BERNSTEIN
SOCIETE GENERALE GROUP

Global Software

Microsoft Corp

Rating

Outperform

Price Target

MSFT **646.00 USD**


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Quick Take on Microsoft: Capacity constraints are causing strange bedfellows

Capacity constraints have plagued not just Microsoft but to differing extents all the hyperscalers due to AI demands driven by model training, coding, and other forms of AI. Initially the limiting factor was GPU availability, but that seems to have abated at least as it relates to the hyperscalers. Next was powered up sq ft in datacenters capable of supporting AI and now not just AI but also traditional capacity, at least as it relates to Microsoft, is an issue.

Microsoft has taken a two-pronged approach to drive both more capacity and triage who to give the next available capacity to. Yesterday we saw the next step and in some ways the most unusual step as Microsoft, it would seem based on news articles (Business Insider), will be renting capacity from Amazon AWS (its largest competitor) for GitHub.

Before commenting on the usage triage, which is important to put in perspective, we want to quickly add more context on Microsoft's approach to adding capacity.

Microsoft started to build capacity for Generative AI workloads starting, we believe, in 2019 and has been ramping capacity ever since. The company, all the way back to the early days of Azure, would much rather own their own datacenters than lease or leverage third parties (see Microsoft: Flashback to the Cloud build-out for an exploration of the topic). But building datacenters can take years (What is in a Datacenter contract?) so the next best was renting from datacenter builders. As demand continued to surge over the last 12–18 months Microsoft started renting not just datacenters but capacity (datacenters populated with servers) from neoclouds on a relatively short term basis.

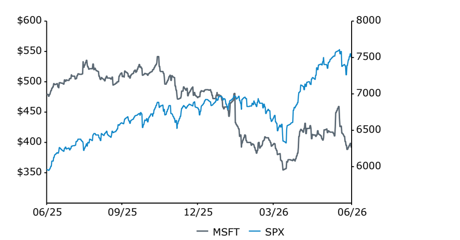
Now it would seem that Microsoft has taken another page our of their cooperating with competitors playbook and is going to rent capacity, it would seem for GitHub from AWS.

Close Date	16 Jun 2026
MSFT Close Price (USD)	393.83
Price Target (USD)	646.00
Upside/(Downside)	64%
52-Week Range	555.45/356.28
SPX	7,511.35
FYE	Jun
Div Yield	0.9%
Market Cap (USD) (B)	2,925.54
EV (USD) (B)	2,972.70

Performance	YTD	1M	6M	12M
Absolute (%)	(18.6)	(6.7)	(17.3)	(17.6)
SPX (%)	9.7	1.4	10.5	24.5
Relative (%)	(28.3)	(8.0)	(27.7)	(42.1)

Source: Bloomberg, Bernstein estimates and analysis.

Price Performance, 1YR



Adjusted EPS	F25A	F26E	F27E
MSFT (USD)	13.64	16.85	19.16

Financials	F25A	F26E	F27E	CAGR
Revenues (M)	281,724	330,125	391,739	17.9%
Operating Earnings (M)	128,528	154,362	177,626	17.6%
Net Earnings (M)	101,832	125,599	142,905	18.5%
Revenue/Share	37.74	44.28	52.51	18.0%
Operating Margin (%)	45.6	46.8	45.3	--
Net Income Margin (%)	36.1	38.0	36.5	--
EPS Growth (%)	15.6	23.5	13.7	--

Valuation Metrics	F25A	F26E	F27E
Adjusted P/E (x)	28.9	23.4	20.6
PEG Adjusted (x)	1.9	1.0	1.5
EV/Sales (x)	10.6	9.0	7.6
P/Sales (x)	10.4	8.9	7.5
PEG Reported (x)	1.9	1.0	1.5
EV/EBIT (x)	23.1	19.3	16.7
Div Yield (%)	0.8	0.9	1.0

Source: Bloomberg, Bernstein estimates and analysis.

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While this may seem a bit bizarre it in fact is not.

Microsoft in November 2023 rented capacity from Oracle for Bing (Microsoft and Oracle: Bing + OCI — more to this than meets the eye) as well as for OpenAI model training[1].

WHY IS MICROSOFT ADDING CAPACITY AT 3RD PARTIES?

Fast-forward to today, and it would seem that GitHub usage has exploded. There was a post April 3rd on X by Kyle Daigle, GitHubs that platform activity is surging. There were 1 billion [code] commits in 2025 and now its 275 million per week on pace for 14 billion this year if growth remains linear and as he said in the blog post - it won't. He goes on further to say that they are pushing CPUs, scaling services and strengthening GitHub's core features.

While the demand is being driven by AI and all the code that is being built using AI code writing tools[2] the demand problem Microsoft, we believe, is having is traditional (CPU) workload based which is in line with comments management made last quarter and a very important sign that inferencing will drive both increased GPU and traditional CPU utilization upward.

We understand that GitHub has been running across Microsoft, independently managed datacenters, and multiple Cloud provider's datacenters since Microsoft acquired GitHub (many of these agreements preceded the acquisition). Microsoft has been working to move those workloads into Azure datacenters but naturally their priority has been to meet the demands of Azure and 1st party app customers over decreasing the usage of 3rd party datacenter and Cloud providers.

While we do not know if Amazon AWS was one of the pre-existing Cloud providers hosting GitHub we frankly would not be at all surprised given the size of AWS' business and the quality of its IaaS.

With demand exploding across AI and non-AI workloads Microsoft is continuing the approach of moving 1st party apps to 3rd party datacenters while leveraging Azure for Azure customers which makes sense. You want to get your customers used to a fully Azure experience and lock them in for the long term, while you can move your own workloads more easily and not place future customer demand at risk to go elsewhere.

What is interesting is the ramp in demand that Microsoft is seeing that we are not necessarily seeing elsewhere. We understand from our checks that customers are being told to wait for Azure capacity due to limitations in Azure capacity (likely where the workloads need to be located). Office 365 Copilot paid usage grew 33% QoQ (likely faster than most if not all other SaaS AI workload at that scale) and now we are finding that GitHub usage is more than doubling year-over-year.

WHAT DOES THIS MEAN FOR ORACLE?

From an Oracle perspective the articles (Times of India article) imply that Microsoft required Fedramp certification which we understand Oracle Cloud for Government and Oracle Defense Cloud offer but not all other Oracle datacenters and datacenter offerings which we believe is not atypical. In other words, Oracle did not have the capacity where Microsoft wanted it and the cost and time of adding certification may have been prohibited, so Microsoft went to the proverbial plan B (Amazon AWS - which had capacity with certification).

WHAT ABOUT AZURE USAGE TRIAGE?

We have been meaning to write for a while about the issue of where Microsoft is allocating additional Cloud resources. At a high-level Microsoft has determined, and we would agree, that they must develop their own models. They need to have their own models for multiple reasons including:

- Specialized models for 1st party apps. There are very specific queries going to the different Copilots and if Microsoft is going to deliver quality / competitive capabilities to their customers and good economics Microsoft must have their own specialized models. In fact, we would expect a lot more specialized models to be created as the capabilities and demands of the Copilots increase.

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[1] We believe that this showed Oracle's capabilities in AI IaaS/PaaS which in turn led to their ~$300B 10+ year OpenAI agreement.

[2] An interesting side-bar is that we are hearing from developers that the code being written by AI is larger in size and possibly less effecient in some ways.

- Azure needs models and as we believe that there will be multiple competitive frontier models and tens of thousands or more small / specialized models Microsoft needs to have their own models. Some will be specialized for specific pain points that their enterprise focused customers are dealing with and others will be cheaper for customers and possibly more secure.

- Microsoft can not rely only on model builders, some of which are or will become more competitive in Microsoft's core businesses.

- We note that Microsoft's models have started to become competitive, at least based on some sources, with models from the leading frontier model companies (Lushbinary comparison) and quickly / more efficient.

We had expected that Azure (Microsoft: Could the bear case in fact be the bull case?) would grow faster last quarter than it did, and the reason growth was not as strong as we expected was the 33% QoQ growth in Office 365 Copilot paid seats. This surprisingly strong growth rate, especially considering how bearish many on the street are on the future of Office 365 Copilot, took capacity that otherwise would have gone to Azure. While Microsoft continues to add capacity, including by moving some 1st party app usage to other providers, the guidance of more seats added this coming quarter and more seats in the back half of the CY than in the 1st half will take capacity that could be applied to Azure.

In other words, Microsoft is not able to meet demand and is having to do what would otherwise be unusual acts but all of this is in fact good and as the spending on the datacenter build out is slowing we believe that demand and supply will be normalizing and Microsoft will be capturing and monetizing this demand.

INVESTMENT IMPLICATIONS

Microsoft (MSFT, TP $646, Outperform): Near term these demand constraints are worrying investors as Microsoft is ramping their CAPEX spending to meet all their diverse demands. But with Office 365 Copilot seats growing 33% QoQ and seats added to be higher in each of the next 3 quarters and GitHub usage exploding (and this is non-AI usage driven by AI usage) growth is likely to be much stronger going forward than investors are expecting. We are just starting to see CAPEX grow slower than Azure and that should continue, baring a massive acceleration in demand (which would be good for the business).

Oracle (ORCL, TP $325, Outperform): Oracle's ability to respond more quickly, and it would seem to add capacity quicker than peers continues to surprise. While Oracle did not capture this contract with Microsoft we do not see this as an issue or limitation for Oracle. Everyone has to triage where to allocate very limited resources and while the relationship is strong with Microsoft we believe that Oracle would be better positioned to allocated resources more diversely since Microsoft is already a partner / customer / supplier.

BERNSTEIN TICKER TABLE

			16 Jun 2026		TTM		Adjusted EPS			Adjusted P/E (x)		
			Closing	Price	Rel.							
Ticker	Rating	Cur	Price	Target	Perf.	Cur	2025A	2026E	2027E	2025A	2026E	2027E
MSFT (Microsoft)	O	USD	393.83	646.00	(42.1)%	USD	13.64	16.85	19.16	28.9	23.4	20.6
ORCL (Oracle)	O	USD	188.33	325.00	(34.0)%	USD	7.63	8.57		24.7	22.0	14.6
SPX			7,511.35									

O - Outperform, M - Market-Perform, U - Underperform, NR - Not Rated, CS - Coverage Suspended

ORCL base year is 2026;

Source: Bloomberg, Bernstein estimates and analysis.

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Microsoft Corp

We value Microsoft shares based on our estimate for 12-month forward NOPLAT per share in 1 year's time ($22.02), and apply a P/FE multiple of 29x. We then add back in the net cash per share, discounted at 15% to account for potential tax costs and other "friction" to repatriate all cash ($7.6 per share), arriving at price target of $646.

Oracle Corp

We value Oracle shares based on our estimate for 12-months adjusted EPS in 1 years' time ($15.22) and apply an adjusted P/FE multiple of 24.5x. We then add back in the net cash per share, (-$47.6 per share), arriving at price target of $325.

RISKS

Microsoft Corp

Risks to our price target for MSFT include: a decreased demand for Azure PaaS/IaaS; increased Cloud cybersecurity concerns that impact Cloud demand; lower than forecast sales of Microsoft SaaS offerings; increased competitive pricing pressure on IaaS; increased competition in the Office market; decreased PC sales; increased pirating of the company's software, especially Windows and Office; increased functionality in the virtualization layer that limits the need for Windows server on VMs; decreased monetization of Microsoft's online offerings especially Bing; failure to increase international market share of Bing; lower than forecast sales for Xbox products and services; decreases in Windows sales.

Oracle Corp

Risks to our target price for ORCL include: customer concentration risk, AI Winter scenario where Gen AI fails globally, decreased database sales due to increased pressure from cloud and alternate databases; Slower than expected adoption of SaaS ERP; cybersecurity or other concerns that decrease demand for Cloud; lower than expected demand for Oracle's Autonomous Database and Oracle Multi-Cloud database; OCI growth issues especially at Sovereign Clouds.

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As of March 31, 2026. All figures are updated quarterly.

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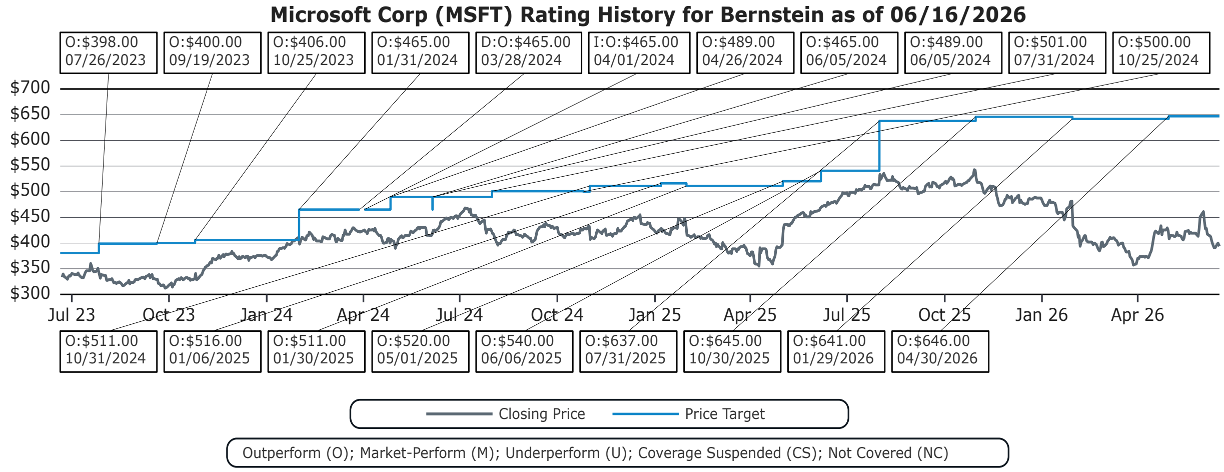

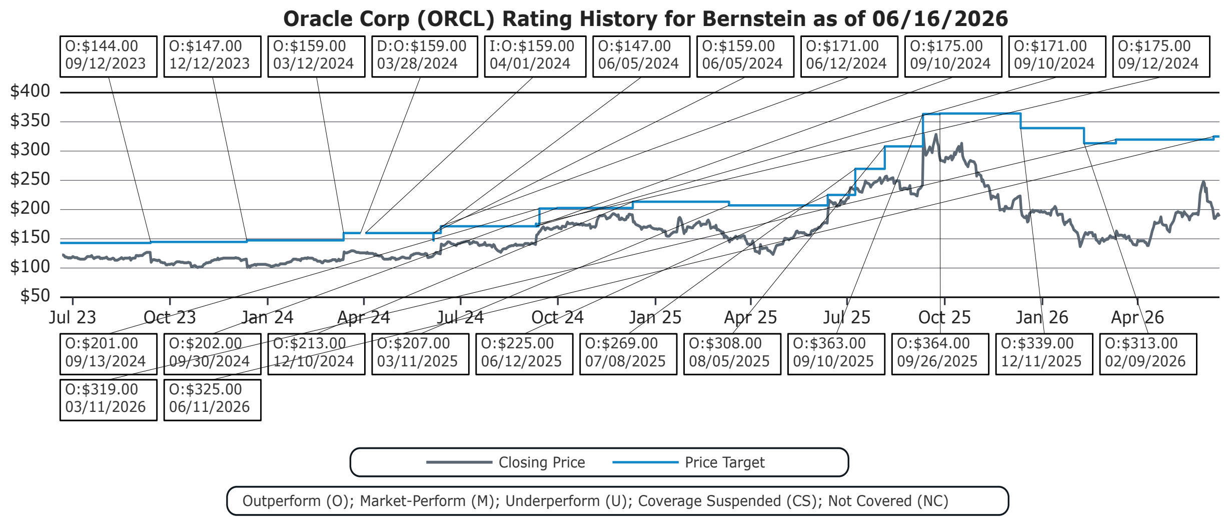

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