Inside Microsoft: Last Quarter's Progress.

Jul. 27, 2020

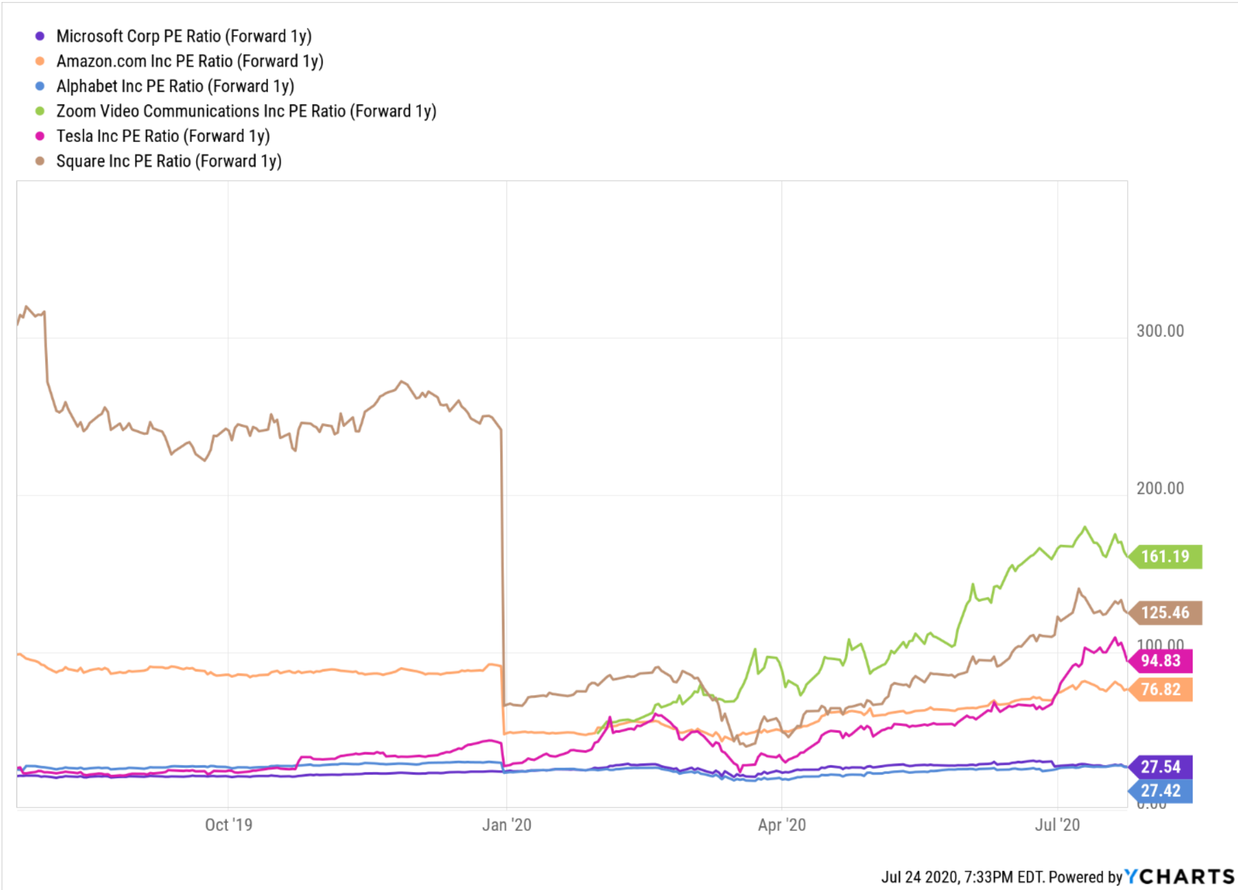
A 13% revenue increase from a year ago made this quarter the 11th consecutive quarter of revenue growth above 10%. Given the past quarter was one of the toughest economic environments in the past decade or so, Microsoft's performed impressively in all 3 of its major divisions. The revenue increase was led by much higher growth than expected in the Personal Computing segment (up 16%), as the world "stayed home" and spent money on personal computing equipment. The need for companies to "digitize its business" is greater than ever before, and this is showing up in Microsoft's results.

While most of Microsoft's business has gained from COVID-related lifestyle changes, there are a few areas which saw negative impacts. LinkedIn's revenue fell his quarter as hiring slowed down and advertising spending in Search dropped as companies cut their ad budgets. In Microsoft's Productivity and Business Processes segment, which includes Office 365, revenue was lower than expected, and the company guided for an even lower number for next quarter due to a customer shift from on-premise products like Office 365 to cloud based products like Azure. This lower revenue guidance for one of Microsoft's three major divisions is most likely what caused Microsoft's stock to drop after earnings.

Other highlights from the quarter include:

- Commercial cloud revenue passed $50 billion in annual revenue for the first time, up 36% from 2019. *Commercial cloud revenue started at just $5 billion in 2015*.
- Gaming revenue keeps breaking records, growing 66% from 2019 to 2020.
- Office 365 for consumers increased subscribers by 23%, and Microsoft is currently adapting its Teams app for personal use.

In light of the media's current thesis that "all tech is overvalued, get ready for a big correction", let's take a look at how Microsoft's price to earnings ratio looks today:



There is Microsoft down at the bottom, with a PE ratio right around Google's at 27. Definitely not cheap, but not anywhere close to the frighteningly high valuations of other "famous" tech stocks these days. Microsoft has a history of beating earnings estimates. (In fact, the last time it did <u>not</u> beat estimates was March of 2016.) So if Microsoft's forward (next 12 months') earnings estimates are too low, as they usually are, that PE of 27x will turn out to be too high—making Microsoft even more attractively valued compared to the high fliers.