Microsoft Corp.

Azure/OpenAI Drives the Upside

Equities

United States
Software

12-month rating **Buy**

12m price target	**US$700.00**
	Prior : US$675.00
Price (28 Oct 2026)	**US$546.45**

RIC: MSFT.O **BBG:** MSFT US

Trading data and key metrics

52-wk range	US$546.45-352.83
Market cap.	US$4,069b
Shares o/s	7,446m (COM)
Free float	90%
Avg. daily volume ('000)	25,212
Avg. daily value (m)	US$12,560.3
Common s/h equity (06/27E)	US$594b
P/BV (06/27E)	6.8x
Net debt to EBITDA (06/27E)	NM

EPS (UBS, diluted) (USD)

	06/27E			
	From	To	% ch	Cons.
Q1	4.86	4.92	1	4.73
Q2E	4.90	5.01	2	4.84
Q3E	4.99	5.06	1	4.90
Q4E	5.18	5.30	2	5.17
06/27E	19.94	20.30	2	19.75
06/28E	23.63	24.15	2	23.54
06/29E	27.58	28.27	2	29.04

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Summary

Despite high expectations into the print (Microsoft shares were a consensus long), the company delivered a solid beat, marked by an Azure beat (1Q/2Q actual/guide of 48%/50% relative to expects of 47%/47%), a reaffirm (no raise) of the CY26 capex guide excluding the impact of a 3P capacity delay and total revs/EPS actuals and guide that landed above our estimates. Microsoft shares were a defensive play into the print and are even more so post the print (given misses elsewhere). We are Buy-rated.

Azure and M365/Copilot Narratives Improve

The Azure upside had a few sources, but one key one to call out was the strength of OpenAI in the quarter, which correlates to higher Azure growth via strong Astra AI model sales that get distributed via Azure. Given that OpenAI is now 30%+ of Azure revs (higher accounting for indirect sales), Azure growth could be more variable depending on large lab customer growth. We're raising our FY27 Azure growth estimates and are now modeling an exit 4Q growth rate of 47%, up from our previous estimate of 43%. The Azure print was a solid read to cloud infra peers but note that if a key driver was OpenAI health, that is more idio to Microsoft near-term. We believe that the M365 upside (a 1-point beat) was rooted in the price increases and solid premium SKU sales, with Microsoft moving away from Copilot seat disclosures (not provided) to revs/usage color.

Capex, Margins and External Financing

We'd note: 1. Capex estimates for CY26 were trimmed slightly ($175b to $170b) but entirely for a 3P capacity delay into 1H CY27 (second straight quarter of no raise). For the Mar/Jun quarters, Microsoft signaled higher capex (a relief for semis investors). 2. Microsoft did not change its guide for OMs to be down 100bps in FY27, and margin/EPS control remains very high. 3. Sensitive to Meta's recent equity raise, investors reacted negatively to Microsoft's comment about being open to external funding sources but post our call-back, we believe that the likelihood of an equity raise is very low.

Valuation:

At CY27E multiples of 24x GAAP EPS and 22x non-GAAP EPS, we still view the stock as being reasonably priced, given growth accelerations in both Azure and M365, strong EPS control and little need for external funding. We're raising our PT to $700 from $675, based on an assumed CY28 non-GAAP EPS multiple of 23x (prior 25x) our raised CY28 estimates, a deserved premium to the peer group.

Highlights (US$m)	06/24	06/25	06/26	06/27E	06/28E	06/29E	06/30E	06/31E
Revenues	245,122	281,724	331,838	399,087	479,658	568,255	660,378	756,802
EBIT (UBS)	109,433	128,528	155,236	188,496	223,459	260,538	298,064	336,920
Net earnings (UBS)	89,782	105,591	128,785	150,900	178,861	208,498	238,492	269,550
EPS (UBS, diluted) (US$)	12.02	14.14	17.28	20.30	24.15	28.27	32.47	36.84
DPS (net) (US$)	2.98	3.28	3.61	3.97	4.37	4.80	5.28	5.81
Net (debt) / cash	23,913	51,414	36,549	28,007	37,362	54,016	80,827	127,909
Profitability/valuation	**06/24**	**06/25**	**06/26**	**06/27E**	**06/28E**	**06/29E**	**06/30E**	**06/31E**
EBIT (UBS) margin %	44.6	45.6	46.8	47.2	46.6	45.8	45.1	44.5
ROIC (EBIT) %	60.4	50.7	48.0	42.0	36.0	31.8	28.7	26.3
EV/EBITDA (UBS core) x	20.8	18.9	16.7	16.4	13.1	10.8	9.0	7.6
P/E (UBS, diluted) x	31.5	30.0	26.6	26.9	22.6	19.3	16.8	14.8
Equity FCF (UBS) yield %	2.6	2.3	2.0	0.8	0.7	0.8	1.2	1.8
Dividend yield (net) %	0.8	0.8	0.8	0.7	0.8	0.9	1.0	1.1

Source: Company accounts, LSEG Eikon, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of US$ 546.45 on 28-Oct-2026 19:30:35 EDT

This report has been prepared by UBS Securities LLC. **ANALYST CERTIFICATION AND REQUIRED DISCLOSURES, INCLUDING INFORMATION ON THE QUANTITATIVE RESEARCH REVIEW PUBLISHED BY UBS, BEGIN ON PAGE 9.**

Our View of the Numbers

Overall, the 1Q/Sept quarter was marked by a modest $500 million beat relative to our estimate, with total revs landing at $92.3 billion (+19% in c/c) and the 2Q/Dec revs guide of $97.1 billion (+19%) at the high end landing a shade above our $96.9 billion estimate, but solidly above assuming a normal beat. Much of the upside came from Azure (the right place, quality beat) so let's start there.

Azure Growth of 48% is an Upside Surprise

The 1Q/Sept c/c Azure growth of 48% was a full 6-point acceleration from 4Q/Jun Azure growth of 42% and a point above what we described as a 47% investor bogey. Azure growth of 48% in 1Q/Sept implies sequential dollar adds of $3.7 billion, an all-time record by a wide margin. Microsoft guided to c/c Azure growth of 49-50% in 2Q/Dec, comfortably above the buy-side bogey of ~47% and implying sequential dollar adds of $3.0 billion, lower but still very strong and suggesting some upside potential. Beyond 2Q/Dec, Microsoft did not confirm whether Azure growth would KEEP accelerating to 50%+. Rather, the reminder that the y/y comps get tough in the Mar/Jun 2027 quarters could have been a gentle reminder to NOT get carried away and assume a continued strong acceleration.

Microsoft cited several drivers/moving pieces:

- **Rev Rec'ing OpenAI Sales:** We've argued for some time (see our "Hyperscaler Bull Case" report from June 2026 here) that the extraordinary ramp in hyperscaler revs growth and sequential dollar adds stems in part from enterprises procuring AI models/products through AWS, Azure and Google Cloud and the CSPs rev rec'ing this activity. When Microsoft said that "token pricing improved", we believe this means that sales of OpenAI's Astra model (premium-priced) through Azure were VERY strong, as they are expected to be in 2Q/Dec as well. This is a reminder that Microsoft has very high exposure to OpenAI ($10b of 1Q/Sept revs or 30% of Azure) and as Microsoft said, "when OpenAI is healthy, it's good for Azure". Much of this lands in Foundry, hence the strong Azure Foundry growth color. Where we need to be careful is if in CY27, a) Astra pricing declines and/or b) OpenAI doesn't have a "hit", making for tough sequential compares. In our view, the Azure beat cadence has widened in recent quarters because of the challenge in estimating the OpenAI uplift and is perhaps a rationale for Microsoft to embed slightly more conservatism in its Azure guide going forward. Given that OpenAI is accessed predominantly through Azure, Astra success wouldn't have the same impact on AWS growth.
- **OpenAI Revs Share:** The other way in which OpenAI health translates to Azure uplift is via the OpenAI revs share to Microsoft, but consistent with the last few quarters, Microsoft did not explicitly point to the revs share as a source of Azure upside.
- **3P Allocation:** Microsoft signaled that via "engineering efficiency" gains, they increased the throughput per GW of capacity and were able to monetize more capacity via Azure. Again, we need to be careful not to extrapolate too linearly into CY27, as Microsoft may need more incremental capacity in CY27 for 1P needs if/as Copilot usage continues to ramp.
- **Capacity Adds:** After disclosing that it stood up 1 GW of capacity in each of the 3 previous quarters, Microsoft did not give a capacity add disclosure this call. We pressed, and Microsoft indicated that a) adds can be lumpy by quarter and b) it doesn't want investors to get too anchored in GWs of capacity added as an input to Azure growth, as there are other variables such as the 1P-3P mix. Microsoft implied that the guide for 2Q/Dec Azure growth of 49-50% would have been even higher but for the 3P capacity delays into the Mar/Jun 2027 period.

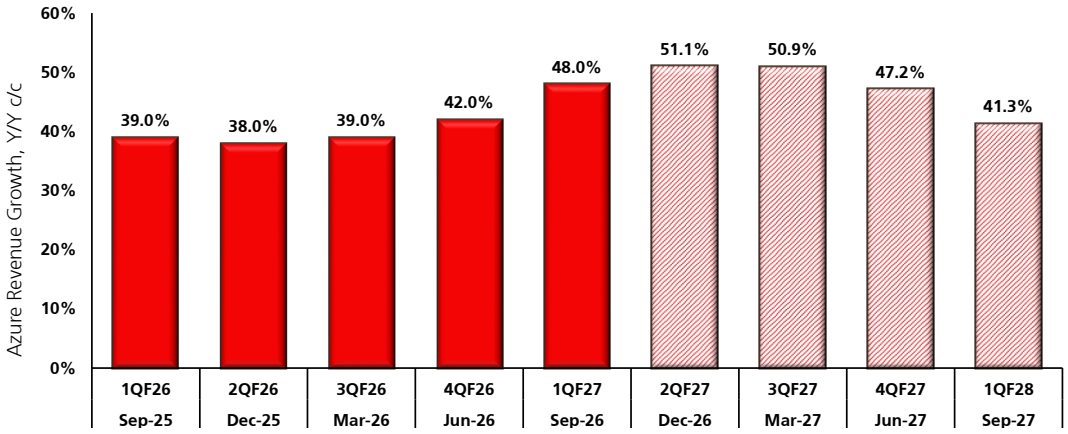


- **Tough Comps:** Microsoft appeared to go out of its way to highlight tougher y/y Azure growth compares in the Mar/Jun quarters, as if to signal investors not to extrapolate too linearly from the last few quarters of acceleration. Combined with language about the need for 1P capacity, lumpiness in GW of capacity adds and how upside in lab success one quarter may not persist, we concluded that Microsoft was attempting to keep Azure growth expects in check for the Mar/Jun 2027 quarters.

Bottom Line – Azure Estimates Moving Up

Reflecting on all the above, we are raising our Azure estimates, as shown below. We now assume a 2Q/Dec 2026 growth rate of 51%, up from our previous estimate of 47%.

Figure 1: UBS c/c Azure Revenue Growth Estimates

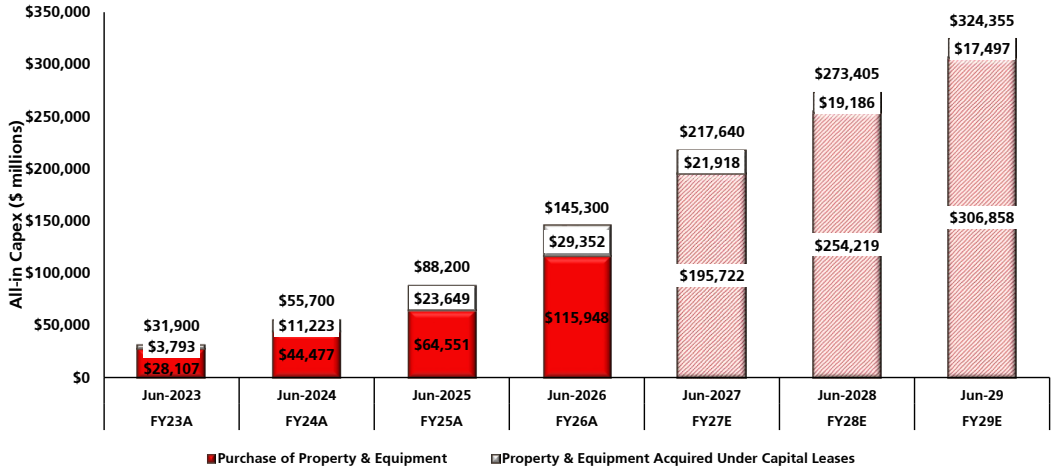


Source: Company filings, UBSe

Still-Strong Capex Signals

Microsoft had guided to capex of $50+ billion in 1Q/Sept and at $45 billion, capex fell short. Microsoft cited capacity go-live delays with a 3P partner (we assume a neo-cloud partner), with this capacity and related capex moving into 1H CY27. This explains the entire trim in the CY26 capex guide from $175 billion to $170 billion, although adjusted for this, it implies of course that (for the second straight quarter), capex estimates did not go up. That said, Microsoft signaled still-strong and higher capex (above $50 billion/ quarter) for the Mar/Jun 2027 quarters given strong demand, hardware inflation and the delayed 3P capacity (this may come as a relief to semis investors). Net, we're raising our FY27 capex estimate from $213 billion to $218 billion (implying y/y capex growth of 50%).

Figure 2: Revised All-In Capex Estimate



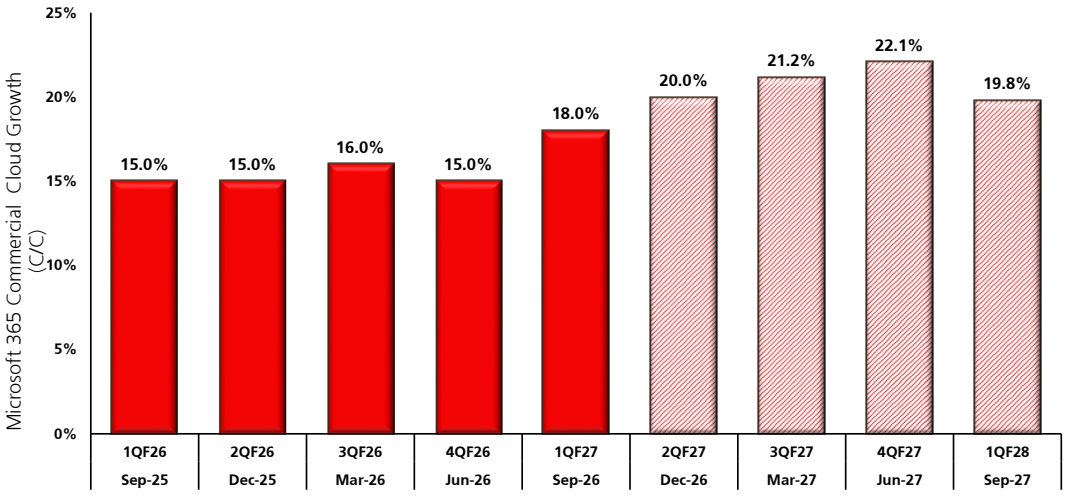
Source: Company filings, UBSe

M365 Segment Revs Estimates

The results and outlook for the big M365 Commercial Cloud segment were solid, with 1Q/Sept c/c revs growth landing at 18%, a point above the guide. Microsoft guided to M365 growth of 19% in 2Q/Dec, a slight acceleration, and reaffirmed the guide for this segment to accelerate again in the Mar/Jun quarters. Under the hood, there are a few moving pieces:

- **Usage Pricing:** The revs growth boost from the shift of GitHub Copilot to a hybrid seat/usage pricing model remains material, but Microsoft cautioned that the growth rate boost from usage pricing across the (non-coding) Copilot suite would take much longer. We had been thinking about a 1H CY27 boost but it may take a bit longer than that.
- **Seat Growth of 5%:** This compares to 5-7% in previous quarters, with Microsoft citing some internal/GTM execution issues on E3 sales (not on the premium E5/E7 sales, which were strong). That said, combined with still-tough D365 CRM sales, Microsoft's decision not to disclose Copilot seats as well as other apps firms (notably ServiceNow this evening) posting mixed results, this certainly doesn't boost sentiment about seat-based SaaS demand.
- **Security Uplift:** Microsoft sounded bullish about the potential for strong AI security demand to drive E5/E7 traction, which would be a source of uplift to M365 segment growth, an opportunity that we expect management to lean into during the Nov 17/18 Ignite investor meetings.
- **No Copilot Seat Disclosure:** We didn't get an update to the 30m paid Copilot seat disclosure from 4Q/Jun, with Microsoft explaining that a) it's not a KPI that they committed to disclosing each quarter and b) revs and usage are better barometers of Copilot health than seats (we agree).

Figure 3: UBS M365 Commercial Cloud Segment Estimates



Source: Company filings, UBSe

Other Observations

- **The Margin Story Was Solid:** Microsoft again beat our 1Q/Sept estimates on OMs (49.8% versus our 49.2% estimate) and GMs (67.8% versus our 67.6% estimate). While Microsoft did not explicitly reaffirm its guide for FY27 OMs to be -100ps y/y, the message was "no change to the guide". This is despite some incremental pressure in high-GM segments such as Windows OEM. Note that Microsoft is embedding some separation expenses related to its just-announced VEOs (voluntary exit offers) in its 2Q/Dec opex growth guide as well as COGS guide.

- **Low Chance of an Equity Offering:** The inclusion of language expressing the potential to access external financing markets was perhaps the only setback on the call, as it triggered concerns that Microsoft could, a la Meta, do an equity offering to fund capex despite the reaffirmed guidance to be FCF positive in FY27. We asked Microsoft and came away concluding that an equity raise has a very low probability (it would be unusual to buy back equity in 1Q/Sept and then turn around and issue equity in 2Q/Dec), but that a debt raise is possible at the right terms (we have no issues with this).

Valuation and Stock Sentiment

At the after-market price, Microsoft shares trade at CY27E multiples of 24x GAAP EPS and 22x non-GAAP EPS. In our view, Microsoft shares deserve an EPS multiple premium based on the emerging AI opportunity and the company's strong execution. If Azure can sustain anything close to 50% growth and margins remain stable, then the valuation multiples appear reasonable and we remain BUY-rated. We're raising our PT to $700 from $675 , based on an assumed CY28 non-GAAP EPS multiple of 23x (prior 25x) our raised CY28 estimates, a deserved premium to the peer group.

Figure 4: Peer Group Valuation

		Stock Price	% Change	Market	Revenue Growth			EV/FCF		Non-GAAP P/E	
Company	**Ticker**	**10/28/2026**	**YTD**	**Cap ($M)**	**MRQ**	**CY27E**	**CY28E**	**CY27E**	**CY28E**	**CY27E**	**CY28E**
Atlassian Corp.	TEAM	$220.12	36%	$55,647	27.6%	15.1%	18.3%	24.1x	20.6x	33.3x	28.0x
SAP SE	SAP	€236.93	(2%)	€274,591	13.2%	12.0%	12.0%	23.6x	20.6x	28.0x	23.6x
ServiceNow, Inc.	NOW	$123.00	(2%)	$128,289	20.5%	18.2%	17.1%	18.0x	14.6x	26.4x	21.6x
Microsoft Corp.	MSFT	$546.45	13%	$4,076,517	18.8%	18.7%	17.9%	NM	NM	22.0x	18.3x
Amazon.com, Inc.	AMZN	$254.60	10%	$2,776,430	19.6%	14.8%	14.2%	NM	NM	22.3x	17.8x
Alphabet Inc.	GOOGL	$324.89	4%	$4,018,240	24.7%	25.2%	21.3%	NM	NM	21.2x	17.7x
Autodesk, Inc.	ADSK	$242.38	(18%)	$51,263	16.1%	11.5%	10.1%	16.5x	14.4x	17.4x	14.9x
Workday, Inc.	WDAY	$204.36	(5%)	$50,335	12.8%	10.1%	9.4%	13.2x	11.8x	15.6x	14.4x
Salesforce, Inc.	CRM	$242.11	(9%)	$198,772	10.8%	10.0%	10.9%	13.3x	11.7x	14.4x	12.4x
Oracle Corporation	ORCL	$144.54	(26%)	$474,103	29.6%	40.2%	43.8%	NM	NM	16.1x	11.1x
Intuit, Inc.	INTU	$328.19	(50%)	$89,268	13.7%	9.5%	9.1%	9.5x	8.7x	10.9x	9.9x
Adobe, Inc.	ADBE	$249.76	(29%)	$98,755	12.9%	9.5%	8.4%	8.6x	7.9x	8.7x	7.5x
Mean:			**-8%**		**18.3%**	**16.0%**	**15.9%**	**15.9x**	**13.8x**	**19.5x**	**16.3x**
Median:			**-5%**		**16.1%**	**12.0%**	**12.0%**	**14.9x**	**13.1x**	**17.4x**	**14.9x**

Source: FactSet, UBSe, Visible Alpha

Forecast returns

Forecast price appreciation	28.1%
Forecast dividend yield	0.8%
Forecast stock return	28.9%
Market return assumption	9.7%
Forecast excess return	19.2%

Valuation Method and Risk Statement

We value Microsoft on a relative P/E multiple on CY28 estimates. Key risks for Microsoft include the IT spending environment, the pace of decline in legacy businesses relative to growth in newer Cloud-centric businesses, the required capex investment needed to build Cloud datacenters, competitive pressure from Cloud-native leaders like Amazon and Google, and legal and regulatory risk given Microsoft's dominant position in PC operating systems and productivity applications. Microsoft operates in the technology industry which also sees rapid change and innovation, and the company's market opportunity could change rapidly if technology and demand preferences shift in an unanticipated direction.

Quantitative Research Review

UBS Global Research publishes a quantitative assessment of its analysts' responses to certain questions about the likelihood of an occurrence of a number of short term factors in a product known as the 'Quantitative Research Review'. The views for this month can be found below. Views contained in this assessment on a particular stock reflect only the views on those short term factors which are a different timeframe to the 12-month timeframe reflected in any equity rating set out in this note. For previous responses please make reference to (i) previous UBS Global Research reports; and (ii) where no applicable research report was published that month, the Quantitative Research Review which can be found at https://neo.ubs.com/quantitative, or contact your UBS sales representative for access to the report or the Quantitative Research Team on ubs-quant-answers@ubs.com. A consolidated report which contains all responses is also available and again you should contact your UBS sales representative for details and pricing or the Quantitative Research Team on the email above.

Microsoft Corp.

Question	Response
1. Is the industry structure facing the firm likely to improve or deteriorate over the next six months? Rate on a scale of 1-5 (1 = getting worse, 3 = no change, 5 = getting better, N/A = no view)	5
2. Is the regulatory/government environment facing the firm likely to improve or deteriorate over the next six months? Rate on a scale of 1-5 (1 = getting tougher 3 = no change, 5 = getting better, N/A = no view)	N/A
3. Over the last 3-6 months in broad terms have things been improving/no change/getting worse for this stock? Rate on a scale of 1-5 (1 = getting a lot worse, 3 = not much change, 5 = getting a lot better, N/A = no view)	5
4. Relative to the current CONSENSUS EPS forecast, is the next company EPS update likely to lead to: (1 = negative surprise vs consensus, 3 = in-line with consensus, 5 = positive surprise vs consensus expectations, N/A = no view)	4
5. What's driving the difference?	
6. Relative to YOUR current earnings forecast, is there relatively greater risk at the next earnings result of:(1 = downside skew risk to earnings, 3 = equal upside or downside risk to earnings, 5 = upside skew risk to earnings, N/A = no view)	4
7. What's driving the difference?	
8. Is there an upcoming catalyst for the company over the next three months?	No Catalyst
9. Is there an actual or approximate date for the catalyst?	
10. Is the catalyst date an actual or approximate date?	
11. What is the catalyst?	