

MIT Sloan School of Management
15.535 Business Analysis and Valuation Using Financial Statements

Business Valuation Project

For this project, you are required to prepare an analyst report on Microsoft. The main text of the report (i.e., excluding supporting exhibits) should be a maximum of 10 pages. At the minimum, it should include a discussion of the results of your financial statement analysis and valuation.

What is expected in the report?

- Perform reformulation of the financial statements of Microsoft, with focus on separating operating and financing activities.
- Perform cross-sectional and time-series analyses of Microsoft, with particular focus on profitability and growth. These analyses generally require the computation of ratios using numbers from the reformulated financial statements. Discuss the results of these analyses, especially in the context of how these ratios affected your forecasts.
- Use valuation models (e.g., methods of comparables, free cash flow model, residual income model, and abnormal earnings growth model) to value Microsoft.

Note:

- i) To compute the required rate of return on equity, you can use the CAPM model. Under CAPM, the required rate of return, r , is given by
 $r = \text{risk-free rate} + \text{beta} \times \text{risk premium}$.
Risk-free rate is about 3% and the market risk premium is about 5%.
- ii) To compute the continuing value, a growth rate is required. You might want to be conservative about growth estimates for Microsoft because Microsoft is becoming or has become a mature firm. Mature firms tend to have limited growth options (i.e., investment opportunities). Note that valuation is usually quite sensitive to assumptions of growth and analysts much time figuring the growth estimate to use. Run some sensitivity analyses and choose a growth estimate that you are comfortable in setting a target price.
- In your report, you can also reference the findings of other professional analyst reports.
- You can choose to use the Excel workbook (called BYOAP – Build Your Own Analysis Product) available on Stellar website. The workbook contains the steps to help you develop your own financial statement analysis and valuation tool. Note that the analysis and valuation for Nike Inc. for 1996-2004 is found in the workbook. You should first review what has been done for Nike Inc. and then adapt this workbook for Microsoft.

You are given 10 points for investing in Microsoft. With the 10 points, you can choose to either long, short, or not trade in Microsoft. The closing price of the Microsoft on Nov 26 will be the buying (selling) price if you long (short) the Microsoft. You are required to let me know by email your group's decision (i.e., number of points and trading decision) between 4.30 pm and 11.59 pm EST on Nov 26. The closing price of the Microsoft on Dec 3 will be the selling (buying) price if you originally longed (shorted) the Microsoft. The points that you have invested will be adjusted for the gains or losses from your investment. The maximum amount of points that you can gain or lose is 2 points.

Your presentation (with the use of PowerPoint slides) should be for at most 10 minutes. For your presentation, you are required to provide a summary of your analyst report. You should also discuss your investment strategy and performance, e.g., size of investment and factors that led to unexpected outcomes. The presentation will be on Dec 8 and Dec 10. I will let you know the time for your presentation later.