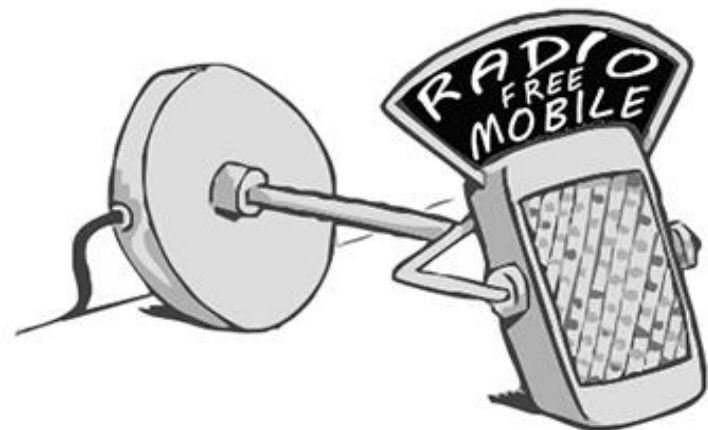


# Microsoft

## Mission impossible



- Three missions to achieve long-term growth.
- Legacy businesses look under control...
- ...but the ecosystem needs a lot of work to make users love it.
- Marketing and mobile turnaround needed to succeed in Missions 2 & 3.
- Shares are attractive even if Missions 2 & 3 fail...
- ...with a valuation of \$61.0 per share, it is safe to live in hope.

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**11<sup>th</sup> May 2015**



# Microsoft

## Mission Impossible

11<sup>th</sup> May 2015

Microsoft's position is difficult but not impossible. Nadella's mission, which he has decided to accept, is three fold. 1) Control legacy, 2) Bring the ecosystem to life and 3) Merge Digital Work and Digital Life. Microsoft must reverse its share declines in mobile, make its ecosystems delightful and fix its marketing in order to succeed. Fortunately, the shares of Microsoft are attractive even it blows Missions 2 and 3.

- **Opening act:** Nadella has already achieved what many thought was impossible in flipping the culture of Microsoft on its head. From boardroom to water cooler, the company is aligned in realising that things have to be very different going forward.
- **Mission 1: Control legacy.** RFM calculates that Microsoft has snuffed out the PC revenue time bomb by moving to business subscriptions. There is a long pay-back period but there will be more profit generated in the long run. RFM thinks that Microsoft has succeeded in this mission, moving the focus onto Missions 2 and 3.
- **Mission 2: Ecosystem.** Microsoft's position in Digital Work is very strong and it has a good portfolio of Digital Life services. However, the services need to be properly integrated in order to offer the seamless user experience that will win the hearts and minds of users. Microsoft must also reverse its market share losses in mobile as this is having a seriously negative impact upon its credibility in mobile. Progress so far in fiscal 2015E has been disappointing.
- **Mission 3: Digital Life and Work.** Merging Digital Life and Digital Work seamlessly in a way that is both easy and fun to use is something that only Microsoft has a real hope of achieving. This will create differentiation allowing the company to monetise and improve profit growth. To succeed here requires Mission 2 to work, service integration at least as good as Google's, and a turnaround in marketing.
- **Marketing.** RFM thinks that Microsoft's marketing is not nearly as effective as it should be. In the ecosystem, Microsoft is the challenger and hence it must explain to users why they should live their Digital Lives and Work with Microsoft. Simply telling users that it exists may have worked 20 years ago. It no longer does today.
- **Safe to live in hope.** The good news is that Microsoft's valuation is undemanding even if it fails to execute on Missions 2 and 3. RFM has used a combination of comparative valuation and DCF to arrive at a valuation of \$61.0 per share. This makes Microsoft is attractive just on the basis of the success Mission 1 where it is already showing excellent progress.

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