Microsoft (MSFT US)

Robust cloud revenue growth with enhanced monetization in AI-empowered products

Microsoft reported (30 Oct HKT) 1QFY26 (June year-end) results: revenue was US$77.7bn, up 18.4% YoY (4QFY25: +18.1% YoY), 3% better than both our forecast/Bloomberg consensus estimates, driven by an all-round beat in all three business segments. Net profit was up 12.5% YoY to US$27.7bn, 2%/1% better than our forecast and consensus. Excluding the earnings impact from investment in OpenAI, EPS would grow 23% YoY. In the print, Microsoft demonstrated its ability in delivering robust cloud revenue growth with high operating efficiency, and in driving incremental monetization from AI features of Copilot services, in our view. Azure and other cloud services revenue growth came in at 40% YoY in 1Q, driven by ongoing strong demand, ahead of previous guidance of 37%. Management highlighted that overall commercial bookings increased 112% YoY in 1Q, and commercial RPO increased to US$392bn (up 51% YoY) with weighted average duration staying relatively stable at c. 2 years, which in our view speaks to ongoing strong demand and decent monetization potential to support revenue growth in the coming quarters. Meanwhile, the 2.3ppts YoY expansion in OPM in 1Q suggests Microsoft can drive revenue growth in an efficient way. To account for the beat in results and better-than-expected operating efficiency gains which will likely sustain, we lift FY26-28E revenue/OP forecasts by 1-2%/3-4%, and DCF-based TP by 6% to US$636.3 (was US$601.5), translating into 34.8x FY27E PE. BUY.

- **Cloud revenue sustained robust growth momentum.** Intelligent Cloud (IC) segment recorded revenue growth of 28.2% YoY in 1QFY26 to US$30.9bn (40% of total revenue), and Azure and other cloud services within the segment saw revenue growth of 40% YoY (4QFY25: 39%), better than previous guidance of 37%. Management guided for 26-27% YoY revenue growth for IC in 2QFY26, among which it guided for 37% YoY revenue growth for Azure on a constant currency basis. Capex (incl. finance leases) came in at US$34.9bn for 1QFY26, up 75% YoY, among which roughly half of the spend was still on short-lived assets (such as GPUs and CPUs) to fulfil demand. Management now expects growth of Capex in FY26E to be higher than FY25 (58% YoY), which indicates a minimum spend of c. US$140bn in FY26 (vs our previous forecast of US$120bn).
- **ARPU expansion trend continued in PBP business.** Productivity and Business Processes (PBP) revenue was US$33.0bn in 1Q, up 16.6% YoY (1QFY25: 12.3%; 4QFY25: 15.7%), and accounted for 43% of total revenue. M365 commercial/consumer cloud revenue increased by 17/26% YoY (4QFY25: 18/20%), aided by 6/7% YoY growth in paid M365 commercial seats/subscribers and ARPU expansion. Microsoft's family of Copilot apps has surpassed 150mn MAUs across commercial and consumer in 1QFY26, and the ARPU expansion trend could sustain in FY26, in our view.
- **OPM expansion better than consensus expectation.** Although GPM came down 0.4ppt YoY to 69.0% in 1QFY26 due to the incremental infrastructure investment to support the growth of AI related business, overall OPM came in at 48.9%, up 2.3ppts YoY and was better than consensus at 46.5%, driven by 3.5/3.4ppts margin expansion in PBP/more personal computing (MPC) segment aided by operating efficiency gains, although this was partly offset by 0.3ppts YoY decline in OPM of IC to 43.3% (consensus: 42.4%).

BUY (Maintain)

Target Price	**US$636.30**
(Previous TP	US$601.50)
Up/Downside	**21.0%**
Current Price	**US$525.76**

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Stock Data

Mkt Cap (US$ mn)	3,922,696.5
Avg 3 mths t/o (US$ mn)	4,594.1
52w High/Low (US$)	542.07/354.56
Total Issued Shares (mn)	7461.0

Source: FactSet

Shareholding Structure

Vanguard Group	8.9%
Blackrock	7.3%

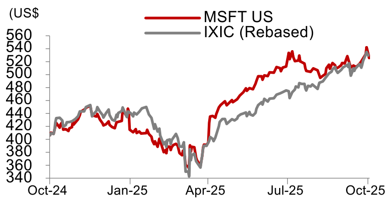
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	1.5%	-2.5%
3-mth	-1.5%	-11.7%
6-mth	33.0%	-1.6%

Source: FactSet

12-mth Price Performance



Source: FactSet

Earnings Summary

(YE 30 Jun)	FY24A	FY25A	FY26E	FY27E	FY28E
Revenue (US$ mn)	245,122	281,724	328,013	378,958	433,571
YoY growth (%)	15.7	14.9	16.4	15.5	14.4
Net profit (US$ mn)	88,136.0	101,832.0	115,514.1	136,452.2	160,167.2
YoY growth (%)	21.8	15.5	13.4	18.1	17.4
EPS (Reported) (US$)	11.86	13.70	15.54	18.35	21.53
Consensus EPS (US$)	na	13.64	15.62	18.34	21.54
P/E (x)	44.3	38.4	33.8	28.7	24.4

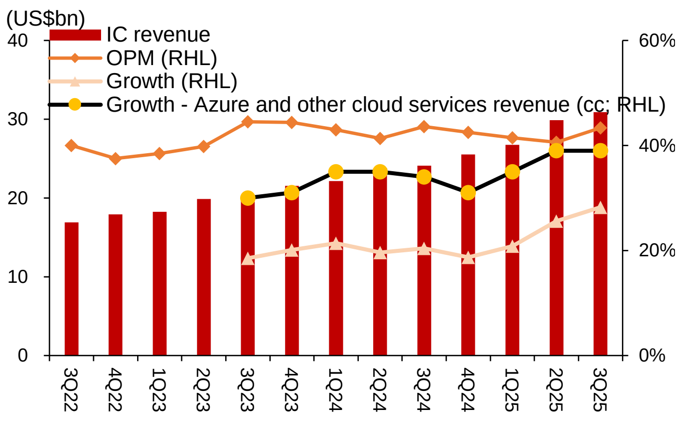
Source: Company data, Bloomberg, CMBIGM estimates

Figure 1: Microsoft: quarterly financial results

(USDbn)	1QFY25	2QFY25	3QFY25	4QFY25	1QFY26	BBG consensus	Diff (%)	CMBI estimates	Diff (%)
1. Productivity and Business Processes revenue	**28.3**	**29.4**	**29.9**	**33.1**	**33.0**	**32.3**	2.3%	**32.3**	2.1%
Growth - yoy	*12.3%*	*13.9%*	*10.4%*	*15.7%*	*16.6%*				
As % of total revenue (%)	43.2%	42.3%	42.7%	43.3%	42.5%				
2. Intelligent Cloud revenue	**24.1**	**25.5**	**26.8**	**29.9**	**30.9**	**30.2**	2.4%	**30.2**	2.2%
Growth - yoy	*20.4%*	*18.7%*	*20.8%*	*25.6%*	*28.2%*				
As % of total revenue (%)	36.7%	36.7%	38.2%	39.1%	39.8%				
3. More Personal Computing revenue	**13.2**	**14.7**	**13.4**	**13.5**	**13.8**	**13.1**	5.1%	**12.6**	9.2%
Growth - yoy	*16.8%*	*0.1%*	*6.1%*	*9.2%*	*4.4%*				
As % of total revenue (%)	20.1%	21.0%	19.1%	17.6%	17.7%				
Total revenue	**65.6**	**69.6**	**70.1**	**76.4**	**77.7**	**75.6**	**2.8%**	**75.2**	**3.3%**
Growth - yoy	*16.0%*	*12.3%*	*13.3%*	*18.1%*	*18.4%*				
Gross profit	**45.5**	**47.8**	**48.1**	**52.4**	**53.6**	**51.1**	**4.9%**	**50.7**	**5.7%**
Growth - yoy	*13.1%*	*12.8%*	*11.1%*	*16.4%*	*17.9%*				
Research and development expenses	**7.5**	**7.9**	**8.2**	**8.8**	**8.1**	**8.2**	-0.2%	**8.5**	-3.9%
Growth - yoy	*13.3%*	*10.9%*	*7.1%*	*9.6%*	*8.0%*				
R&D expense ratio (%)	11.5%	11.4%	11.7%	11.6%	10.5%	10.8%	-0.3 ppt		
Sales and marketing expenses	**5.7**	**6.4**	**6.2**	**7.3**	**5.7**	**6.2**	-7.7%	**6.3**	-9.6%
Growth - yoy	*10.2%*	*3.1%*	*0.1%*	*6.9%*	*0.0%*				
S&M expense ratio (%)	8.7%	9.2%	8.9%	9.5%	7.4%	8.2%	-0.8 ppt		
General and administrative expenses	**1.7**	**1.8**	**1.7**	**2.0**	**1.8**	**1.6**	10.6%	**0.8**	138.3%
Growth - yoy	*13.5%*	*-7.8%*	*-9.2%*	*-11.4%*	*7.9%*				
G&A expense ratio (%)	2.6%	2.6%	2.5%	2.6%	2.3%	2.2%	0.2 ppt		
Operating income	**30.6**	**31.7**	**32.0**	**34.3**	**38.0**	**35.1**	**8.0%**	**35.2**	**7.9%**
Growth - yoy	*13.6%*	*17.1%*	*16.0%*	*22.9%*	*24.3%*				
- PBP	16.5	16.9	17.4	19.0	20.4	18.6	9.6%	18.8	8.3%
- IC	10.5	10.9	11.1	12.1	13.4	12.8	4.6%	13.0	3.2%
- MPC	3.5	3.9	3.5	3.2	4.2	3.7	12.1%	3.4	23.8%
Net income	**24.7**	**24.1**	**25.8**	**27.2**	**27.7**	**27.4**	**1.1%**	**27.3**	**1.7%**
Growth - yoy	*10.7%*	*10.2%*	*17.7%*	*23.6%*	*12.5%*				
GPM	**69.4%**	**68.7%**	**68.7%**	**68.6%**	**69.0%**	**67.7%**	**1.4 ppt**	**67.5%**	**1.5 ppt**
OPM	**46.6%**	**45.5%**	**45.7%**	**44.9%**	**48.9%**	**46.5%**	**2.4 ppt**	**46.8%**	**2.1 ppt**
- PBP	58.3%	57.4%	58.0%	57.4%	61.8%	57.7%	4.1 ppt	58.3%	3.5 ppt
- IC	43.6%	42.5%	41.5%	40.6%	43.3%	42.4%	0.9 ppt	42.9%	0.4 ppt
- MPC	26.8%	26.7%	26.4%	23.7%	30.3%	28.4%	1.9 ppt	26.7%	3.6 ppt
NPM	37.6%	34.6%	36.9%	35.6%	35.7%	36.3%	-0.6 ppt	**36.3%**	-0.6 ppt

Source: Company data, Bloomberg, CMBIGM estimates

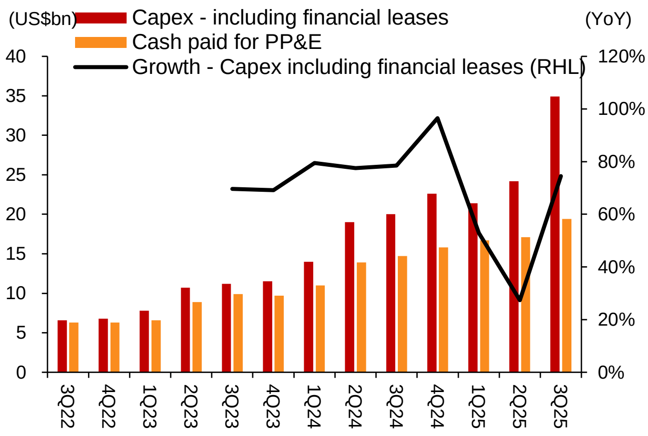
Figure 2: Microsoft: IC revenue and growth



Source: Company data, CMBIGM

Note: cc: constant currency

Figure 3: Microsoft: quarterly capex trend



Source: Company data, CMBIGM estimates

Changes in forecast and valuation

Figure 4: Microsoft forecast revision

	Current			Previous			Change (%)		
USD bn	FY26E	FY27E	FY28E	FY26E	FY27E	FY28E	FY26E	FY27E	FY28E
Revenue	328.0	379.0	433.6	326.5	377.2	424.9	0.5%	0.5%	2.0%
Gross Profit	222.7	255.4	290.1	222.0	254.6	285.1	0.3%	0.3%	1.7%
Operating Profit	153.3	176.2	200.1	148.9	171.5	192.5	3.0%	2.8%	4.0%
Net profit	115.5	136.5	160.2	115.7	133.5	151.5	-0.1%	2.2%	5.7%
GPM	67.9%	67.4%	66.9%	68.0%	67.5%	67.1%	-0.1 ppt	-0.1 ppt	-0.2 ppt
OPM	46.7%	46.5%	46.2%	45.6%	45.5%	45.3%	1.1 ppt	1.0 ppt	0.9 ppt
NPM	35.2%	36.0%	36.9%	35.4%	35.4%	35.7%	-0.2 ppt	0.6 ppt	1.3 ppt

Source: CMBIGM estimates

Figure 5: Microsoft: CMBI forecast vs consensus

	Current			Consensus			Difference （%）		
USD bn	FY26E	FY27E	FY28E	FY26E	FY27E	FY28E	FY26E	FY27E	FY28E
Revenue	328.0	379.0	433.6	323.1	370.3	427.2	1.5%	2.3%	1.5%
Gross Profit	222.7	255.4	290.1	218.6	249.5	287.3	1.9%	2.4%	1.0%
Operating Profit	153.3	176.2	200.1	147.2	169.9	196.8	4.2%	3.7%	1.7%
Net profit	115.5	136.5	160.2	116.1	135.6	159.2	-0.5%	0.6%	0.6%
GPM	67.9%	67.4%	66.9%	67.7%	67.4%	67.3%	0.2 ppt	0.0 ppt	-0.4 ppt
OPM	46.7%	46.5%	46.2%	45.6%	45.9%	46.1%	1.2 ppt	0.6 ppt	0.1 ppt
NPM	35.2%	36.0%	36.9%	35.9%	36.6%	37.3%	-0.7 ppt	-0.6 ppt	-0.3 ppt

Source: Bloomberg, CMBIGM estimates

Figure 6: Microsoft: DCF valuation (WACC of 7.9%; terminal growth of 3%; both unchanged)

(USDbn)	FY26E	FY27E	FY28E	FY29E	FY30E	FY31E	FY32E	FY33E	FY34E	FY35E	FY36E
Total revenue	321	361	400	438	474	509	545	581	617	653	687
NPV of FCF	1,259	1,334									
Discounted terminal value	3,463	3,738									
Total equity valuation	4,747	5,082									
No. of shares (diluted, mn)	7,461	7,457									
Valuation per share (USD)	636.3	681.5									
TP per share (USD)	636.3										

Source: CMBIGM estimates
Note: our target price is based on FY26E target price.

Risks

1. Slower-than-expected margin expansion;
2. Slower-than-expected ramp-up in revenue contribution from AI related service.

Financial Summary

INCOME STATEMENT	2023A	2024A	2025A	2026E	2027E	2028E
YE 30 Jun (US$ mn)						
Revenue	**211,915**	**245,122**	**281,724**	**328,013**	**378,958**	**433,571**
Cost of goods sold	(65,863)	(74,114)	(87,831)	(105,292)	(123,540)	(143,512)
Gross profit	**146,052**	**171,008**	**193,893**	**222,721**	**255,417**	**290,059**
Operating expenses	**(57,529)**	**(61,575)**	**(65,365)**	**(69,377)**	**(79,195)**	**(89,913)**
Selling expense	(22,759)	(24,456)	(25,654)	(25,913)	(29,559)	(33,385)
SG&A expense	(7,575)	(7,609)	(7,223)	(8,366)	(9,088)	(10,135)
R&D expense	(27,195)	(29,510)	(32,488)	(35,097)	(40,548)	(46,392)
Others	0	0	0	0	0	0
Operating profit	**88,523**	**109,433**	**128,528**	**153,344**	**176,223**	**200,147**
Other income/expense	788	(1,646)	(4,901)	(10,734)	(6,717)	(1,181)
Others	0	0	0	0	0	0
Pre-tax profit	**89,311**	**107,787**	**123,627**	**142,610**	**169,506**	**198,965**
Income tax	(16,950)	(19,651)	(21,795)	(27,096)	(33,054)	(38,798)
Others	0	0	0	0	0	0
After tax profit	**72,361**	**88,136**	**101,832**	**115,514**	**136,452**	**160,167**
Net profit	**72,361**	**88,136**	**101,832**	**115,514**	**136,452**	**160,167**

BALANCE SHEET	2023A	2024A	2025A	2026E	2027E	2028E
YE 30 Jun (US$ mn)						
Current assets	**184,257**	**159,734**	**191,131**	**162,049**	**160,839**	**193,550**
Cash & equivalents	34,704	18,315	30,242	686	18,427	50,966
Account receivables	48,688	56,924	69,905	70,379	83,589	83,761
Inventories	2,500	1,246	938	938	938	938
Other current assets	98,365	83,249	90,046	90,046	57,885	57,885
Non-current assets	**227,719**	**352,429**	**427,872**	**544,729**	**654,000**	**747,800**
PP&E	95,641	135,591	204,966	321,823	431,094	524,894
Right-of-use assets	14,346	18,961	24,823	24,823	24,823	24,823
Investment in JVs & assos	9,879	14,600	15,405	15,405	15,405	15,405
Intangibles	9,366	27,597	22,604	22,604	22,604	22,604
Goodwill	67,886	119,220	119,509	119,509	119,509	119,509
Other non-current assets	30,601	36,460	40,565	40,565	40,565	40,565
Total assets	**411,976**	**512,163**	**619,003**	**706,778**	**814,839**	**941,350**
Current liabilities	**104,149**	**125,286**	**141,218**	**155,981**	**172,092**	**184,937**
Short-term borrowings	5,247	8,942	2,999	2,999	2,999	2,999
Account payables	18,095	21,996	27,724	31,881	38,054	40,583
Other current liabilities	80,807	94,348	110,495	121,102	131,039	141,355
Non-current liabilities	**101,604**	**118,400**	**134,306**	**134,306**	**134,306**	**134,306**
Long-term borrowings	41,990	42,688	40,152	40,152	40,152	40,152
Obligations under finance leases	12,728	15,497	17,437	17,437	17,437	17,437
Other non-current liabilities	46,886	60,215	76,717	76,717	76,717	76,717
Total liabilities	**205,753**	**243,686**	**275,524**	**290,287**	**306,398**	**319,243**
Share capital	93,718	100,923	109,095	109,095	109,095	109,095
Retained earnings	118,848	173,144	237,731	310,743	402,693	516,358
Other reserves	(6,343)	(5,590)	(3,347)	(3,347)	(3,347)	(3,347)
Total shareholders equity	**206,223**	**268,477**	**343,479**	**416,491**	**508,441**	**622,106**
Total equity and liabilities	**411,976**	**512,163**	**619,003**	**706,778**	**814,839**	**941,350**

CASH FLOW	2023A	2024A	2025A	2026E	2027E	2028E
YE 30 Jun (US$ mn)						
Operating						
Profit before taxation	**89,311**	**107,787**	**123,627**	**142,610**	**169,506**	**198,965**
Depreciation & amortization	13,861	22,287	34,153	24,188	34,733	44,942
Tax paid	(16,950)	(19,651)	(21,795)	(27,096)	(33,054)	(38,798)
Change in working capital	(2,388)	1,824	(5,350)	14,289	2,900	12,674
Others	3,748	6,301	5,527	0	0	0
Net cash from operations	**87,582**	**118,548**	**136,162**	**153,991**	**174,086**	**217,784**
Investing						
Capital expenditure	(28,107)	(44,477)	(64,551)	(141,046)	(144,004)	(138,743)
Acquisition of subsidiaries/ investments	(37,651)	(17,732)	(29,775)	0	0	0
Net proceeds from disposal of short-term investments	33,510	24,775	16,079	0	32,162	0
Others	9,568	(59,536)	5,648	0	0	0
Net cash from investing	**(22,680)**	**(96,970)**	**(72,599)**	**(141,046)**	**(111,842)**	**(138,743)**
Financing						
Dividend paid	(19,800)	(21,771)	(24,082)	(24,082)	(26,082)	(28,082)
Net borrowings	0	24,395	0	0	0	0
Share repurchases	(22,245)	(17,254)	(18,420)	(18,420)	(18,420)	(18,420)
Others	(1,890)	(23,127)	(9,197)	0	0	0
Net cash from financing	**(43,935)**	**(37,757)**	**(51,699)**	**(42,502)**	**(44,502)**	**(46,502)**
Net change in cash						
Cash at the beginning of the year	13,931	34,704	18,315	30,242	686	18,427
Exchange difference	(194)	(210)	63	0	0	0
Cash at the end of the year	**34,704**	**18,315**	**30,242**	**686**	**18,427**	**50,966**

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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