Microsoft Stock: Is it Time to Buy Yet?

Description

Despite the scary tumble of 32% from its 52-week and all-time high, **Microsoft** (NASDAQ:MSFT) stock still has a wonderful underlying business. The main culprit of the selloff in the quality tech stock is the valuation compression of stocks in general due to quantitative tightening.

Money supply rose during the pandemic period. For example, there were government programs to help workers and businesses that were directly impacted by economic shutdowns related to the pandemic.

As well, high inflation is devaluing fiat currencies, including U.S. dollars, more quickly than normal. Rising interest rates make it more costly for businesses and consumers to borrow. Consequently, businesses' growth projects look less compelling now than they did a year ago. Businesses are expected to invest less, and consumers are expected to spend less. Ultimately, it leads to a reduction in businesses' earnings outlook.

As it looks like the new normal in the near term will be high inflation and rising interest rates, stocks, including Microsoft, will continue to be pressured over the next while.

Valuation and returns

Other than choosing a great business, the valuation investors buy stocks at also affect their investment returns. From its peak, MSFT stock simply retreated to a more normalized price-to-earnings ratio (P/E).

Despite the recent bear market, in the last decade, MSFT stock has still delivered annualized returns of approximately 25.7%. In other words, it grew an initial $10,000 investment into $98,770! Compared to the returns of 12% per year from the U.S. stock market (using **SPDR S&P 500 ETF Trust** as a proxy) that transformed the same initial investment to $31,090.

Much of the tech giant's decade's growth came from the transition to cloud, led by Satya Nadella, who took over the role of Microsoft's chief executive officer since February 2014.

Over the next three to five years, 49 analysts have an average earnings-per-share (EPS) growth rate estimate of 15.4% for MSFT stock. Assuming a more normalized target P/E of about 22.3, the quality tech stock can deliver annualized returns of about 13-14% in the period.

Microsoft stock is a decent buy at current levels, but the market correction can continue for some time. If you want to buy closer to a P/E of 22.3 for a safer entry point, wait until a drop to the $205-per-share level.

Microsoft is still a wonderful business

Using fiscal 2019 as a base year for comparison, Microsoft improved its gross profit margin to 68.4% from 65.9%. Its three-year revenue-growth rate is 16.4%, which is superb for a large-cap company that has a current market cap of over $1.7 trillion. Its operating income of over US$83 billion is almost double the levels from fiscal 2019. Its operating margin improved to 42.1% from 34.1%, which indicates management has been controlling costs really well.

Microsoft is also a free cash flow (FCF) machine. It brings in annual FCF of over US$65 billion. Its fiscal 2022 payout ratio was 28% of FCF and 25% of earnings. With the double-digit EPS growth expectation and a safe payout ratio, investors can expect many more years of dividend growth. For reference, its five-year dividend-growth rate is 9.6%, which aligns with its most recent dividend hike of 9.7% in September. The company also allocates about 27% of its operating cash flow in capital investments for long-term growth.

It only yields about 1.15% right now. So, investors of MSFT are seeking growth. In this environment, it'd be prudent to space out one's purchases. If you like the company, consider taking a partial position and adding more shares on further weakness.

CATEGORY

1. Investing
2. Tech Stocks

TICKERS GLOBAL

1. NASDAQ:MSFT (Microsoft Corporation)

PARTNER-FEEDS

1. Business Insider
2. Flipboard
3. Koyfin
4. Msn
5. Newscred
6. Quote Media
7. Sharewise
8. Smart News
9. Yahoo CA

PP NOTIFY USER

1. kayng
2. kduncombe

Category

1. Investing
2. Tech Stocks

Date
2025/06/27
Date Created
2022/09/30
Author
kayng