Microsoft

F1Q27 Preview: Execution on Azure and M365 Commercial Cloud Upsides to Drive Estimate Revisions, Along with Focus on Capex Trajectory; Reiterate OW

Overweight

MSFT, MSFT US
Price (21 Oct 26):$532.95

Software - Large Cap / Mid & Small Cap

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Microsoft reports F1Q27 (Sep-Q) on October 28th, with investor conversations pointing to much better sentiment on the shares heading into the print with investors expecting the momentum in the keenly watched areas of Azure growth as well as M365 Commercial Cloud to continue. With Microsoft about to report under its new segment structure, investors are looking for better clarity on Azure growth, and we expect Azure growth to track ahead of the updated guide of 44-45% CC, which side-by-side with our expectations for a better-than-consensus outcome for M365 Commercial Cloud will reinforce the bull thesis around compute efficiencies and strong execution supporting a broad-based acceleration in growth. For the quarter itself, in addition to the watch point in relation to Azure growth, we expect investors will focus on Copilot seat additions (which tracked to 10M last quarter) as well as Agents & Infra operating margins where the expectations are for resilience on the confluence of side-by-side ramps in both Azure and M365 Cloud. However, share price reactions might be influenced more by the outlook rather than the quarter itself, with the watchpoints centering on: 1) Sustainability of Azure upsides through execution and the flow-through of recent upsides to the F2Q27 outlook, including buyside expectations for 100-200 bps growth acceleration q/q along with continued pace of capacity additions at or better than ~1GW per quarter; 2) the M365 Commercial Cloud revenue growth trajectory, which is already guided to accelerate to ~17% y/y in CC from 15% CC in F4Q26, led by E5/E7 and Copilot mix, and expectations are for strong pace of Copilot seat adds to translate into acceleration in growth in the coming quarters on top of the beat expected in F1Q; 3) Copilot seat adds have a high bar from the 10M seat adds last quarter, but our latest checks with a global channel partner are pointing to a robust pace of additions in the coming quarters and supporting expectations for accelerations in M365 Commercial Cloud revenue growth to continue; and 4) FY27 capex guide, which we expect will be issued in conjunction with an outlook for Azure growth through the year, for an estimated ~$210B vs. the ~$175B outlook for CY26. While we appreciate a modestly higher bar following the rally in the shares since June, we expect the continued progress in relation to acceleration in Azure and M365 Commercial Cloud in conjunction with a still inexpensive ~25x P/E multiple keeps adequate room for upside for the shares. We reiterate our Overweight rating and Dec-27 price target of $625.

- **F1Q27 (Sep-end) Results: Expect revenue modestly above the midpoint of guidance, led by Azure.** We forecast F1Q revenue of $90.5B (+17% y/y), modestly above the midpoint of the guided range and vs. consensus of $90.6B. Within this, we expect A&I (Agents and Infra) revenue of $75.6B (+23% y/y), driven by Azure revenue of $32.2B (+44% y/y reported), with upside from continued efficiency gains, and M365 Commercial Cloud revenue of $25.6B (+17% y/y reported). The key watchpoints for investors will be in relation to beats to Azure growth guidance and M365 Commercial Cloud revenue growth, as well as forward commentary in relation to acceleration on both fronts. We

See page 3 for analyst certification and important disclosures.



forecast D&C (Devices & Consumer) revenue of $14.9B (-7% y/y), near the midpoint of the $14.7-15.2B guide, on both pricing led volume elasticity as well as Windows 10 end-of-support comparable. We forecast gross margins of 67.2%, which along with opex of $16.8B translates into operating margins of 48.6% and EPS of $4.71 (+14% y/y) vs. consensus of $4.73. We forecast total capex including finance leases of $50B, in line with the guide for over $50B.

- **F2Q27 (Dec-end) Guidance: Continued acceleration in both Azure and M365 Commercial Cloud key to the outlook.** We forecast F2Q revenue of $96.2B (+18% y/y) vs. consensus of $95.7B, driven by A&I revenue of $79.7B (+24% y/y), with Azure growth of +44.5% y/y, consistent with management's framing of H1 growth accelerating vs. 2H FY26, and M365 Commercial Cloud growth of +18% y/y, also consistent with guidance for acceleration through the year. We expect the key for investors will be continued acceleration on both fronts, despite a higher bar following the likely beats in relation to both in F1Q27; beyond the H1 framing provided so far, we expect management to outline expectations for continued strength in Azure growth through the year, supported by a step-up in capacity.
- **FY27 (Jun-end) Outlook: Capex guide and Copilot seat ramp to support expectations in relation to estimate revisions to out-years.** We expect a FY27 capex guide of ~$210B (including finance leases), with incremental capacity, including the ramp of Maia 300 into 2027, positioned to support revenue growth across Azure and Copilot from the same fungible fleet. Our FY27 revenue forecast of $393B (+18% y/y) comprises expectations of Azure revenue of $146B (+43% y/y) and M365 Commercial Cloud revenue of $109B (+18% y/y). We view upside to M365 Commercial Cloud in the out-years as the key variable for estimates, supported by strong ramp in Copilot adoption, with substantial flow-through of revenue upside to profit on account of the higher margins for M365 Commercial Cloud.