

Microsoft Corporation (MSFT)

Value Fit 7 / 10

University of Wisconsin–Milwaukee | Lubar College of Business | Investment Management Certificate Program

Analyst: Max Aria Recommendation: BUY As of: 09/28/2026 Philosophy Fit 4 / 5

WISCONSIN VALUE FUND LENS — Maximize return by buying improving companies at reasonable valuations.

Performance level — ROIC (FY2026E) vs. ke	25.2% vs 9.6% → Above ke
Change in performance — ΔROIC	-1.6 pts, FY2026E vs FY2025A → Declining
Lifecycle phase	Phase IV — high expectations, declining
Valuation gap — target vs. price	+3.3% → Price below our value



BUSINESS DESCRIPTION

Microsoft Corp. engages in the development and support of software, services, devices, and solutions. It operates through the following segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing. The Productivity and Business Processes segment is composed of products and services relating to productivity, communication, and information services such as Office Commercial, Office Consumer, LinkedIn, and Dynamics business solutions. The Intelligent Cloud segment consists of public, private, and hybrid server products and cloud services for businesses

INVESTMENT THESIS

Microsoft's AI capital spending is being priced as a cost when it is largely contracted demand: backlog grew 84% to \$678B, Azure passed \$100B growing 41%, and demand still exceeds capacity, so the drop in free cash flow is a timing gap between building capacity and recognizing revenue rather than value destruction. At roughly 26x forward earnings versus a three-year average of 29x, the market is applying a discount to a business with 46.8% operating margins and a recurring Microsoft 365 base that funds the entire buildout internally.

MARKET SNAPSHOT

Current Price	\$493.78	Market Cap (\$B)	\$3,666.6	Beta	1.15
52-Week Range	\$353 – \$542	Inst. Ownership	76.7%	Insider Own.	1.5%
Shares Out. (mm)	7,433.0	Short Interest (% float)	1.0%	Dividend Yield	0.8%
Consensus L-T Growth	19.0%	Payout Ratio	20.3%	Cost of Equity	9.6%
Price Target	\$510.00	Upside to Target	3.3%	Value Range	\$160 – \$770

VALUATION SUMMARY — equity DCF, FCFE discounted at ke

Method	Value / Share	Upside	Terminal Assumption
Equity DCF – terminal P/E	\$536.81	8.7%	20.8x P/E
Equity DCF – terminal P/S	\$572.08	15.9%	8.4x P/S
Equity DCF – terminal P/B	\$770.25	56.0%	6.3x P/B
Equity DCF – constant growth	\$159.62	(67.7%)	2.0% g, 9.6% ke
Average of methods	\$509.69	3.2%	Equal-weighted
Analyst price target	\$510.00	3.3%	Blue = analyst override

PHILOSOPHY FIT — Five pillars · Score: 4 / 5

		Fit?
1. Fundamental improvement & valuation discipline	ΔROIC -1.6 pts; price is 0.97x our average value	No
2. Investing through company cycles	Phase IV; EBIT margin 45.6% → 45.0%	Yes
3. Initial position sizing & risk limits	Initial position sized within fund limits; risk limits set at entry	Yes
4. Capital allocation discipline	Net debt/invested capital 4.1%; net debt/EBIT 0.1x	Yes
5. Identifiable catalysts & conservative underwriting	Catalysts: Recurring revenue from SAAS Product, Datacenter demand, LLM	Yes

VALUE CRITERIA — 10-Point Checklist · Score: 7 / 10

		Pass?
1. Catalyst / Investment Drivers		Yes
Driver 1 — Microsoft 365/Recurring Revenue	Microsoft 365 Commerical made up \$102B and up 16% YoY. It is sold as per user subscriptions under multi year enterprise agreements, making revenue recurring and highly predictable. Growth now comes from users upgrading from standard to premium for security and Copilot. The software is already built which lets Microsoft hold EBIT margins near 45% even as AI depercition surges.	
Driver 2 — Azure	Azure and the AI infrastructure, make up two-thrids of there growth. Azure passed \$100B and grew 41% YoY and demand is still exceeding capactiy. Backlog rose 84% to \$678B giving multi-year visibility. Every AI model trained or run on Azure gives revenue for Microsoft including two of the biggest AI labs, OpenAI and Anthropic.	
Driver 3 — Copilot	Copilot adds a new pricing tier on top of an installed base Microsoft already owns. Microsoft 365 Copilot is sold as a per user add on to exisging seats so growth comes from upselling rather then getting new seats. Paid seats have reportedly passed 20 million. It feeds through Azure, but ROI needs to be proved before discounting could erode prices	
What does management say?	Management is prioritizing AI investment which is seen through there drop in FCF. Capex is guided to \$175B in FY2027 and CFO Amy Hood has committed that FCF will stay positive. Dividend raise slowed to 8% and buybacks fell to \$3.4B per quarter showing that there business in going all in on the AI trade.	

2. Low P/E Ratio						No
	FY2023A	FY2024A	FY2025A	FY2026E	FY2027E	FY2028E
EPS (model)	\$9.72	\$11.86	\$13.70	\$18.04	\$19.92	\$23.55
P/E at current price	50.8x	41.6x	36.0x	27.4x	24.8x	21.0x
Peer median P/E (FactSet, subject excl.)	21.8x	FY2026E P/E vs. peer median		+26%		
3. Low Price / Cash Flow						No
FCFE / share	\$5.10	-\$4.39	\$4.47	-\$1.62	\$2.07	\$7.13
Price / FCFE	96.8x	NM	110.5x	NM	NM	69.3x
Peer median P/CF (FactSet, subject excl.)	15.1x	Price / FCFE (today) vs. peer median		+630%		
4. Low Price / Book Value						Yes
	FY2023A	FY2024A	FY2025A	FY2026E	FY2027E	FY2028E
Book value / share	\$27.70	\$36.13	\$46.21	\$59.65	\$74.99	\$93.23

Price / Book	17.8x	13.7x	10.7x	8.3x	6.6x	5.3x
ROE (EOY book)	35.1%	32.8%	29.6%	30.2%	26.6%	24.9%
Peer median P/B (FactSet, subject excl.)	6.7x	Price / book (today) vs. peer median		+60%		

Microsoft Corporation (MSFT) — Value Criteria, continued

5. Financial Soundness							No
	FY2023A	FY2024A	FY2025A	FY2026E	FY2027E	FY2028E	
Total debt (\$mm)	79,441	97,852	112,184	128,813	146,813	166,973	
Net debt (\$mm)	-31,821	22,309	17,619	51,970	67,304	49,817	
Total debt / equity (gross)	38.5%	36.4%	32.7%	29.1%	26.4%	24.1%	
Total debt / assets (gross)	19.3%	19.1%	18.1%	17.0%	16.0%	15.1%	
Net debt / invested capital	-13.3%	6.5%	4.1%	9.4%	9.9%	6.0%	
Net debt / EBIT	-0.4x	0.2x	0.1x	0.3x	0.4x	0.2x	
Tax rate	17.6%	Book equity (\$mm)		343,479			
6. Positive Earnings Dynamics							Yes
	FY2023A	FY2024A	FY2025A	FY2026E	FY2027E	FY2028E	
Sales growth	6.9%	15.7%	14.9%	17.8%	17.0%	18.0%	
EBIT margin	42.3%	44.6%	45.6%	46.8%	45.0%	45.0%	
EPS growth	0.1%	22.0%	15.5%	31.6%	10.5%	18.2%	
7. Business Strategy & Segment Mix							Yes
Strategy	Own every layer of the AI stack, infrastructure through Azure, models through OpenAI, Anthropic, and it's own in house models and applications through Copilot so Microsoft can capture spending wherever it lands. It then monetizes its base by moving customers up a pricing ladder, and by charging Azure customers on a pay per use basis.						
Segment / geography mix	Three segments, Productivity & Business Processes 42%, Intelligent Cloud 41%, More Personal Computing 16%. Half U.S. half international. FY2027 reporting shifts to two segments, Agents & Infrastructure and Devices & Consumer						
8. Capable Management & Insider Ownership							Yes
Insider ownership	1.5%	Inst. ownership		76.7%	Buybacks, % of NOPAT (FY1E)		26.0%
Insider activity / governance	Insider ownership of 1.5%. Satya Nadella is the CEO with a proven track record of growing the company						
9. Valuation — Value Creation (ROIC vs. ke)							Yes
ROIC (FY1E)	25.2%	Cost of equity (ke)		9.6%	EVA spread (ROIC – ke)		15.6%
Price target / upside	\$510.00	3.3%		Value / share range (low–high)		\$160 – \$770	
10. Uses of Capital — allocation discipline							Yes

Reinvestment 102% of NOPAT, dividends + buybacks 26% in FY2026E; no dividend and no large M&A — full detail in the Uses of Capital table below.

VALUE FIT SCORE — criteria met 7 / 10

FINANCIAL SUMMARY (\$mm except per share)							
	FY2023A	FY2024A	FY2025A	FY2026E	FY2027E	FY2028E	CAGR 2023–2028
Sales	211,915	245,122	281,724	331,839	388,252	458,137	16.7%
Gross margin	68.9%	69.8%	68.8%	67.9%	66.0%	66.0%	
EBIT	89,723	109,433	128,528	155,237	174,713	206,162	18.1%
Net income	72,361	88,136	101,832	133,749	147,536	174,092	19.2%
EPS (basic)	\$9.72	\$11.86	\$13.70	\$18.04	\$19.92	\$23.55	19.4%
Dividend / share	\$2.66	\$2.93	\$3.24	\$3.57	\$3.86	\$4.18	
FCFE / share	\$5.10	-\$4.39	\$4.47	-\$1.62	\$2.07	\$7.13	6.9%
Invested capital	240,122	344,520	425,057	552,553	682,332	835,940	28.3%
ROIC	35.4%	27.4%	26.8%	25.2%	22.8%	22.8%	
NOPAT margin	34.3%	36.5%	37.6%	40.4%	38.8%	38.8%	
Sales / NWC	-9.50x	-9.35x	-8.52x	-17.42x	-20.00x	-20.00x	
Sales / NFA	0.93x	0.70x	0.66x	0.60x	0.57x	0.57x	
Sales / invested capital (ex cash)	1.03x	0.75x	0.71x	0.62x	0.59x	0.59x	

USES OF CAPITAL — full range, as % of cash generated (NOPAT)							
	FY2023A	FY2024A	FY2025A	FY2026E	FY2027E	FY2028E	Avg 2023–2028
NOPAT before reinvestment (\$mm)	72,695	89,482	105,869	133,970	150,778	177,917	
Uses, as % of NOPAT							
CapEx, R&D & content (Δ NFA)	44.8%	139.4%	71.3%	91.7%	86.5%	68.9%	83.8%
Working capital (Δ NWC)	2.5%	(4.4%)	(6.5%)	10.5%	(0.2%)	(2.0%)	(0.0%)
Dividends	27.2%	24.3%	22.7%	19.7%	19.0%	17.4%	21.7%
Share buybacks	17.7%	4.6%	2.6%	6.3%	4.0%	3.9%	6.5%
Debt repaid (neg. = borrowing)	(1.4%)	(20.6%)	(13.5%)	—	(11.9%)	(11.3%)	(9.8%)
Cash & securities build	8.9%	(39.9%)	18.0%	(13.2%)	1.8%	21.2%	(0.6%)
Interest & other (residual)	0.2%	(3.4%)	5.4%	(14.9%)	0.9%	1.9%	(1.6%)
Total uses of capital	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Discipline — reinvestment, % of NOPAT	47.3%	135.0%	64.8%	102.1%	86.3%	66.9%	83.7%
Dividends + buybacks, % of NOPAT	45.0%	28.9%	25.3%	26.0%	22.9%	21.3%	28.2%

Framework: the full range of capital allocation — CapEx/R&D/brand, dividends, buybacks, cash and debt. Cautious at the top of the cycle, invest for the future at the bottom, without over-levering. Total ties to 100% by construction, with interest and unallocated items in the residual.

COMPS OVERVIEW (current multiples, FactSet)						
Ticker	Company	P/E	P/S	P/B	P/CF	EV/EBIT
MSFT	Microsoft Corporation	27.5x	11.1x	8.3x	20.1x	18.1x
AMZN	Amazon.com, Inc.	20.4x	3.6x	5.0x	17.1x	29.0x
GOOGL	Alphabet Inc. Class A	17.6x	9.6x	6.9x	23.2x	28.3x
ORCL	Oracle Corporation	23.1x	6.2x	7.2x	9.4x	34.3x
META	Meta Platforms Inc Class A	25.1x	7.5x	6.5x	13.1x	20.1x
Median	Peer median (subject excluded)	21.8x	6.8x	6.7x	15.1x	28.7x
MSFT	Subject, at current price	36.0x	13.0x	10.7x	110.5x	28.7x
Premium / (discount) to peer median		+66%	+91%	+60%	+630%	+0%

Note: MSFT appears in its own peer list (AutoTearSheet-5Page!D14:D19). It is excluded from the median, but replace that slot with a real peer to use all six.

KEY RISKS		
1. The AI buildout doesn't earn it's return: Capex jumped 8% to \$115.9B in FY2026 and FY2027 is guided around \$175B. There are also \$196.6B of datacenter leases signed but not yet started. The 10-K itself warns that overestimating demand could leave infrastructure underused and force write downs. If AI pricing falls or demand plateaus Microsoft is left with expensive depreciating hardware.		
2. Concentration in few AI customers: OpenAI is Azure's anchor customer and committed \$250B more in 2025, but OpenAI has since signed with other customers providing computing power. Microsoft also holds roughly 27% of OpenAI so OpenAI results flow through Microsoft.		
3. Competition and AI weakening the moat: In cloud Azure is behind AWS with Google close behind it. The bigger long run threat is AI agents working across apps to reduce switching costs, which is what Office/Windows relies on. Copilot also has to prove ROI to customers. If it doesn't it get stalls or get discounted.		

