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Microsoft | North America

Recasting the Business for the AI Era

Microsoft's new reporting structure better reflects how the company manages its increasingly integrated cloud + AI business, while providing cleaner Azure disclosure and greater revenue visibility, with prior 1H27 Azure and FY27 M365 commercial cloud growth commentary unchanged.

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Microsoft (MSFT.O, MSFT US)

Software | United States of America

Stock Rating	**Overweight**
Industry View	**Attractive**
Price target	**$600.00**
Shr price, close (Sep 2, 2026)	$496.82
Mkt cap, curr (mm)	$3,697,096
52-Week Range	$553.72-349.20

Fiscal Year Ending	06/26	06/27e	06/28e	06/29e
EPS ($)**	17.94	19.66	24.06	30.11
Prior EPS ($)**	-	-	-	-
P/E	20.8	25.3	20.6	16.5
EPS ($)§	-	19.72	23.46	28.57
Div yld (%)	1.0	0.8	0.9	1.0

framework
** = Based on consensus methodology
§ = Consensus data is provided by Refinitiv Estimates

QUARTERLY EPS ($)

Quarter	2026	2027e Prior	2027e Current	2028e Prior	2028e Current
Q1	3.72	-	4.76	-	5.82
Q2	5.16	-	4.93	-	5.97
Q3	4.27	-	4.89	-	6.00
Q4	4.81	-	5.09	-	6.27

Key Takeaways

- New reporting structure better reflects how MSFT runs its increasingly integrated cloud + AI business, consolidating the three historical segments into two.
- Azure becomes a cleaner consumption KPI with quarterly revenue disclosure; the ~1pt growth change is mechanical, largely reflecting GitHub's reclassification...
- ...Which implied that GitHub's growth was higher than overall Azure, while its addition modestly lifts M365 Commercial Cloud's reported growth profile.
- Prior growth commentary is unchanged: Azure growth acceleration in 1H27 vs. 2H26 and M365 Commercial Cloud growth acceleration through FY27 remain intact.
- Broader segments reduce standalone margin visibility, making Microsoft Cloud GM an even more important read on underlying cloud profitability; reiterate OW.

Microsoft Resegments Around an Increasingly Integrated Cloud + AI Business. Microsoft announced a broad refresh of its external reporting structure (effective in FY27), consolidating its three historical operating segments (Productivity and Business Processes, Intelligent Cloud, and More Personal Computing) into two new segments: **1) Agents and Infra** and **2) Devices and Consumer**. Microsoft noted that the changes better align its external reporting with how the company manages the business, as the boundaries across infrastructure, applications and AI increasingly converge. Importantly, the changes primarily represent a reclassification of Microsoft's businesses rather than any incremental change to the underlying economics. A few key takeaways following the business re-classification:

1. **New Reporting Better Reflects How Microsoft Is Managing the Business.** Microsoft's historical distinction between Productivity & Business Processes and Intelligent Cloud has become increasingly less representative of a technology stack where infrastructure, applications and AI services increasingly operate together. **The new Agents and Infra** segment brings together Microsoft's commercial cloud and software businesses under a single reporting structure, while Devices and Consumer consolidates the company's consumer-oriented businesses. In our view, the change is largely strategically meaningful, as the company's reporting is increasingly

investors should be aware that the firm may have a conflict of

Research as only a single factor in making their investment decision.

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reflecting Microsoft's integrated approach to managing its commercial cloud and AI businesses rather than signaling a change in underlying fundamentals. *This is consistent with Microsoft's rationale for its 2024 disclosure changes, when the company similarly sought to align external reporting more closely with how it operated internally (see Microsoft: Right-Click on Disclosure Changes (9 Sep 2024)).*

2. **A 'Cleaner' Azure KPI, With the Underlying Growth Trajectory Unchanged.** The most important KPI change, in our view, is the removal of GitHub cloud and other developer cloud services from Azure, creating a more focused Azure revenue metric centered on cloud and AI consumption-based services. The change mechanically reduced historical Azure growth by ~1pt in F4Q26 (for example, see Exhibit 3), while Microsoft's updated F1Q27 Azure outlook similarly moves modestly lower under the new definition (see Exhibit 4). Importantly, **we view these changes as mechanical rather than indicative of a change in underlying Azure momentum, as Microsoft's prior commentary around an Azure growth acceleration in 1H27 vs. 2H26 remains unchanged**. Microsoft will also begin providing quarterly Azure revenue dollars, with the restatement pointing to FY26 Azure revenue of $101.9B, which we view positively given greater visibility into the absolute scale and incremental revenue growth of the business, especially with a potentially easier metric to compare against competitor cloud businesses. **Importantly, the reclassification also provides an incremental read-through on GitHub momentum.** With GitHub's removal mechanically reducing Azure growth while its addition increases M365 Commercial Cloud growth, the restatement implies GitHub has been growing faster than the overall Azure business. This puts GitHub's growth profile more in line with JFrog's faster-growing cloud business, which has more concentrated exposure to software development, vs. Atlassian's more diversified business mix (with roughly half of revenue tied to software development). *FROG is covered by Sanjit Singh.*
3. **M365 Commercial Cloud Growth Moves Slightly Higher Under the New Definition.** GitHub cloud and other developer services move into M365 Commercial Cloud under the new structure, contributing to the upward restatement of historical M365 Commercial Cloud growth (see Exhibit 3 Exhibit 3), while Security Copilot represents a relatively small component of the reclassification. Microsoft will also begin providing quarterly M365 cloud revenue dollars, with the new disclosure showing the business generated $100.3B of revenue in FY26. Importantly, Microsoft's prior commentary around M365 Commercial Cloud growth acceleration through FY27 remains unchanged, supported by Copilot, E7 and continued migration toward E5. However, the broader M365 construct further abstracts the contribution from individual products, including Copilot and GitHub. *This is similar to Microsoft's 2024 disclosure changes, when the broader M365 Commercial Cloud KPI increased the scale of the reported business while simultaneously reducing visibility into the standalone Copilot contribution.*
4. **Less Standalone Margin Visibility Is the Key Trade-Off.** The primary drawback from the new reporting structure, in our view, is reduced visibility into the profitability of Microsoft's individual businesses, as investors move



from gross and operating margin disclosure across three segments to two significantly broader segments without standalone equivalents for the underlying businesses. Agents and Infra in particular combines businesses with meaningfully different margin and capital-intensity profiles, which represents ~81% of FY26 revenue and ~88% of operating income, making it more difficult to isolate the underlying economics of individual products. **While Microsoft Cloud gross margin has already been a key metric for investors assessing the underlying margin profile of Microsoft's cloud businesses, we think it becomes an even more important reference point alongside Agents and Infra segment margins as some of the prior segment-level visibility goes away.** At the same time, we think the broader reporting structure is consistent with Microsoft's increasingly integrated allocation of infrastructure and engineering resources across its commercial businesses, making the economics of the overall platform increasingly relevant vs. individual legacy reporting buckets.

5. **Dynamics and LinkedIn Disclosures Become More Abstracted.** Microsoft's new structure also changes how investors will track Dynamics and LinkedIn, with Dynamics 365 and LinkedIn's business-process-oriented offerings moving into Industry Solutions, while LinkedIn's advertising-oriented businesses are grouped with Search and Advertising going forward. We think the new classifications are directionally consistent with Microsoft's effort to organize reporting around the underlying economic activity of each business, though the trade-off is reduced standalone visibility into Dynamics and LinkedIn growth trends.

Bottom line, underlying growth commentary is unchanged. While the new reporting structure meaningfully changes how to model and evaluate Microsoft's underlying businesses, we see little change to the fundamental outlook from the reclassification. Prior commentary around Azure growth acceleration in 1H27 and M365 Commercial Cloud acceleration through FY27 remains unchanged, while the changes to the respective growth rates largely reflect mechanical re-classifications. We view the cleaner Azure KPI and forthcoming quarterly Azure revenue disclosure positively, while reduced standalone margin and product-level visibility represent the primary trade-offs. **Taking a step back,** the debate around near-term AI infrastructure margins, capital intensity, and ROI is likely to persist, but we remain confident in Microsoft's ability to monetize this investment cycle and expand AI economics over time through higher capacity utilization, infrastructure, silicon, and model efficiencies, a richer mix of higher-value cloud and AI services, and broader Copilot and agent monetization across its installed base (as described in detail here: *Microsoft: Battle of the AI Stack: Infrastructure to Knowledge Workers – Azure and Copilot Are Set to Inflect*). We are not updating our estimates with this note, while we reiterate our OW rating and $600 PT.

Exhibit 1: Microsoft Moves From Three Reporting Segments to Two

Segment Structure

FY26 Segment Structure		FY27 Segment Structure	
Productivity and Business Processes		**Agents and Infra**	
Microsoft 365 commercial products and cloud services	Microsoft 365 commercial cloud	Azure	
	Microsoft 365 commercial products	Microsoft 365 cloud	Microsoft 365 commercial cloud
Microsoft 365 consumer products and cloud services	Microsoft 365 consumer cloud		Microsoft 365 consumer cloud
	Office consumer products	Productivity and server licensing	Server products
Dynamics products and cloud services	Dynamics 365		Microsoft 365 commercial products
	Dynamics products		Microsoft 365 consumer products
LinkedIn		Industry solutions	Industry solutions cloud
Intelligent Cloud			Industry solutions products
Server products and cloud services	Azure and other cloud services	Frontier and support services	
	Server products		
Enterprise and partner services			
More Personal Computing		**Devices and Consumer**	
Search advertising		Search and advertising	
XBOX	XBOX content and services	XBOX	XBOX content and services
	XBOX hardware		XBOX hardware
Windows and devices	Windows OEM and devices	Windows OEM and devices	
	Windows other		

Source: Microsoft FY27 Segments & Investor Metrics Presentation

Exhibit 2: Updated Segment Definitions

FY27 Metric Updates

As a result of the product and service reporting updates, the following metrics have been updated:

Azure revenue growth metric definition has been updated to reflect the move of GitHub cloud and other developer cloud services revenue, and the move of Security Copilot revenue to Microsoft 365 commercial cloud, as well as the move of Healthcare and Life Sciences cloud revenue to Industry solutions cloud

Microsoft 365 commercial cloud revenue growth metric definition has been updated to include revenue from GitHub cloud and other developer cloud services, as well as Security Copilot, which were previously reported in Azure

Microsoft 365 commercial seat growth metric definition has been updated to include paid GitHub seats

Industry solutions cloud revenue growth metric is created by combining revenue from Dynamics 365 together with revenue from LinkedIn Talent Solutions and Sales Solutions, which were previously reported in LinkedIn, as well as Healthcare and Life Sciences cloud which was previously reported in Azure

Search and advertising revenue (ex TAC) growth metric definition has been updated to include revenue from LinkedIn Marketing Solutions (ex TAC) and Premium Subscriptions which were previously reported in LinkedIn

Source: Microsoft FY27 Segments & Investor Metrics Presentation

Exhibit 3: Updated Segment Growth Levels

FY27 Investor Metrics

Restated metrics with impact from changes outlined in this presentation

As Restated

	2026				
	Q1	Q2	Q3	Q4	Fiscal Year
Azure revenue growth *(y/y)*	40% / 39%	39% / 38%	40% / 39%	42%	40%
Microsoft 365 commercial cloud revenue growth *(y/y)*	18% / 15%	17% / 15%	20% / 16%	16% / 15%	18% / 15%
Microsoft 365 commercial seat growth *(y/y)*	7%	7%	6%	7%	7%
Industry solutions cloud revenue growth (y/y)	11% / 9%	12% / 10%	14% / 10%	11% / 9%	12% / 10%
Search and advertising revenue (ex TAC) growth *(y/y)*	16% / 15%	13% / 12%	14% / 11%	13% / 12%	14% / 12%

As Reported

	2026				
	Q1	Q2	Q3	Q4	Fiscal Year
Azure and other cloud services revenue growth *(y/y)*	40% / 39%	39% / 38%	40% / 39%	43%	41% / 40%
Microsoft 365 commercial cloud revenue growth *(y/y)*	17% / 15%	17% / 14%	19% / 15%	14%	17% / 14%
Microsoft 365 commercial seat growth *(y/y)*	6%	6%	6%	6%	6%
Dynamics 365 revenue growth (y/y)	18% / 16%	19% / 17%	22% / 17%	13% / 12%	18% / 15%
LinkedIn revenue growth *(y/y)*	10% / 9%	11% / 10%	12% / 9%	12% / 10%	11% / 9%
Search advertising revenue (ex TAC) growth *(y/y)*	16% / 15%	10% / 9%	12% / 9%	10% / 9%	12% / 10%

***LinkedIn was** previously reported as a standalone unit in the Productivity and Business Processes segment. LinkedIn Talent Solutions and Sales Solutions will now be reported in the Industry solutions cloud revenue growth metric. LinkedIn Marketing Solutions and Premium Subscriptions will now be reported in the Search and advertising revenue (ex TAC) growth metric. Quarterly growth rates include non-GAAP CC growth (GAAP % / CC %).*

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Source: Microsoft FY27 Segments & Investor Metrics Presentation

Exhibit 4: Outlook Provided on 4Q26 EPS Reiterated

FY27 Q1 Outlook Detail

We will report our FY27 Q1 results in the structure discussed on the prior slides. Therefore, we have provided mechanical adjustments only to our outlook as provided on July 29, 2026, for the changes discussed in this presentation.

As provided July 29, 2026		Adjusted Outlook	
Commercial Business		**Agents and Infra**	
Commercial bookings	• Healthy growth on a growing expiry base when adjusted for OpenAI contracts in the prior year	Commercial bookings	• No change to outlook
Microsoft Cloud gross margin percentage	• Relatively stable quarter-over-quarter	Microsoft Cloud gross margin percentage	• No change to outlook
Productivity and Business Processes		Azure revenue	• Growth of 44% to 45% in constant currency, with FX expected to decrease revenue by less than 1 point
Microsoft 365 Commercial cloud revenue	• Growth of approximately 15% in constant currency • Growth of approximately 16% in constant currency when adjusting for prior-year in-period revenue recognition	Microsoft 365 commercial cloud revenue	• Growth of approximately 17% in constant currency • Growth of approximately 18% in constant currency when adjusting for prior-year in-period revenue recognition
Microsoft 365 Commercial products revenue	• Growth in mid-single digits	Microsoft 365 consumer cloud revenue	• No change to outlook
Microsoft 365 Consumer cloud revenue	• Growth in the mid-teens	Productivity and server licensing revenue	• Decline in low-single digits
LinkedIn revenue	• Growth in high-single digits	Industry solutions cloud revenue	• Growth in high-single digits
Dynamics 365 revenue	• Growth in low-teens		
Intelligent Cloud			
Azure and other cloud services revenue	• Growth of approximately 45% in constant currency		
Server products revenue	• Decline in low- to mid-single digits		
More Personal Computing		**Devices and Consumer**	
Search advertising revenue (ex TAC)	• Growth in mid-single digits	Search and advertising revenue (ex TAC)	• Growth in mid- to high-single digits
XBOX revenue	• Content and services revenue expected to decline in mid-single digits • Hardware revenue should decline year-over-year	XBOX revenue	• No change to outlook
Windows OEM and Devices revenue	• Decline in low-twenties	Windows OEM and devices revenue	• No change to outlook

Source: Microsoft FY27 Segments & Investor Metrics Presentation

Valuation Methodology and Risks

Microsoft (MSFT.O)

25x Base Case FY28e EPS of $24.06. 25x PE is a slight premium to large cap software peers, 1.2x PEG is a discount to MSFT historical PEG and large-cap software peers.

Risks to Upside

- Cloud adoption accelerates, with Azure as convincing winner
- AI leadership results in substantial revenue contribution over-time
- Operational efficiencies leading to greater than anticipated economies of scale and margin expansion

Risks to Downside

- Weak macro impacting IT spending
- On-premises cannibalization by Cloud
- Increased investments hurt margin expansion
- AI adoption proves limited