Microsoft

Takeaways from a Discussion with a Large Global IT Distributor on Copilot Adoption and Azure Consumption

Overweight

MSFT, MSFT US
Price (05 Oct 26):$525.18

Software - Large Cap / Mid & Small Cap

Samik Chatterjee, CFA [AC]
(1-212) 622-0798
samik.x.chatterjee@jpmorgan.com

Jaiden R Patel
(1-212) 270-6953
jaiden.patel@jpmchase.com

Brian Hyska
(1-212) 622-2883
brian.hyska@jpmchase.com

Mashu Nishi
(1-212) 622-0078
mashu.nishi@jpmorgan.com
J.P. Morgan Securities LLC

We recently hosted a call with a Director at a large global IT distributor and Microsoft CSP partner to collect feedback on Copilot adoption, the relaunched Copilot lineup, and Azure consumption trends. Key takeaways from the discussion include:

- **Copilot seat penetration is expected to rise ~7x by Microsoft's fiscal year-end.** Penetration sits at ~5% of the partner's total M365 seats, given a heavy mix of kiosk, E1, and Business Basic seats in SMB and SMC, but at 7%-10% of Copilot-eligible seats. The partner expects 7x current penetration by the end of Microsoft's fiscal year, or roughly 30% of the base, on seat growth alone with consumption on top, and noted the expectation is global and consistent with conversations with peers in the industry. In his view, about 70% of that growth should come from resellers that already have five or more Copilot implementations, with the balance from activating newer resellers. Per the partner, Copilot is being added on top of customers' use of the frontier labs rather than displacing them.
- **The Copilot relaunch and free trials are removing the main friction to adoption.** Confusion over which Copilot to use, and whether it is free, licensed, or metered, had been holding back adoption, and per the partner, the new lineup is now "crystal clear", with Copilot Chat free, Chat grounded in Work IQ a paid seat, and Cowork and Code are metered. At the same time, Microsoft's 25 free licenses for 30 days let partners prove the business case before the customer pays, which helps address what the partner acknowledged is "some AI skepticism." He has seen purchasing shift from three to five licenses specifically for boards and senior managers to purpose-driven packs of 10-20 seats, and the trials are now moving the conversation from how many seats to buy toward which departments to bring onto Copilot.
- **Power users are already moving into Cowork, with Cowork and Code to lead consumption.** Almost half of Copilot power users (those using it more than 15 days a month) are already prompting Cowork according to the partner, pointing to a direct correlation between seat adoption and metered consumption. Usage billing by default, now delayed from November to December, removes the need for customers to set up a separate Azure subscription to access metered capabilities. That said, governance and cost control are a concern, with the partner noting that metered AI is effectively "giving the key to our bank account to users," though he notes that when governance is addressed, customers shift from disbelief towards empowerment. In his view, over the next 12 months, Cowork and Code should drive incremental consumption, with Autopilot a later step for users who have already adopted Cowork.
- **Renewal recapture is trending to 130%-140% as Microsoft favors growth over renewal.** About 40% of the partner's renewals fall between January and March, and the partner expects renewal revenue recapture of 130%-140% this year versus a ~125% baseline, driven by Copilot seat and consumption expansion. On discounting, Microsoft sets list price guidance and partners are

See page 3 for analyst certification and important disclosures.

free to discount from their own margin, while Microsoft's incentives for partners are clearly weighted toward growth rather than maintaining the existing base. Additionally, the July M365 price increase drew no real pushback from the partner's customers, with a June pull-forward and a softer July before trends normalized in August.

- **E7 is lifting upgrades across the stack and expanding the Copilot-eligible base.** The partner notes that E7 adoption is limited to early adopters so far, but its launch has created "FOMO" in SMB now that E5 or Business Premium is no longer the top tier. Upgrades from Business Basic to Premium and from E3 to E5 have "rapidly accelerated," and Copilot-eligible seats have "increased drastically" since the announcement, which the partner cited as one of the reasons behind the 7x expectation.
- **Azure growth has been "like a spaceship," with Fabric pulling through ~5x its own spend.** The partner notes that Fabric is still growing more than 200% y/y, from ~500% y/y in its early years, and his internal studies show about $5 of incremental spend in an account associated with every $1 of spend with Fabric, as customers place the next workload next to their data to minimize egress. He sees accounts with AI workloads, primarily Fabric or Foundry, growing about twice as fast as those without, with AI acting as a precursor to growth in databases, data warehouses, and other workloads.
- **Foundry has taken model choice off the table, and there are no capacity constraints.** With model selection now embedded through Foundry, the model is "no longer a topic of conversation" according to the partner. While customers can now buy OpenAI directly, the partner sees three reasons to keep buying through Microsoft: one bill, drawdown against existing consumption commitments, and governance and usage monitoring within Foundry. On Azure, the partner has seen no customer capacity constraints, and rather only timing differences in regional availability, and no recent Azure pricing actions. He notes that sovereignty now comes up in day-to-day conversations, but the partner has yet to see it drive the choice between Microsoft and alternatives.
- **2027 budgets should accelerate, with the pace of change the only concern.** Customers that have moved from AI experimentation to AI value should see accelerating IT budgets in 2027 according to the partner, while skeptics should see roughly flat spend plus inflation, though overall pointing to an acceleration. The partner's only concern is the speed and volume of change at Microsoft across products, incentives, programs, and customer relationships, which is leaving partners feeling "reactive rather than proactive," even while being fully aligned with the direction Microsoft has taken.

