. However shareholders' capital return programs and investments should be moderate and we don't expect a significant deterioration in the credit metrics, given its rich cash buffer and its financial policy that historically has been conservative.

Chart 1: Revenue growth rates



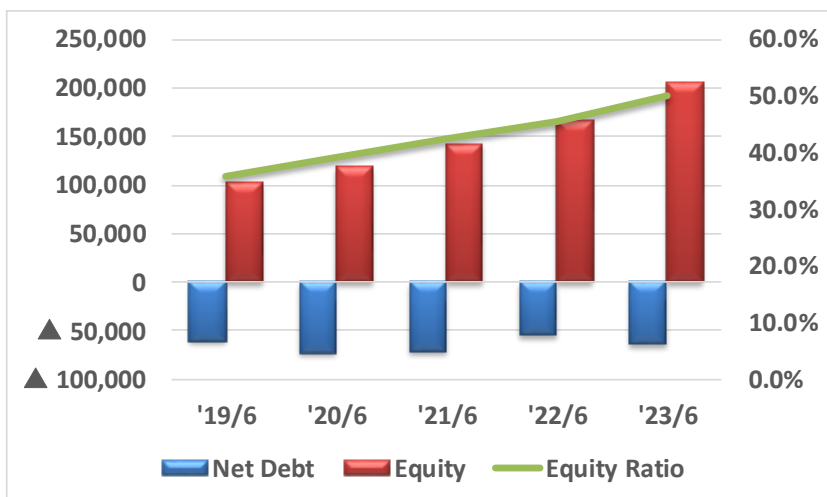
Source: Company materials, Bloomberg; compiled by Daiwa.

Chart 2: Business segment share in total revenues (FY23 revenues)



Source: Company materials, Bloomberg; compiled by Daiwa.

Chart 3: Net debt, equity (\$m) and Equity ratio (%)



Source: Company materials, Bloomberg; compiled by Daiwa.

FY23 Financial Highlights (Fiscal year ended June 30, 2023)

Total revenues increased 7% y/y to \$211.9bn driven by growth in Intelligent Cloud and Productivity and Business Processes, partially offset by a decline in More Personal Computing. Intelligent Cloud revenue increased 17% y/y to \$87.9bn driven by Azure and other cloud services. Productivity and Business Processes revenue increased 9% y/y to \$69.3bn driven by Office 365 Commercial and LinkedIn. More Personal Computing revenue decreased 9% y/y to \$54.7bn driven by declines in Windows and Devices.

Remaining performance obligation (unearned revenue and amounts to be recognized in future periods) was \$229bn as of June 30, 2023.

Operating income increased 6% y/y to \$88.5bn driven by growth in Productivity and Business Processes and Intelligent Cloud and a change in accounting estimate, partially offset by a decline in More Personal Computing. Productivity and Business Processes operating income increased 15% y/y to \$34.2bn driven by growth in Office 365 Commercial and LinkedIn, as well as a change in accounting estimate. Intelligent Cloud operating income increased 14% y/y to \$37.9bn driven by Azure and other cloud services. More Personal Computing operating income decreased 20% y/y to \$16.5bn driven by declines in Windows and Devices.

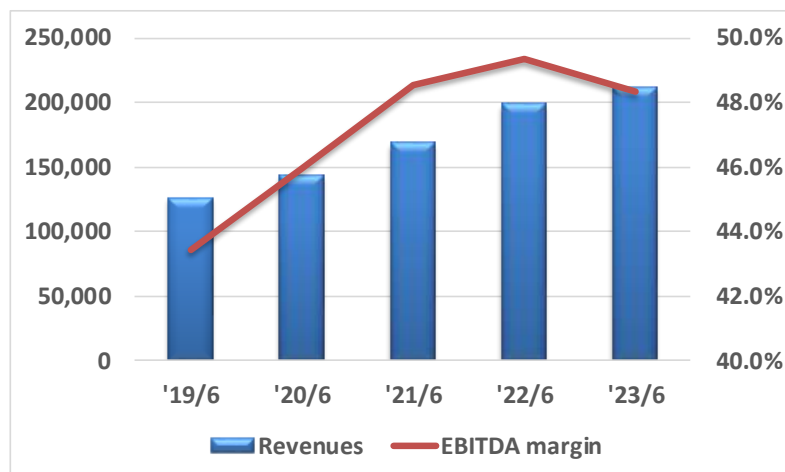
Microsoft recorded \$1.2bn of charge 2Q23, which included employee severance expenses of \$800 million, impairment charges to the hardware portfolio and other costs. To align the firm's cost structure with the current economic conditions, Microsoft reduced its workforce by approximately 10,000 jobs in FY23, which represents less than 5% of the total employee base.

Free operating cash flow (FOCF) decreased 9% y/y to \$59.5bn due to lower cash from operations and higher CapEx. Cash from operations decreased 2% y/y to \$87.6bn mainly due to an increase in cash paid to employees and suppliers and cash used to pay income taxes. CapEx increased 18% y/y to \$28.1bn due to additions to property and equipment to support cloud demand.

During FY23, Microsoft repurchased common stock for \$18.4bn and declared dividends totaling \$20.2bn.

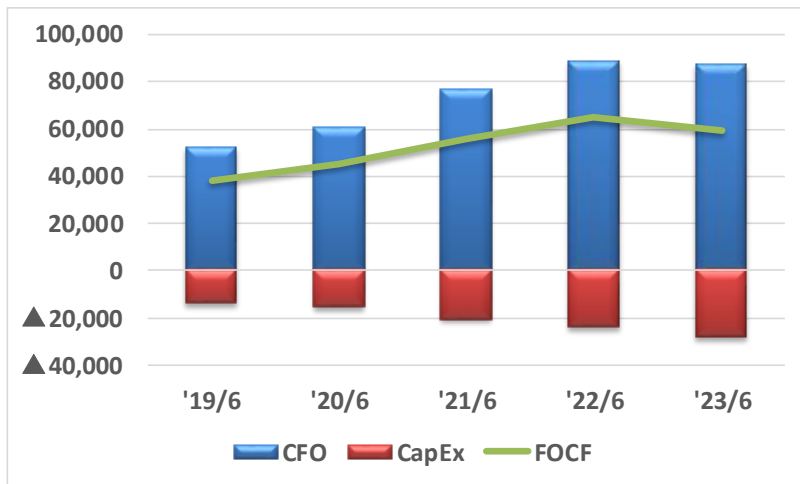
Microsoft had a net cash position (Cash& Marketables- Total Debt) of \$64bn as end of June 2023. Cash, cash equivalents & short-term investments increased 6% y/y to \$111.3bn. Total debt declined 5% y/y to 47.2bn.

Chart 4: Revenues (\$m) and EBITDA margin (%)



Source: Company materials, Bloomberg; compiled by Daiwa.

Chart 5: Cash flows (\$m)



Source: Company materials, Bloomberg; compiled by Daiwa.

Chart 6: Financial Results

(\$m) Period End	FY 2019 '19/6	FY 2020 '20/6	FY 2021 '21/6	FY 2022 '22/6	FY 2023 '23/6	YOY
■ P/L						
Revenues	125,843	143,015	168,088	198,270	211,915	6.9%
EBITDA	54,641	65,755	81,602	97,843	102,384	4.6%
EBITDA margin	43.4%	46.0%	48.5%	49.3%	48.3%	▲ 1.0
Operating Income	42,959	52,959	69,916	83,383	88,523	6.2%
Pretax Income	43,688	53,036	71,102	83,716	89,311	6.7%
Net Income	39,240	44,281	61,271	72,738	72,361	-0.5%
■ C/F						
Cash from operations	52,185	60,675	76,740	89,035	87,582	-1.6%
Depreciation & amortization	11,682	12,796	11,686	14,460	13,861	-4.1%
Cash from investing	▲ 15,773	▲ 12,223	▲ 27,577	▲ 30,311	▲ 22,680	-25.2%
CapEx	▲ 13,925	▲ 15,441	▲ 20,622	▲ 23,886	▲ 28,107	17.7%
Free cash flow (FCF)	36,412	48,452	49,163	58,724	64,902	10.5%
Free operating cash flow (FOCF)	38,260	45,234	56,118	65,149	59,475	-8.7%
Cash from financing	▲ 36,887	▲ 46,031	▲ 48,486	▲ 58,876	▲ 43,935	-25.4%
Net cash flow	▲ 475	2,421	677	▲ 152	20,967	---
■ B/S						
Assets	286,556	301,311	333,779	364,840	411,976	12.9%
Current assets	175,552	181,915	184,406	169,684	184,257	8.6%
Cash&Marketable	133,819	136,527	130,334	104,757	111,262	6.2%
Liabilities	184,226	183,007	191,791	198,298	205,753	3.8%
Current liabilities	69,420	72,310	88,657	95,082	104,149	9.5%
Total Debt	72,178	63,327	58,146	49,781	47,237	-5.1%
ST debt	5,516	3,749	8,072	2,749	5,247	90.9%
LT debt	66,662	59,578	50,074	47,032	41,990	-10.7%
Net Debt (*)	▲ 61,641	▲ 73,200	▲ 72,188	▲ 54,976	▲ 64,025	16.5%
Equity	102,330	118,304	141,988	166,542	206,223	23.8%
■ Financial Ratios						
Equity Ratio	35.7%	39.3%	42.5%	45.6%	50.1%	4.4
NetD/E	▲ 0.60	▲ 0.62	▲ 0.51	▲ 0.33	▲ 0.31	0.0
NetD/EBITDA	▲ 1.13	▲ 1.11	▲ 0.88	▲ 0.56	▲ 0.63	▲ 0.1
ROA	14.4%	15.1%	19.3%	20.8%	18.6%	▲ 2.2
ROE	42.4%	40.1%	47.1%	47.2%	38.8%	▲ 8.3

Source: Company materials, Bloomberg; compiled by Daiwa.

(*)Net debt = total debt- cash- marketables

FCF (free cash flow) = CFO (cash flow from operating activities)- CFI (cash flow from investing activities)

FOCF (free operating cash flow) = CFO (cash flow from operating activities)- CapEx (Capital Expenditure)

We are using last twelve months net income for ROA and ROE calculations.

Chart 7: Revenues/ Operating Income by business segment

(\$m) Period End	FY 2019 2019/6/30	FY 2020 2020/6/30	FY 2021 2021/6/30	FY 2022 2022/6/30	FY 2023 2023/6/30	YOY
Total Revenues	125,843	143,015	168,088	198,270	211,915	7%
More Personal Computing (MPC)	45,698	48,251	54,093	59,941	54,734	-9%
Productivity and Business Processes (PBP)	41,160	46,398	53,915	63,364	69,274	9%
Intelligent Cloud (IC)	38,985	48,366	60,080	74,965	87,907	17%
Total Operating Income	42,959	52,959	69,916	83,383	88,523	6%
More Personal Computing	12,820	15,911	19,439	20,490	16,450	-20%
Productivity and Business Processes	16,219	18,724	24,351	29,690	34,189	15%
Intelligent Cloud	13,920	18,324	26,126	33,203	37,884	14%
Corporate and Other	-	-	-	-	-	-
Operating Margins	34.1%	37.0%	41.6%	42.1%	41.8%	▲ 0.3
More Personal Computing	28.1%	33.0%	35.9%	34.2%	30.1%	▲ 4.1
Productivity and Business Processes	39.4%	40.4%	45.2%	46.9%	49.4%	2.5
Intelligent Cloud	35.7%	37.9%	43.5%	44.3%	43.1%	▲ 1.2

Source: Company materials, Bloomberg; compiled by Daiwa.

Chart 8: Revenues breakdown by product

(\$m) Period End		FY 2019 2019/6/30	FY 2020 2020/6/30	FY 2021 2021/6/30	FY 2022 2022/6/30	FY 2023 2023/6/30	YOY
Segment	Total Revenues	125,843	143,015	168,088	198,270	211,915	7%
PBP	Office products and cloud services	31,769	35,316	39,872	44,862	48,728	9%
IC	Server products and cloud services	32,622	41,379	52,589	67,350	79,970	19%
MPC	Windows	20,395	21,510	22,488	24,732	21,507	-13%
MPC	Gaming	11,386	11,575	15,370	16,230	15,466	-5%
MPC	Search and news advertising	7,628	8,524	9,267	11,591	12,208	5%
IC	Enterprise Services	6,124	6,409	6,943	7,407	7,722	4%
PBP	LinkedIn	6,754	8,077	10,289	13,816	15,145	10%
MPC	Devices	6,095	6,457	7,143	7,306	5,521	-24%
PBP	Dynamics			3,754	4,687	5,437	16%
	Other	3,070	3,768	373	289	211	-27%

Source: Company materials, Bloomberg; compiled by Daiwa.

Back Numbers

Industrials

GE	Raised financial guidance for FY23	2023/08/02
Boeing	Near-term delivery delays	2023/05/19
Airbus	Growth momentum continues	2023/04/06
Boeing	Towards operations stability?	2023/02/24
GE	Positioned to drive further growth	2023/02/07
Boeing	An asset or a liability?	2022/11/24
GE	Planned spin-offs on track	2022/11/22
Boeing	Commercial deliveries below expectations	2022/09/02
GE	Aerospace remains the key growth driver	2022/08/10
GE	Aviation recovery continues	2022/06/16
Boeing	Limited impact from Russia-Ukraine conflict	2022/05/30
Keppel	Agreed on the combination of Keppel O&M and Sembcorp Marine	2022/05/10

Information Technology

Amazon	Retail business into red	2023/03/14
Apple	Another record-breaking year	2022/12/13
Microsoft	Excellent execution abilities	2022/09/09
Amazon	Increased capital spending requirements	2022/04/28
Apple	Strong demand drives new revenue records	2021/12/15
Microsoft	Well-balanced growth	2021/09/22

Communication Services

AT&T	CapEx requirements to remain high in 2023	2023/03/24
Disney	Record results at theme parks	2023/02/01
AT&T	On track to achieve the annual financial targets	2022/11/11
AT&T	Warning of the challenging operating environment	2022/08/09
AT&T	Exited media business	2022/05/26
Disney	Could Genie grant Disney's wish?	2022/02/14

Energy

US and European Energy Majors	Continue to deleverage	2023/06/12
US and European Energy Majors	Update on 3Q22 Results	2023/01/11
ExxonMobil	Record profits	2022/09/08
ExxonMobil	Recorded losses from Russia exit	2022/06/24

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