Investor Lessons From Microsoft's History

This year Microsoft surged to over $3 trillion in value, becoming the largest company among the so-called "Magnificent 7" (Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia and Tesla).

The company recently announced excellent Q2 results for the period ending December, with revenue and earnings per share ahead of consensus. A significant driver of this growth has been the continued expansion of the company's cloud division, which is growing at over 30%.

Reflecting on the past 24 years since 2000, both for the business and its investors, it's been a tale of two halves. After an extraordinary rise in the 1990's, the share price reached a peak in December 1999 at a split adjusted $59. Like most other technology companies, the price plummeted following the burst of the "dot-com" bubble in March 2000 and then again in the 2008/09 global financial crisis. It wasn't until October 2016 that the $60 price level was surpassed.

Over the entire period, the growth in the share price, averaging 12% per annum, roughly matched the earnings per share growth rate of approximately 11.2% per annum. However, investor experiences in the first and last decades have been vastly different.

The First Decade

During the first decade of the century the business performed well, with diluted earnings per share growing at 9.5% per annum. However, investors did not fare as well, as the **stock price fell by approximately 13%** over the 10 years due to the need for the high valuation to unwind.

The Last Decade

In the subsequent years it has been a completely different story altogether. This month marks Satya Nadella's 10-year tenure as CEO. He took over from Steve Ballmer when Microsoft was valued at "only" $300 billion and played a pivotal role in driving the then-nascent Azure cloud business, which has since become one of the company's primary revenue drivers.

Over the last decade, earnings per share have grown at a rate of 14%, while the **share price has surged by close to 30% per annum.**

Chart 1: Microsoft EPS and Average Share Price

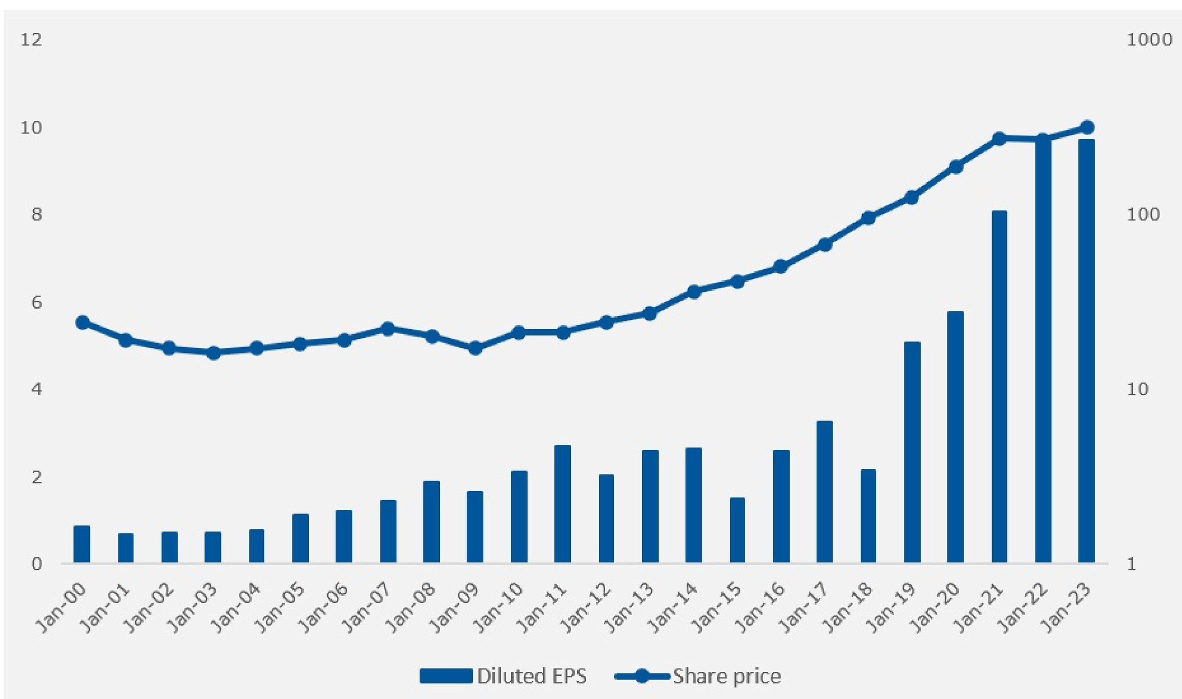

Chart Source/s: YCharts and Macrotrends

In conclusion, the **significant disparity** in investor experience underscores the importance of extreme valuations. At the beginning of the century, Microsoft was growing at 40% per annum, but with a valuation of over 70 times its earnings, it had to be corrected over the next decade, resulting in shareholder losses.

At the end of 2013, the valuation had collapsed to around 11.5 times earnings. Exceptional management boosted growth, while the market re-rated these earnings to a current multiple of 34 times. **History tells us that valuations can become richer, but at the same time increased investor caution is warranted.**

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