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Microsoft – defying gravity

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The coronavirus pandemic has radically altered the way we communicate, how we socialise and how we work. This societal shift has proved a great opportunity for companies exposed to this rapid change, and one notable example is Microsoft.

In fact, Microsoft is a stock that to many is defying gravity having rallied back to near all-time highs just when the economic background appears so challenging.

When analysing investment opportunities, above and beyond everything else I am always looking for something that positively differentiates that business from its peers. Sometimes that is a personal observation or judgement. Right now, we have a rare situation where we can share and experience that unique ‘differentiator’, understand its importance and try to value its worth to society and equity investors. Right now, we are living Microsoft Teams, a previously considered modestly useful application integrated into Office365.

Teams was, until recently, considered an incidental application within the Microsoft product range. Now it is a critical addition to Microsoft’s strategy of bundling software products, security, analytics, AI and so on through the cloud to sell to the corporate world. All this leveraging from Office 365 with businesses on long term contracts which are priced off volume of workload data (which tends to go up - hence the high recurring revenue model). Teams provides a competitive advantage, is competing with the equally successful Zoom, both of which have provided unwelcome competition to existing video conference market incumbents.

Turning to the numbers: Microsoft recently reported positive earnings. Sales for the quarter were at 15% and it maintained its start of year guidance of 12% full year. Not bad for a \$1.4tn market capitalised business to be able to grow sales at a rate 3-4x the rate of global GDP in a normal year.

Given the economic situation, it is important to also reference previous downturns in 2003 and 2008. In these years, Microsoft reported a significant loss in sales momentum. Both are useful references but are very limited in their predictive ability. We know that Microsoft is a completely different company now. In previous years, the business focused on hardware, phones, computers to the consumer. Fast forward to today, and the focus is selling bundled software to the corporate customer.

Of course, that's not to say that Microsoft is without risk. While it does have some transaction business risks and is not immune to economic risk, but the company's earnings reassure the market that the investment case remains very much intact and it is set to continue to be, I believe, a strong performer in this economic environment.

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