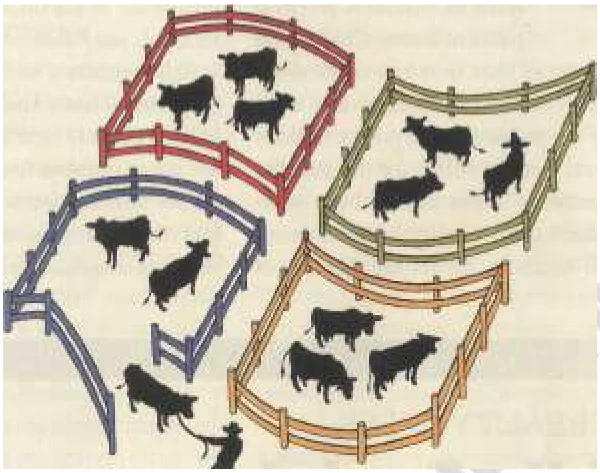


Microsoft, the Cash Cow

The software giant may not be a high-powered growth machine anymore, but it offers financial strength and an attractive yield. **BY MICHAEL v. COPELAND**

WITH THE STOCK market finally showing that it can go up as we as down, you might be wondering if you should get back into the fray—and worried about the possibility of more dips to come. One relatively low-risk strategy is to look for fimancially sound companies that offer both reliable dividends and the prospect of some real upside in share price. A sterling example: the world's largest software maker, **Microsoft (MSFT, $18),** which has an annual dividend yield of just under 3%.

Microsoft's stock has suffered along with the rest of the market, falling about 40% over the past 12 months, mirroring the S&P 500. And it could certainly go lower. On March 9, when the market had a particularly tough day, shares fell below $15, a level not seen since 1997. But since that dip the stock has climbed almost 20% and in recent months has shown resilience in the $16 range.

Microsoft is being challenged by the likes of Google and Apple, as more software and services are delivered via the Internet or a mobile device. But let's face it, people are not abandoning PCs anytime soon, especially for work, even if they are migrating to lower-cost "netbooks." Over the next three years or so, Microsoft will maintain its very lucrative grip on the market for computer operating systems (Windows 7 is coming this year), and desktop and business products like its Office software. And it stands a good chance of adding Yahoo's online search business to the fold as well. "The next 15 years arerit going to be as good for Microsoft as the last 15," says Toan Tran, associate director of research at Morningstar, which has a buy rating and a fair-value estimate of $35 on the

Credit Check

Some key interest rates are dropping, a sign that credit markets are less jittery.

1.23%

The three-month LIBOR (London interbank offered rate), a benchmark for interbank loans, down from 3.48% in September.

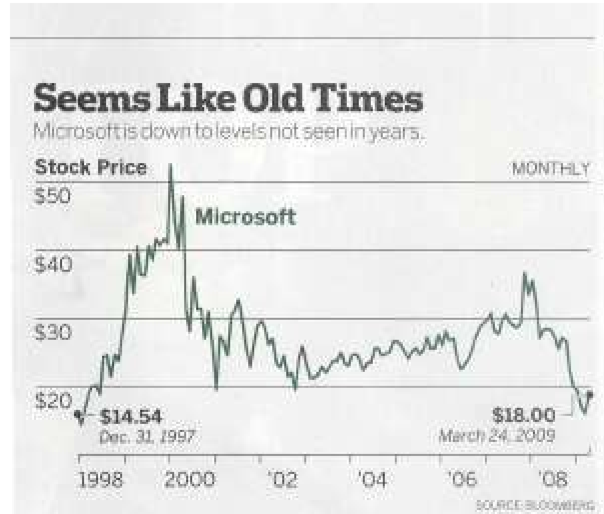
5.13%

The average rate on a 30-year fixed mortgage in February, barely up from January's 5.05%—the lowest on record, according to Freddie Mac, which has tracked rates since 1971—and down more than three-quarters of a point from February 2008.

—*Beth Kowitt*

SOURCES: BLOOMBERG; FREDDIE MAC

ILLUSTRATION BY DANIEL BEJAR



stock. "But Microsoft will do well when the economy turns around. Sure, cloud computing [delivering software and services via the Internet] is a threat, but nothing you can do over the next year is going to have much of an effect on their business."

Investors are treating Microsoft like a cash cow rather than a growth engine: The stock trades around 10 times estimated 2009 earnings, vs. just north of 13 for the S&P 500, 16 for Google, and 20 for Apple. So if earnings grow as the economy recovers, investors have the potential for a real bounce in the share price. And don't forget that dividend. Is it safe? With more than $20 billion in cash in the most recent quarter, and annual free cash flow of $17 billion, there is not much question that Microsoft can afford the current quarterly payout of 13¢ a share. The company may not keep raising the dividend annually, as it has done since first offering one in 2003, but it's not likely to cut it either.

Bob Turner, who manages $15 billion at Turner Investment Partners, based in Berwyn, Pa., isn't investing in Microsoft right now, because it doesnt have enough of a growth story for his fund. But he endorses it for value investors. "If you are comparing it with other technology companies, shares of Qualcomm, Apple, and Broadcom could grow faster," Turner says. "But if you compare it with other dividend stocks like, say, AT&T, I would rather own Microsoft at a yield of 3% than AT&T at 5%, because Microsoft has better growth prospects."

Local Bank Makes Good

A CONSERVATIVE LENDER WEATHERS THE STORM.

As the real estate boom heated up, **New York Community Bancorp (NYB, $11)** suffered. The regional bank saw its shares sink as big outfits like Washington Mutual and Deutsche Bank cut rates and made riskier loans to New York City developers and landlords.

Those days are over, of course, and with many rivals either out of business or restricting lending to conserve capital, NYB looks ready to rebound. "We designed our business model back in 1992–93 for the purpose of dealing with the next credit cycle turn," says Joseph Ficalora, CEO of the bank since 1993. "We just didn't expect it to be this far out."

NYB is a holding company with $32.5 bilion in assets, operating under various names in the New York metro area, inciuding Atlantic Bank. And it's going strorsg.

"In 2008 it had four quarters in a row of earnings growth, four quarters of margin expansion, doubie-digit loan growth," says analyst Anthony Polini of Raymond James. "And the trends all look positive this year."

Moreover, the stock is attractively priced, trading for about 10 times estimated 2009 earnings and offering a dividend yietd of 9.5%. (Anaiysts say the bank wiil have no trouble maintaining its payout.)

The bank owes its success to strict underwriting standards. For example, when apartment building owners want to upgrade their units, NYB values loans based on current cash flows from apartment rents—not market value of the buildings or projected future rents—then offers 40% less as a cushion against default. Net charge-offs for bad loans represented 0.03% of loans at the end of last year (that compares with 1.84% at Wells Fargo, for example).

Some analysts predict that tosses will mount in NYB's commercial real estale and construction portfolio, which makes up 24% of the bank's outstandíng loans. Sterne Agee's Matthew Kelley downgraded the stock to sell in February, saying its reserves don't reflect the risk of increasing defaults as the economy sours. But Peter Winter of BMO Capital Markets disagrees: "We expect charge-offs to increase in 2009, but they should be manageable," And Polini expects the bank to survíve the slump in style. "NYB is coming through this as a winner," he says. —Scott *Cendrowski*

COPELAND, Michael V. Microsoft, the cash cow. **Fortune**, Amsterdan, v. 159, n. 7, p. 24-25, 20 April. 2009.