Stock story: Microsoft

The software giant has benefited from pandemic-driven push to online.

For Microsoft, October 4 just gone was to be a notable day. The software company had marked the first Monday of this month as return-to-the-office day for its US staff. But the fourth wave of covid-19 tearing through the US ruined such hopes and the office reopenings across the country were postponed indefinitely.

It's probably one of the few events businesswise that has not gone Microsoft's way during the pandemic. Microsoft, along with many other tech companies, has thrived during the health crisis as government restrictions and self-imposed isolation prompted people to work from home, forced students to sit virtual lessons and compelled just about everyone to hang out more on the internet to amuse themselves or shop.

For Microsoft, working from home boosted demand for hardware and software. Among the most notable was Teams, a collaboration and communication app built into Office that enables in-house meetings via video, instant messaging and conference calls. In roughly the first six months of the pandemic, for instance, the numbers of active users using Teams jumped to more than 115 million a day, which meant that people spent 30 billion minutes each day on Teams, for an average of four hours per user. Another work-from-home boost for Microsoft was increased business demand for cloud services. Remote learning and being stuck at home lifted demand for video-chat resources and adequate hardware, as did time on Skype (up 220% in the early phase of the pandemic) and video games.

This accelerated switch to online helped Microsoft deliver revenue of US$168.1 billion in fiscal 2021, up 18% from 2020, and post an operating profit of US$69.9 billion (and a net income of US$61.3 billion).

But don't give too much credit to the pandemic. The company founded in 1975 enjoys such success largely thanks to its thriving business-oriented divisions, which is ironic for a household-name company commonly known for its consumer products, from Windows to Xbox.

One business-focused arm is the Productivity division, which generated 35% of Microsoft's operating profits in fiscal 2021, as its revenue growth accelerated to 16%. The driver here is Microsoft Office, which includes Excel, Outlook, PowerPoint, Word and now Teams, with a 90% global market share in office productivity software. These and Microsoft's other software are best-in-class products protected by the high cost and friction of switching to competing products.

The other business-focused arm is the newer Intelligent Cloud division that includes Microsoft's thriving Azure public-cloud arm, which pulled in 37% of operating profits in fiscal 2021 after a 24% increase in revenue that helped the unit tighten its top-two position in cloud. The third division, the More Personal Computing arm, generated the remainder of fiscal 2021's profits, recording a 12% jump in revenue.

But it's not just products driving Microsoft's recent success. The other ingredient is Satya Nadella, who joined Microsoft in 1992, and was made the company's third CEO in 2014 after Steve Ballmer (2000-2014) and Bill Gates (1975-2000) who resigned as chairman when Nadella took over. At the time, the software giant was criticised for having missed out on the mobile revolution and Microsoft's share price had idled for more than a decade.

Under Nadella, Microsoft has transitioned to selling more subscription and consumption services often tied to multi-year contracts, rather than one-off, upfront product licences for software. Another noticeable feature of the Nadella era has been some of the strategic takeovers. Three among the most notable swoops were on LinkedIn in 2016 for US$26 billion, GitHub, an online code-sharing platform, for US$7.8 billion in 2018 and Nuance Communications this year for US$19.7 billion to help expand the industry cloud opportunity. Other focuses in the Nadella era have been spending discipline, ensuring privacy and cybersecurity, and exploring the opportunities presented by artificial intelligence and the internet of things.

But even in the years of Ballmer as CEO, Microsoft still made substantial revenues from its business products. Such holds on business are what make Microsoft one of the world's most valuable companies (at times, the world's most valuable) and a compelling long-term investment.

To be sure, the pandemic boost is temporary. Zoom is a mighty competitor to Teams. Laptop and other device sales are being hampered by the global chip shortage and other disruptions to supply networks. The growth rate of the cloud and software businesses is likely to slow over time. Big Tech is facing regulatory threats from many angles, though Microsoft has so far avoided the worst of the scrutiny.

While the cloud and business software markets stay strong and Nadella's oversight remains discerning, Microsoft is well positioned even for a more-normal world when Microsoft and other companies have their staff back in the office.

Sources: Company filings and website.

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