

Microsoft Corporation | MSFT

Common Stock · NASDAQ · Software & Cloud Infrastructure

Initiation of Coverage · 20 July 2026 · Prices as of 17 July 2026 close

\$393.82

Price (17 Jul)

BUY

Recommendation

\$470

12-mo fair value

+19.3%

Implied return

75 / 100

Investment score

Investment Summary

Microsoft has fallen 22% over twelve months and sits 15.5% below its June high, having traded as low as \$349.20 on 25 June. The de-rating is not a response to deteriorating operations. Azure grew 40% in constant currency in the March quarter — the fifth consecutive quarter of acceleration — Intelligent Cloud revenue rose 30% to \$34.7 billion, net income rose 23% to \$31.8 billion, and the AI business is now a \$37 billion run-rate. The de-rating is a response to what those results cost.

Capital expenditure and finance leases reached \$31.9 billion in the quarter, up 49%, and management guided calendar-2026 capex to approximately \$190 billion — roughly \$35 billion above the consensus figure of \$154.6 billion, and inclusive of about \$25 billion attributable purely to higher component prices. Free cash flow consequently fell to \$15.8 billion from \$20.3 billion a year earlier, even as operating cash flow rose 26% to \$46.7 billion. A market that had valued Microsoft as a capital-light compounder is being asked to value it as something closer to an infrastructure builder, and it is doing so at a discount.

The resulting price is the interesting part. At \$393.82 the shares trade on 23.5× trailing and 21.3× forward earnings against a three-year consensus EPS growth forecast of 18.1%, a return on invested capital of 27.2% against a weighted average cost of capital near 10.1%, and a 68.3% gross margin. That is a defensible price for one of the highest-quality franchises in global equities. The bear case — that the AI infrastructure spend does not earn its cost of capital, that Copilot loses the assistant market, and that a depreciation wave crushes reported margins from 2027 — is credible and is the reason the multiple is where it is. It is also, at 21× forward, substantially priced in. The recommendation is Buy, on a staged entry and with the 29 July result treated as a genuine two-sided event.

The core judgement

Microsoft is spending roughly \$190 billion of calendar-2026 capital at a business that has historically earned **27% on invested capital**. The bear case requires that these particular dollars earn far less than every prior dollar the company has deployed. That may prove true — the depreciation from this build has barely begun to hit the income statement — but it is an assertion about a cycle that is three quarters old, made against a twenty-year track record, and the market is now charging almost nothing for the possibility that management is right.

Framework: What Actually Determines the Return Here

Microsoft is three businesses with different economics: a near-monopoly productivity software franchise with 90%-plus incremental margins, a hyperscale cloud business in a capital-intensive land-grab, and a declining consumer hardware and gaming operation. Over the next one to two years the share price is governed almost entirely by the second, and specifically by whether investors come to believe the capital being deployed into it will be recovered. Five variables carry the outcome.

#	Return driver	Why it matters for this company	Wt.
1	Azure growth durability against capacity constraints	Azure grew 40% in constant currency and has accelerated for five straight quarters, but management has repeatedly attributed shortfalls to compute capacity rather than demand. Growth that is supply-limited is a better problem than growth that is demand-limited — provided the supply arrives. This is the single variable the market watches on 29 July.	30%
2	The capital expenditure trajectory and the free cash flow trough	The stock does not need capex to fall. It needs capex to stop surprising upward. The \$190 billion calendar-2026 guide overshoot consensus by \$35 billion and produced an 11% single-day decline in January on a related disclosure. Confirmation that the growth rate of spending is plateauing is worth more to the multiple than any plausible revenue beat.	25%
3	Copilot and Microsoft 365 AI monetisation	Copilot passed 20 million seats but paid penetration of the installed base is roughly 3.3%, and the product trails ChatGPT badly in consumer preference surveys. The April restructuring removed the revenue share paid to OpenAI on Copilot products, which mechanically improves gross margin on every seat sold. Attach rate, not seat count, is the number that matters.	20%
4	Operating margin defence against depreciation and input inflation	Trailing depreciation and amortisation of \$35.5 billion is running at barely a third of trailing capex of \$97.2 billion. The gap becomes an income-statement expense over the next several years. Separately, roughly \$25 billion of the 2026 capex guide is pure component price inflation — principally memory — which is a direct transfer of margin to suppliers.	15%
5	OpenAI relationship economics	Microsoft holds a 27% stake whose mark-to-market swings have moved quarterly EPS by more than a dollar in both directions. The April 2026 restructuring ended Azure's exclusivity on OpenAI compute, allowing OpenAI to sell through AWS and Google. This removes a moat while retaining the earnings volatility.	10%

Segment Performance and Financial Position

Segment (FY26 Q3, quarter ended March 2026)	Revenue	Growth	Read-through
Intelligent Cloud	\$34.7bn	+30%	Server products and cloud services up \$7.8bn or 32%, with Azure and other cloud services up 40%. This is the segment carrying the equity story and the one absorbing essentially all of the capital.
Productivity and Business Processes	\$35.0bn	+17%	The quiet engine. High-margin, contractually sticky, and the natural distribution channel for Copilot. Seventeen percent growth from a base this large is genuinely unusual.
More Personal Computing	\$13.2bn	-1%	Windows and Devices down 2%, Gaming down 7%. Structurally challenged and now a modest drag rather than a material contributor.
Total	\$82.9bn		Diluted EPS of \$4.27; net income \$31.8bn, up 23%. Microsoft Cloud up 29%; AI revenue run-rate approximately \$37bn; Copilot past 20 million seats.

Metric (trailing twelve months)	Value	Interpretation
Revenue	\$318.27bn	Consensus three-year revenue growth forecast of 17.4%.
Gross / operating / net margin	68.3% / 46.8% / 39.3%	Operating margin near 47% at this revenue scale is close to the practical ceiling for a diversified software business.
Net income / EPS	\$125.22bn / \$16.79	Consensus three-year EPS growth forecast of 18.1%, giving a PEG of 1.30.
Operating cash flow	\$170.14bn	Grew 26% year on year in the March quarter. The cash engine is intact.
Capital expenditure	-\$97.23bn	The entire controversy. Against D&A of \$35.50bn, roughly two-thirds of this is growth capital not yet in the cost base.
Free cash flow	\$72.92bn	FCF per share \$9.82, putting the shares on 40.1× free cash flow — the metric on which the stock genuinely looks expensive.
Balance sheet	\$78.23bn cash / \$125.43bn debt	Net debt of \$47.20bn, or \$6.35 per share. Debt/EBITDA of 0.66×, interest coverage 52.1×, Altman Z-score 9.28. Immaterial as a risk.
ROE / ROIC / WACC	34.0% / 27.2% / 10.1%	A 17-point spread of returns over cost of capital. This is the number that justifies the capital deployment in principle.
Capital returns	\$3.64 dividend, 0.92% yield	Twenty consecutive years of dividend growth, payout ratio 21.7%, buyback yield 0.13%. Shareholder yield 1.06% — buybacks have been substantially crowded out by capex.

Source: S&P Global Market Intelligence via StockAnalysis, as of 20 July 2026; Microsoft FY26 Q3 results reported 29 April 2026.

Competitive Position

	Microsoft	Amazon (AWS)	Alphabet (Google Cloud)
Structural advantage	Enterprise distribution and bundling. Office and Windows give a channel into essentially every large organisation, which is why Copilot can reach 20 million seats without winning a product bake-off.	Scale, breadth of primitives, and the longest enterprise track record in public cloud.	Model quality and vertically integrated silicon (TPU), lowering the cost of serving inference.
Principal weakness	Consumer AI preference sits decisively with ChatGPT, and the OpenAI compute exclusivity was surrendered in April 2026.	Slower to a coherent frontier-model story; relies on partnership rather than in-house leadership.	Enterprise sales motion remains the weakest of the three despite technical strength.
Bearing on the thesis	The moat is distribution, not model supremacy. That is a more durable asset than the market currently credits, and it is why Productivity and Business Processes growing 17% matters more than Copilot losing a preference survey.	Constrains Azure pricing power over time.	The most credible long-term threat to Azure gross margin.

Valuation

Microsoft is valued here primarily on forward earnings, because earnings remain a fair representation of the economics while free cash flow does not — the FCF line is temporarily depressed by growth capital that has not yet begun generating revenue. Enterprise value to EBITDA is used as a cross-check because it is less distorted by the depreciation timing, and a reverse discounted cash flow is used to test what the market is currently assuming.

Method	Calculation	Implied value
Forward P/E	FY27 consensus EPS of approximately \$20.50 (18.1% growth on an estimated FY26 base of roughly \$17.40) at 23×, a modest discount to the 24–28× band the shares held through 2023–2025	\$470
EV / EBITDA	Trailing EV/EBITDA of 16.1× against a five-year average nearer 21×. Applying 18× to forward EBITDA of roughly \$205bn, less \$47bn net debt, across 7.43bn shares	\$490
Reverse DCF	At \$393.82, with a 10.1% WACC and 3% terminal growth, the market is discounting roughly 9% long-run free cash flow growth. Consensus revenue growth alone is 17.4%. The market is pricing a permanent step-down in capital efficiency	Undervalued
Price to free cash flow	40.1× trailing FCF is genuinely expensive and is the strongest single argument for the bears. It is also an artefact of \$97bn of capex against \$35bn of depreciation	Not supportive
Consensus target	56 covering analysts, average target \$558.77, consensus rating Strong Buy. Noted, and treated as an upper bound rather than a base case	\$558.77

Conclusion: modestly undervalued. Fair value is assessed at \$470, roughly 19% above the current price. The shares are not cheap on free cash flow and will not be until the capex growth rate flattens; they are reasonably valued on earnings and clearly below their own historical range on enterprise value to EBITDA. The gap between those two readings is the investment case, and it resolves over the next four to six quarters as depreciation normalises against a revenue base that the capital is actively building.

Risk Register

Risk	Prob.	Severity	Assessment
Capital expenditure guidance rises again	Medium	High	The January and April prints both delivered upside capex surprises and both were punished. A third would materially damage management credibility on this issue and is the most likely source of a move below \$350.
Depreciation wave compresses reported margins	High	Medium	Near-certain in direction, uncertain in magnitude. D&A of \$35.5bn against capex of \$97.2bn means several years of rising expense. Partially offset by revenue from the same assets.
Copilot fails to monetise at scale	Medium	High	Paid penetration near 3.3% with weak consumer preference against ChatGPT. Distribution buys time but does not guarantee conversion; the removal of the OpenAI revenue share improves unit economics on whatever does convert.
AI infrastructure returns below cost of capital	Medium	Very high	The central bear case. If the \$190bn cohort earns materially below the historical 27% ROIC, the multiple should be lower than it is today. Unfalsifiable for at least another two years.
Memory and component cost inflation	High	Medium	Roughly \$25bn of the 2026 capex guide is component price inflation. Memory suppliers are currently earning operating margins above 70%; that margin is coming out of buyers like Microsoft.

Risk	Prob.	Severity	Assessment
OpenAI exclusivity loss and equity volatility	High	Medium	OpenAI may now sell through AWS and Google. Separately, the 27% stake swung quarterly EPS by -\$0.41 and +\$1.02 in consecutive quarters — genuine noise in reported results.
Securities class action	High	Low	Class period 1 May 2025 to 28 January 2026, lead plaintiff deadline 11 August 2026, concerning Copilot and Azure capacity disclosures. Financially immaterial for a company of this size; relevant as a governance signal.
More Personal Computing decline	High	Low	Windows and Devices down 2%, Gaming down 7%. A 16% revenue segment in structural decline is a modest persistent drag, already reflected in estimates.
Regulatory and antitrust	Medium	Medium	Bundling Copilot into Microsoft 365 is precisely the conduct that has attracted scrutiny historically.

Sentiment, Ownership and Technicals

Institutional ownership of 74.4% against negligible insider ownership of 0.03% is typical for a mega-cap and carries little signal. Short interest is 89.06 million shares, or 1.20% of shares outstanding, and has fallen from 95.19 million the prior month — shorts are covering into the decline rather than pressing, which is mildly constructive. Sell-side sentiment remains overwhelmingly positive: 56 analysts, a Strong Buy consensus, and an average target of \$558.77, 41.9% above the market. That degree of unanimity against a 22% twelve-month decline indicates estimates that have not yet been cut, which is a risk into the 29 July print.

Computed technical indicators

Indicator	Value	Reading
Close (17 Jul 2026)	\$393.82	Down 1.82% on the session; 22.1% lower over twelve months.
SMA 20 / EMA 20	\$381.16 / \$389.15	Price above both. Short-term trend has turned up.
SMA 50 / EMA 50	\$401.51 / \$394.79	Price marginally below. The 50-day is the immediate overhead barrier.
SMA 100 / EMA 100	\$399.24 / \$396.68	Price just below. A cluster of resistance sits at \$395–405.
SMA 200	\$439.35	Well above the price. The primary downtrend is intact and unbroken.
RSI (14)	51.92	Neutral. Neither oversold nor extended; no divergence signal.
MACD (12,26,9)	-1.01 / signal -4.24 / hist +3.23	Bullish crossover completed below the zero line, with the histogram positive and expanding for eight consecutive sessions. A classic early base signature, not yet a trend reversal.
ATR (14)	\$12.10 (3.07% of price)	Elevated. Position sizing and stop placement must respect a 3% average daily range.
Volume (20d / 50d average)	46.87m / 40.60m	20-day above 50-day, inflated by the 186 million share capitulation print on 26 June.
Support	\$349.20	The 25 June intraday low, and the origin of the current rally.
Resistance	\$405.99, then \$439	The 20-day high, then the 200-day moving average.

Moving averages, RSI, MACD, ATR and volume averages computed directly from 100 sessions of daily OHLCV data (24 February to 17 July 2026). The 200-day moving average is sourced, as it falls outside the available sample. Computed RSI of 51.92 and SMA(50) of \$401.51 reconcile to independently published values of 51.86 and \$401.51 respectively.

The technical read is therefore: a stock still in a primary downtrend, trading below its 50-, 100- and 200-day averages, but which has reclaimed its 20-day average, put in a capitulation low on heavy volume on 26 June, and is building a positive MACD divergence. It is an acceptable place to begin accumulating and a poor place to commit a full position. Technicals inform the entry schedule here; they do not drive the thesis.

Scoring

Component	/10		Wt.	Assessment
Business Quality	9		15%	68% gross margin, 47% operating margin, contractually recurring revenue at \$318bn scale.
Financial Strength	8		12%	Altman Z 9.28, interest coverage 52×. Marked down only because FCF is temporarily impaired.
Competitive Advantage	9		15%	Enterprise distribution is the durable moat; model leadership is not, and was never the asset.
Management	7		8%	Excellent long-run record, but two consecutive capex surprises and a securities action over disclosure quality.
Growth Potential	7		12%	Azure +40% cc and PBP +17% are strong; MPC declining and the law of large numbers binds.
Valuation	7		18%	21.3× forward with 18% expected EPS growth is reasonable; 40× FCF is not, hence not higher.
Risk	6		15%	AI capital return is genuinely unresolved and the depreciation wave has not yet landed.
Technical Setup	5		5%	Below the 50-, 100- and 200-day averages, but basing above a capitulation low with MACD turning.

Overall Investment Score: 75 / 100. Derived as the weight-adjusted sum of the components above $(9 \times 15 + 8 \times 12 + 9 \times 15 + 7 \times 8 + 7 \times 12 + 7 \times 18 + 6 \times 15 + 5 \times 5) \div 10 = 74.7$. The profile is a high-quality asset at a fair rather than exceptional price, with a single large unresolved question about capital returns holding down the risk and valuation components.

Scenario Analysis

Scenario	%	Revenue and earnings path	Fair value	Return
Bull	28%	Azure sustains growth above 35% into FY27 as capacity lands. Capex guidance holds at roughly \$190bn rather than rising, and the market recognises a free cash flow trough. Copilot attach improves toward 6–7% of seats with the OpenAI revenue share removed. FY27 EPS near \$21.50, re-rating to 26×.	\$560	+42%
Base	45%	Azure decelerates gradually to the low thirties. Capex plateaus near guidance and free cash flow troughs in FY27 before recovering. Copilot monetisation improves slowly. FY27 EPS near \$20.50 at 23×, a modest discount to the historical multiple to reflect higher capital intensity.	\$470	+19%
Bear	27%	Capex guidance rises again, depreciation compresses operating margin below 44%, Azure decelerates to the high twenties on softening AI demand, and Copilot stalls. FY27 EPS near \$17.50 with the multiple compressing to 17× as the market re-classifies Microsoft as capital-intensive.	\$300	-24%
Weighted average	100%	Expected value across the three states.	\$449	+14.1%

Probabilities sum to 100%.

Recommendation: Buy

Parameter	Level	Rationale
Recommended entry	\$393.82 or better	Current market. The setup does not require patience to initiate a first tranche.
Ideal buy range	\$355 – \$385	Between the 25 June capitulation low and the 20-day average. A retest of the low is a buying opportunity, not a thesis break.
Cut-loss	\$339	Below the \$349.20 swing low with roughly one ATR of tolerance. A decisive break of that low invalidates the basing pattern and implies the capex problem is worsening.
Take-profit 1	\$470	Base case fair value; the level at which the position should be reduced by roughly one third.
Take-profit 2	\$545	Approaching bull-case fair value and the prior trading range. Exit the balance into strength.
Expected upside	+19.3% to TP1, +38.4% to TP2	Against a probability-weighted expected return of +14.1%.
Expected downside	-13.9% to the stop	Bear-case fair value of \$300 implies -23.8% if the stop is not respected.
Risk / reward	2.1 : 1	Measured to the midpoint of the two take-profit levels (\$507.50, +28.9%) against the -13.9% stop distance.
Holding horizon	18 – 24 months	The thesis resolves as depreciation normalises against revenue from the current capital cohort. This is not a quarter trade.
Position size	Moderate	Approximately 4–6% of a diversified equity portfolio, entered in three tranches: one third now, one third after the 29 July result, one third on either a retest of \$355 or a confirmed reclaim of the 200-day average.
Portfolio allocation	5%	Sized to reflect a favourable but not exceptional risk/reward and a genuinely unresolved capital-returns question.

The 29 July catalyst

FY26 Q4 results are confirmed for 29 July 2026, after the close. This is a two-sided event and the staged entry above is designed around it. The number that matters is not Azure growth and not EPS — it is the FY27 capital expenditure commentary. Guidance that holds near \$190 billion is a buy signal; a third consecutive upward surprise would take the shares to the June low and require the thesis to be re-underwritten.

Final Verdict

Would a disciplined investor put personal capital into Microsoft today? Yes, at a moderate position size, entered in tranches.

Why now: because the price has fallen 22% while the operating business accelerated. Azure has grown faster for five consecutive quarters, the highest-margin segment grew 17%, and net income rose 23%. The stock is down because of what the company chose to spend, not because of what it earned. That distinction is where mispricing usually lives.

Why at this valuation: 21.3× forward earnings for a business compounding EPS at a forecast 18% with 27% returns on invested capital, a 68% gross margin, and an unassailable enterprise distribution position is a price that requires the future to be only ordinary, not excellent. Enterprise value to EBITDA of 16.1× against a five-year average near 21× says the same thing from a different direction. A reverse discounted cash flow implies the market is discounting roughly 9% long-run free cash flow growth from a company whose consensus revenue growth alone is 17.4%.

What would invalidate the thesis: a third consecutive upward capital expenditure surprise; Azure growth decelerating below 30% in constant currency for two consecutive quarters, which would indicate the problem is demand rather than capacity; operating margin falling below 44% as depreciation lands without corresponding revenue; or Copilot paid penetration failing to move above roughly 5% of the Microsoft 365 base by mid-2027. A close below \$339 would be the market's signal that one of these is occurring before it appears in the reported numbers, and the position should be exited on it rather than argued with.

The honest weakness in this case is free cash flow. At 40× trailing FCF, an investor who insists on that metric will not buy this stock and cannot be shown to be wrong today. The case rests on the judgement that the current FCF figure is a construction-phase artefact rather than a new steady state — that a company spending \$97 billion against \$35 billion of depreciation is building something, not burning something. That judgement is the investment. It should be sized accordingly.

Data and as-of dates. Closing price \$393.82 on 17 July 2026 (Alpha Vantage). Trailing financial statistics, moving averages beyond the computed sample, short interest, ownership and analyst consensus as of 20 July 2026 per S&P Global Market Intelligence. FY26 Q3 segment results reported 29 April 2026 for the quarter ended March 2026; FY26 Q4 results confirmed for 29 July 2026. Calendar-2026 capital expenditure guidance of approximately \$190 billion, including roughly \$25 billion of component price inflation, per management commentary on the Q3 call. Technical indicators computed from 100 sessions of daily OHLCV data covering 24 February to 17 July 2026.

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