29 Jul 2026 17:32:37 ET | 13 pages

Microsoft Corp. (MSFT.O)

Delivers On The Q4 Investors Were Hoping For

CITI'S TAKE

Microsoft delivered an impressive Q4 with a larger than typical top/bottom line beat, led by strength in its most strategic businesses (Azure + Office/Copilot). Importantly, Azure growth returned to an outsized beat (3–4pt beat) with 43% Y/Y cc representing the fastest growth in four years and accelerating 4pts QoQ. Within Office, Copilot paid seats grew +10M QoQ vs last Q's 5M and our 8M, likely setting the stage for accelerating M365 guidance. Cost and capex discipline was also on display, with COGS /capex in line with guidance despite the significant revenue outperformance. While there was no obvious shortfall when examining the preliminary results, we would argue the Q4 Commercial bookings growth of 18% (ex-OpenAI) vs guidance of healthy growth with expiry base looks a bit underwhelming in the context of 27% Y/Y Microsoft cloud growth. Guidance and capex commentary will be key items to watch on the 5:30pm ET call.

Buy	
Price (29 Jul 26 16:00)	US$390.54
Target price	US$570.00
Expected share price return	46.0%
Expected dividend yield	0.9%
Expected total return	46.9%
Market Cap	US$2,901,101M

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4Q26 Highlights — Revenue grew 18% y/y to $90B, 3% above consensus and above prior guidance of $86.7–87.8B, with all three segments ahead. Gross profit of $60.5B beat consensus by 4%, while gross margin of 67.2% was ~90bps ahead. Operating income of $40.6B beat by 5% and operating margin reached 45.1%, ~80bps above consensus. Non-GAAP EPS was $4.74 vs $4.21 consensus, though results benefited by $0.27 from discrete items including a $3.2B Anthropic investment gain and lower-than-expected Voluntary Retirement Program expenses, partially offset by severance and Xbox impairments. Commercial bookings grew 18% y/y (11% cc including OpenAI), commercial RPO increased 84% y/y to $678B, and total capex including finance leases was $41B vs $42.1B consensus. Microsoft 365 Copilot exceeded 30M paid seats.

Healthy PBP Beat; Copilot Seat Adds the Real Strength — PBP revenue of $37.8B grew 14% y/y, 1.5% above consensus, 1.2% above CitiE, and above prior guidance of $37–37.3B. Microsoft 365 Commercial Cloud grew 14% y/y cc (16% adjusting for a tougher prior-year comp), ~40bps above consensus but ~80bps below CitiE, and

EPS (US$)	Q1	Q2	Q3	Q4	FY	FC Cons	VA Cons
2025A	3.37A	3.23A	3.46A	3.65A	13.71A	13.64A	13.84A
2026E	**4.13A**	**4.14A**	**4.27A**	**4.24E**	**16.78E**	**16.80E**	**17.06E**
Previous	4.13A	4.14A	4.27A	4.24E	16.78E	na	na
2027E	**4.63E**	**4.82E**	**4.90E**	**5.11E**	**19.45E**	**19.39E**	**19.44E**
Previous	4.63E	4.82E	4.90E	5.11E	19.45E	na	na
2028E	**5.49E**	**5.78E**	**5.94E**	**6.28E**	**23.48E**	**22.77E**	**22.92E**
Previous	5.49E	5.78E	5.94E	6.28E	23.48E	na	na

Source: Company Reports and dataCentral, Citi Research. FC Cons: First Call Consensus. VA Cons: Visible Alpha Consensus.
Click here for Visible Alpha consensus data

was down around 100bps sequentially. Microsoft 365 Copilot paid seats surpassed 30M versus CitiE of 28M.

Large Azure Beat Drives IC Upside — IC revenue of $39.3B grew 31% y/y cc, 2.8% above consensus, 2.6% above CitiE, and above prior guidance of $37.95–38.25B. Azure grew 43% y/y cc, ~330bps above both CitiE and consensus, and accelerated 4pts from 39% in F3Q26. The result represents the quarter's clearest positive given the prior capacity-constrained backdrop and indicates that incremental supply supported stronger demand conversion.

MPC Better than Feared — MPC revenue of $12.9B declined 5% y/y cc but was 5% above consensus, 7% above CitiE, and above prior guidance of $11.75–12.25B. Windows OEM and Devices declined 7% y/y cc, ~11pts ahead of consensus and ~10pts ahead of CitiE, driving the segment upside despite continued y/y contraction.

Implications — The 4Q26 Azure acceleration and broad revenue upside support higher shares as we wait for Azure and capex guidance on the earnings call. Key debates surround whether stronger supply and demand conversion can offset rising depreciation and infrastructure costs sufficiently to sustain Azure growth above 40% without further margin compression.

Figure 1. F4Q26 Results vs Citi & Consensus Expectations

Financial Metrics	Citi (Before)	Reported (GAAP)	Reported vs. Citi	Consensus	Reported vs. Cons.	Guidance	Comments:
Q4 FY26E	*in millions, except where per share*						
Productivity and Business Process	$37,393	$37,847	1.2%	$37,277	1.5%	37,000 - 37,300	Driven by M365 Commercial Cloud
% Y/Y	*12.9%*	*14.3%*	*137bps*	*12.6%*	*172bps*	12% - 13%	+ Copilot Seats +10M QoQ
% Y/Y CC	*12.5%*	*13.6%*	*106bps*	*11.9%*	*166bps*	11% - 12%	
M365 Commercial Cloud % Y/Y cc	***14.8%***	***14.0%***	*(82bps)*	***13.6%***	***36bps***	**13% - 14%**	
M365 Copilot Paid Seats (#M)	28	30	7.6%	**-**			
Intelligent Cloud	$38,309	$39,306	2.6%	$38,239	2.8%	37,950 - 38,250	Driven by Azure
% Y/Y	*28.2%*	*31.6%*	*334bps*	*28.0%*	*357bps*	27% - 28%	
% Y/Y CC	*27.8%*	*31.3%*	*349bps*	*27.8%*	*346bps*	27% - 28%	
Azure % Y/Y cc	***39.0%***	***43.0%***	*400bps*	***39.7%***	*328bps*	39% - 40%	
More Personal Computing	$12,015	$12,854	7.0%	$12,200	5.4%	11,750 - 12,250	Driven by XBOX, Windows OEM offset Search
% Y/Y	*(10.7%)*	*(4.4%)*	*624bps*	*(9.3%)*	*486bps*	(13%) - (9%)	
% Y/Y CC	*(11.0%)*	*(4.9%)*	*606bps*	*(9.6%)*	*466bps*	(14%) - (10%)	
Windows OEM + Devices % Y/Y cc	***(17.0%)***	***(7.0%)***	*999bps*	***(18.2%)***	***1,121bps***	(15%) - (19%)	
Total Revenue	**$87,718**	**$90,007**	2.6%	**$87,400**	3.0%	86,700 - 87,800	FX impact of ~1pt, in line with expectations
% Y/Y	*14.8%*	*17.7%*	*300bps*	*14.3%*	*341bps*	13.4% - 14.9%	
% Y/Y CC	*14.4%*	*17.2%*	*280bps*	*14.6%*	*267bps*	12.4% - 13.9%	
Cost of Revenue	$29,495	$29,525	0.1%	$29,480	0.2%	29,400-29,600	
Gross Profit	**$58,223**	**$60,482**	3.9%	**$57,915**	4.4%	57,300-58,200	
% margin	*66.4%*	*67.2%*	*82bps*	*66.3%*	*93bps*	66.1%-66.3%	
Microsoft Cloud GM%	***66.0%***	***65.0%***	***(100bps)***	**-**		**~65%**	Decreased 3pts YoY driven AI Infrastructure + AI produ
Operating Expenses	$19,200	$19,879	3.5%	$19,204	3.5%	19,300-19,400	
Operating Income	**$39,023**	**$40,603**	4.0%	**$38,712**	4.9%	38,000-38,800	
% margin	*44.5%*	*45.1%*	*62bps*	*44.3%*	*82bps*	43.8%-44.2%	
EPS - NON-GAAP Diluted	**$4.24**	**$4.74**	11.7%	**$4.21**	12.6%		Excluding OpenAI Impact
EPS - GAAP Diluted	**$3.92**	**$4.81**		**-**			Anthropic Investment benefits of $0.33
CapEx	$31,488	$35,800	13.7%	**$35,000**	2.3%		~2/3's short-lived assets
Total CapEx (+ Cap Leases)	$41,900	$41,000	(2.1%)	**$42,087**	(2.6%)		DC Finance Lease of $5.6B
Commercial Bookings Growth		***18.0%***					Excluding OpenAI, vs guidance of healthy growth
Azure Revenue Growth	***40.0%***	***43.0%***	*300bps*	***40.4%***	*262bps*		
Azure Revenue Growth (cc)	***39.0%***	***43.0%***	*400bps*	***39.7%***	*328bps*	***~39-40%cc***	Accel 4pt Q/Q
Microsoft Cloud % Y/Y cc	***25.0%***	***27.0%***	*200bps*				

Source: Citi Research, Company Reports, FactSet

Figure 2. F1Q27 Citi Estimates vs Consensus and Expectations

$ in millions, except per share	Next Quarter			Citi vs Cons.			Citi vs Cons.
	Citi	Cons.	Expectations		Citi	Cons.	
	1QE	1QE		Δ	FY2027E	FY2027E	Δ
Productivity and Business Processes	$37,146	$36,737	***36,829 - 37,105***	$409	$157,723	$155,047	$2,676
% growth y-o-y	*12.5%*	*11.3%*	*12% - 12%*	*124bps*	*13.0%*	*11.3%*	*177bps*
% y-o-y growth acceleration	*(0.4%)*	*(1.3%)*					
% growth q-o-q	*-0.7%*	*-1.5%*					
Intelligent Cloud	$39,976	$40,165	***40,265 - 40,566***	($189)	$179,510	$176,400	$3,110
% growth y-o-y	*29.4%*	*30.0%*	*30% - 31%*	*(61bps)*	*31.2%*	*29.1%*	*209bps*
% y-o-y growth acceleration	*1.2%*	*2.0%*			*2.5%*	*0.4%*	
Azure							
% growth y-o-y	*41.1%*	*41.0%*		*16bps*	*42.2%*	*40.7%*	*153bps*
% cc growth y-o-y	***41.2%***	***40.9%***	***40-41% cc***		***42.2%***	***40.5%***	*175bps*
More Personal Computing	$12,822	$13,159	***12,896 - 13,028***	($338)	$52,343	$53,142	($799)
% growth y-o-y	*-6.8%*	*-4.3%*	*-6% - -5%*	*(245bps)*	*-1.6%*	*-0.3%*	*(129bps)*
% y-o-y growth acceleration	*3.9%*	*5.0%*					
Total Revenue	$89,944	$89,840	***89,390 - 90,289***	$105	$389,577	$377,807	$11,771
% growth y-o-y	*15.8%*	*15.7%*	*15% - 16%*	*13bps*	*18.2%*	*15.1%*	*309bps*
% y-o-y growth acceleration	*1.0%*	*1.3%*					
% cc growth y-o-y	*15.9%*	*13.1%*			0.0%	14.5%	
Cost of Revenue	$31,403	$29,726			$138,889	$122,297	
Gross Profit	$58,541	$60,114	*59,512 - 60,114*	($1,572)	$250,688	$255,510	($4,821)
% margin	*65.1%*	*66.9%*	*~67%*	*(183bps)*	*64.3%*	*67.6%*	*(328bps)*
% y-o-y margin expansion	*(396bps)*	*(213bps)*			*(338bps)*	*(10bps)*	
Operating Income	$41,839	$42,496		($657)	$176,730	$178,228	($1,497)
% margin	*46.5%*	*47.3%*	*46-47%*	*(79bps)*	*45.4%*	*47.2%*	*(181bps)*
% y-o-y margin expansion	*(236bps)*	*(157bps)*			*(126bps)*	*55bps*	
EPS - Diluted NON-GAAP	$4.63	$4.63		($0.01)	$19.45	$19.40	$0.05
FCF	$13,986	$12,271		$1,716	$31,968	$29,749	$2,220
% margin	*15.6%*	*13.7%*		*189bps*	*8.2%*	*7.9%*	*33bps*

Note: We note expectations for items in the report we expect to be most significant in moving the stock on earnings

Source: Citi Research, Company Reports, FactSet

Microsoft Corp.

Valuation

Our $570 one-year target price for Microsoft is based on ~25x PE multiple to our FY28 GAAP EPS of $22.68, which we discount back to a year forward using ~12% cost of equity. We see the EPS multiple as a better valuation metric due to the more stable earnings growth for a mature company like MSFT and the ramp in near-term CapEx that result in a more volatile FCF. We see the S&P 500 average of 25x multiple as appropriate and justified given the durability of growth at MSFT and their leadership position in AI runway.

Risks

We see potential downside risks to achieving our target price to be:

• The aggressive ramp in CAPEX investment in midst of the ongoing build out of AI capabilities could hurt longer term trajectory if AI adoptions are slower than expected.
• Competition in the hyperscale cloud market, requiring MSFT to aggressively invest here vs. AMZN's AWS and GOOGL's GCP and potentially fast deceleration in key Azure trajectory.
• A larger acquisition that drives earnings dilution in the nearer term.