



Hyperscalers: Capex vs Returns (Six Months On)

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Hyperscalers: Capex vs Returns (Six Months On)

Demand is no longer the open question. The cost of meeting it is, and on consensus numbers, the free cash flow recovery projected earlier for FY27 has moved to FY28.

The debate has moved on

In April we argued three things: 1) that the sector had shifted into a structurally capital-intensive regime; 2) that the free cash flow squeeze would be real but temporary; and 3) that the investment question would migrate from revenue growth to returns on capital. Two quarters of results have settled the first and made the third the whole debate. The second needs revising.

Alphabet, Microsoft and Amazon each have said customer demand exceeds available capacity, and contracted backlog across the three has reached roughly \$1.7tn. What has changed is the price of meeting that demand, and the point at which shareholders get paid.

Capex: guidance is now the risk, not the level

Combined FY26 capex guidance across the five sums to roughly \$745bn - \$770bn (excluding Apple and Nvidia) against the \$610bn consensus we were working from in April and roughly double the \$366bn spent in FY25. Capex is now decisively outpacing revenue growth across Hyperscalers, with aggregate capex expected to reach 25% of revenue, up from 17% in FY25. Management commentary points to further acceleration into FY27, reinforcing that the AI infrastructure buildout remains in its early stages. Nvidia CFO Colette Kress highlighted that Hyperscaler capex could exceed \$1tn by 2027, with AI infrastructure spending potentially reaching \$3-4tn annually by the end of the decade as agentic AI scales across industries. Reflecting this shift, consensus has been revised up 14%, 50% and 66% for FY26, FY27 and FY28 respectively. Figure 1 is on the consensus basis (\$719bn for FY26), which is why it sits below the guidance aggregate.

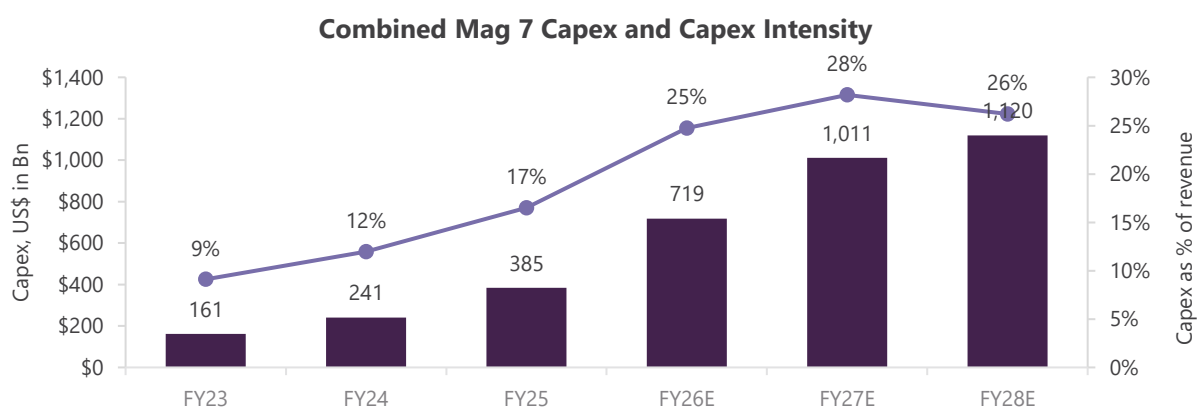


Figure 1: Combined Mag 7 capex and capex as a percentage of revenue, FY23–FY28E. **Source:** Company filings, Factset, Evalueserve analysis

Two qualifications matter more than the headline number.

First, part of the increase buys no additional capacity. Microsoft and Meta together attributed about \$35bn of their raised FY26 guidance to component and memory pricing. That is cost inflation, not compute.

Second, Microsoft's apparent \$15bn cut is not a cut. CY26 guidance moved from ~\$190bn to ~\$175bn because the useful life of data centers and office buildings was extended from 15 to 25 years, pushing future leases from finance to operating classification. Finance leases sit inside reported capex; operating leases do not. However, company guided that the spending plans are unchanged.

The more useful question is what guidance implies for the second half.

Company	H1 26 capex	FY26 guidance (mid)	Implied H2 26	H2 vs H1
Alphabet	80.6	200.0	119.4	+48%
Amazon	98.4	220.0	121.6	+24%
Meta	49.1	137.5	88.4	+80%
Tesla	8.3	25.0	16.7	+102%
Total (four builders)	236.4	582.5	346.1	+46%

Table 1: Implied H2 26 capex to meet FY26 guidance, US\$bn. Microsoft excluded (June fiscal year end, calendar-year guidance).

Source: Company guidance, Evalueserve analysis

Every builder needs a large step-up to hit guidance; Meta and Tesla need close to a doubling. This is the most monitorable risk in the group before February, and it cuts both ways - an underspend will be read as demand softening even when it is only a supply-chain slip.

Monetization is real but the backlog is not all cloud

Revenue has genuinely reaccelerated: \$2.33tn in FY25, a consensus \$2.90tn in FY26 and roughly \$4.0tn by FY28, an 19% CAGR from FY23. Alphabet's cloud backlog nearly doubled to \$514bn since FY25, AWS backlog stands at \$496bn with capacity effectively sold out through 2027, and Microsoft's commercial RPO reached \$678bn, up 84% YoY.

The AI monetization cycle is being fueled by three powerful trends: 1) aggressive infrastructure investment, 2) growing revenue visibility, and 3) rising enterprise adoption. Hyperscalers are investing ahead of demand with assets that can be paid back within 2-3 years, while long-term customer commitments provide strong visibility into future revenue. At the same time, AI adoption is expanding rapidly across enterprises, and usage-based pricing models are turning AI into a scalable, recurring revenue stream with significant long-term monetization potential.

The debate is no longer about revenue growth, but profitability. Heavy AI investments are pressuring margins, cash flow, and returns, creating a temporary disconnect between growth and shareholder value.

One caution on the aggregate. Microsoft's \$678bn is commercial RPO across the whole company, not Azure alone. It includes Microsoft 365, Dynamics 365, LinkedIn commercial, and heavy OpenAI commitments. While Alphabet backlog is roughly around 85-90% to official Google Cloud segment and rest it bundles as SaaS products like Google Workspace productivity tools and cybersecurity. Amazon backlog is of purest form with entire backlog allocated to AWS infrastructure, cloud storage, compute, and native enterprise AI contracts. Adding all the three backlogs together and calling the \$1.7tn contracted cloud backlog overstates the AI-attributable share. **Conversion windows differ too:** Alphabet expects more than half its backlog to convert within 24 months, while roughly 30% of Microsoft's RPO is a next-twelve-months item. For anyone building a revenue bridge, those distinctions do the work.

Free cash flow: the squeeze has arrived

Group FCF falls from \$400bn in FY25 to \$361bn in FY26 and recovering only modestly at \$420bn in FY27. Strip out Apple and Nvidia (neither of which funds this build) and the five builders go from \$205bn to \$27bn to negative \$64bn, before recovering to \$69bn in FY28.

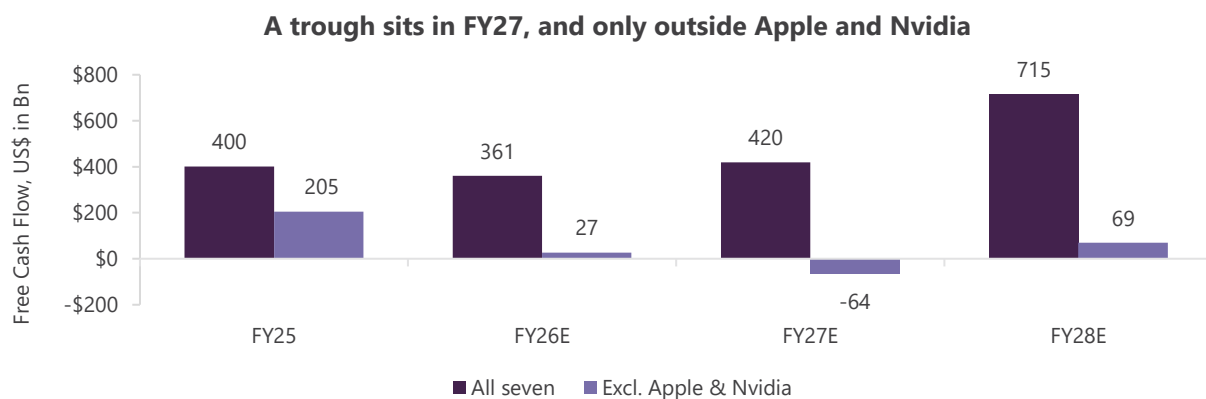


Figure 2: Aggregate free cash flow with and without Apple and Nvidia, FY25–FY28E. **Source:** Company filings, Factset, Evalueserve analysis

This is a change from April. In April, consensus had group FCF recovering to \$479bn in FY27; it is now \$420bn, a 14% downgrade. The trough has moved out a year. Anyone underwriting a FY27 re-rating on cash returns is now underwriting FY28.

The evidence is already in reported results. Alphabet posted negative FCF of \$5.9bn in Q2 '26, its first negative quarter of the cycle. Amazon's H1 FCF was negative at \$27bn. Meta's Q2 FCF fell 81% to \$1.7bn. Microsoft's Q4 FY26 FCF fell 23% to \$19.6bn, although management has guided positive free cash flow for FY27. Apple and Nvidia remain notable outliers, delivering 31% and 59% FCF growth respectively in their most recent quarters.

What the capex line no longer captures

Leases not yet commenced. Microsoft signed more than \$130bn of new data-center lease commitments in the June quarter, taking uncommenced lease obligations to \$329.1bn from \$196.6bn. In April we put that figure at \$93bn. This is a 3.5x increase in a fixed, off-balance-sheet claim on future cash flow inside a year and it is the direct consequence of the same reclassification (finance to operating lease

shift) that lowered reported capex. Amazon disclosed \$137bn in uncommenced leases whereas Alphabet disclosed \$85bn in June 2026.

Purchase Commitments. Alphabet off-balance sheet obligations reached \$811bn in purchase commitments and contractual obligations (with \$200.7bn due short-term). Between March and June, Alphabet dramatically ramped up infrastructure spending. It also began explicitly breaking out components like TPU (Tensor Processing Unit) hardware inventory to scale enterprise AI capacity. Amazon disclosed \$130bn in purchase commitments primarily tied to hardware procurement from major chipmakers, Power Purchase Agreements (PPAs) to run its AWS datacenters, long-term commitments for satellite contracts, and traditional operational commitments for prime video content and retail logistics & fulfillment. Amazon's infrastructure expansion turned its trailing twelve-month free cash flow negative (\$11.6 billion outflow). This required massive funding through both balance-sheet debt and off-balance-sheet contractual agreements to secure long-term power and space for AWS. Microsoft purchased commitment of \$194bn was tied to chipmakers and PPAs to supply energy and power to its datacenters. Microsoft signed massive legally binding take-or-pay infrastructure contracts that will transfer to the balance sheet as official liabilities only when the data center facilities are delivered.

Asset life and mix. Microsoft disclosed that roughly two-thirds of Q4 capex went to short-lived assets, principally CPUs and GPUs. The 25-year life applies to the shell, not the silicon inside it. Mix, not the headline number, sets the recurring replacement floor.

How it is funded. Alphabet's June equity raise launched at \$80bn, priced at \$84.75bn and closed at \$90bn with over-allotments, including \$10bn from Berkshire Hathaway. But \$40bn of that is an at-the-market programme which Alphabet stated is primarily to fund an administrative change in how it settles employee equity tax obligations and not capex. The capex-funding component is closer to \$50bn, and \$15bn of it is 6.25% mandatory convertible preferred: a fixed charge and a dilution event, not free money. A company with a net-cash balance sheet reached for equity at all is the more important signal.

Returns: divergence, not compression

As AI infrastructure spending accelerates, ROIC is expected to reach a cyclical trough across much of the group between FY26 and FY28, reflecting the lag between capital deployment and revenue monetization. With capex rising at unprecedented levels, an increasing portion of investment is being funded through debt issuance and balance sheet expansion rather than solely through internally generated cash flows, materially increasing the invested capital base.

The AI era is shifting the competitive focus from spending power to monetization. As infrastructure investments surge ahead of returns, the winners will be those that convert AI capex into durable revenue, cash flow, and shareholder value most efficiently.

Returns diverge: the builders compress, the beneficiaries compound

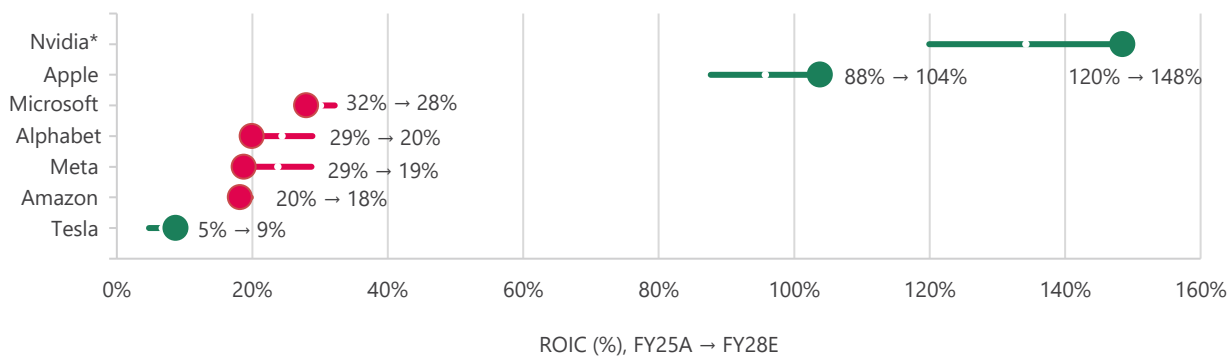


Figure 3: ROIC, FY25 actual to FY28E. NOPAT (Net Operating Profit After Taxes) over average invested capital (net debt plus equity).

*Nvidia FY26 to FY29E. Source: Company filings, Factset, Evalueserve analysis

The builders compress and the beneficiaries compound. Microsoft moves from 32% to 28% by FY28, Amazon 20% to 18%, Alphabet 29% to 20% and Meta 29% to 19%. Apple and Nvidia, which monetize the cycle without funding it, improve.

Two notes on definition, because they change the ranking. Our invested capital is net debt plus equity, which excludes capitalized leases, the adjustment our April report argued for. Capitalize Microsoft's \$329bn of uncommenced leases and its FY28 ROIC falls materially further. We hold both bases in the underlying model; the unadjusted series is shown here for comparability with consensus.

What we are watching

- H2 capex actuals against the implied step-ups.
- Whether consensus downgrades FY28 free cash flow the way it has already downgraded FY27.
- Uncommenced lease disclosures at Q3 across all four builders, not just Microsoft.
- Purchase commitments particularly related to semiconductor and energy contracts.
- Depreciation as a share of cloud revenue, the cleanest read on whether the FY28 recovery is real.

How Evalueserve helps

Evalueserve helps buy side investors and asset managers turn complexity into conviction. By combining deep sector expertise, advanced GenAI platforms, and rich data assets, we accelerate research, financial modeling, valuation, and scenario analysis, enabling faster insights and more informed investment decisions.

For Hyperscalers: The single AI capex theme has become seven distinct capital allocation strategies, and the differences now sit in footnotes rather than headlines. We build and maintain operating models, free cash flow forecasts and lease and commitment adjusted ROIC bridges that make those differences visible. We track guidance, disclosure changes and unit economics between reporting dates, so an inflection is caught when it is disclosed rather than when it is priced.

Our technology, semiconductors, data center and power teams support buy-side clients across screening, due-diligence, fundamental research, valuation, scenario analysis, and portfolio monitoring.

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