Company Overview:
Microsoft is the world's largest software company and the leading provider of operating systems for the PC and server markets. The company's ubiquitous Windows operating system had a 95% share of the global PC market in 2013 and 63% of the global server market. Additionally, Microsoft Office continues to be the dominant productivity suite. The company is also a leading provider of video game and entertainment consoles and video games through its Xbox platform. Founded in 1975, Microsoft is based in Redmond, WA, and has 128,000 employees globally.

Name	Ticker	Yield	Growth	D + G
Microsoft Corporation	MSFT	0.72%	14.00%	14.72%

Highlights:
Microsoft has become far less crowded over the last year due to investors' concerns about CAPEX and the ability of MSFT to convert CAPEX to revenue. Those concerns are about to abate. MSFT is, in fact, investing in global capacity (like their initial Cloud investment cycle), to meet the growing demand for inferencing. Most of the investment is in facilities, rather than computing (CPU or GPU) and we expect CAPEX growth to slow substantially in the near term. At the same time, we expect Azure revenue growth to accelerate to 35% - 40% YoY in the beginning half of this year. We believe that this sets the stock up to outperform as investors shift back into the stock.

Bull Case:

- ***Cloud Investments Driving Sustainable Moat in Large and Fast-Growing Market*** **–** Microsoft's significant investments in scaling its cloud platform, Azure, have driven strong returns, becoming the #2 player in a sizable and growing market that can support multiple winners and continues to consolidate among the largest players. Microsoft's history with enterprise IT purchasers (and ease of integration with its workplace products) has helped the company come to the forefront of the on-prem to cloud shift.
- ***Cloud Innovation a Force Multiplier for the Remainder of the Portfolio*** **–** Microsoft's investments in cloud technology, aside from the IaaS and PaaS capabilities of Azure, are powering notable advances across its product portfolio, in areas as diverse as CRM/ERP offerings, security, gaming, and advertising. Microsoft can invest at a scale that most other competitors in these markets cannot match, and we do not view investment in Azure as a standalone, but rather as a multiplier for the rest of its product portfolio.
- ***Several Market Expansion Opportunities*** **–** We see several large expansion opportunities, underpinning our view that Microsoft can sustain DD growth. Microsoft has historically successfully entered new markets, e.g., hyper-automation, security ($10B+ business growing 40% +), and collaboration. We believe the large Office installation base, Azure's platform/capabilities, and effective bundling are the enablers. We look to customer experience/ engagement as an area to watch given recent investments.

Bear Case:

- ***Negative Margin Pressure in the NT as Azure Mix Increases*** **–** Microsoft could see some near-term gross margin pressure as the Azure business grows as a percentage of overall revenue. While Microsoft's on-premises offerings offer a high margin profile, growth in these lines of business is decelerating. The company believes its SaaS offerings (EMS, Office 365, LinkedIn, and Microsoft Dynamics) are close to reaching steady state gross margins, however, the IaaS and PaaS business still has room for margin leverage. Ultimately Microsoft believes it could achieve gross margins that surpass AWS margins (55-60%).
- ***Application Spending is Highly Cyclical*** **–** Enterprise application spending has proven to be highly cyclical, given the more discretionary nature of applications projects. During an economic slowdown, when firms are faced with shrinking IT budgets, projects involving application upgrades, migrations, or new installations are often deferred. This could present a higher degree of risk for bookings deceleration for Microsoft and other application vendors, in the event of an economic slowdown.
- ***Azure Growth Could Slow*** **–** While we maintain the view that public cloud remains early days, a material slowdown in Azure growth could impact the stock and future growth.

Overview:
We see a collection of sustainable advantages in the Microsoft story including 1) strong positioning in fast-growing, innovation-heavy markets including public cloud, gaming, and digital advertising; 2) significant scale advantages from the cumulative effect of years of investment; and 3) deep, established relationships with enterprise software purchasers and essentially universal brand recognition, which 4) positions Microsoft as a "low risk" vendor that can take share regardless of (or perhaps especially during) periods of soft economic conditions.