

# AI panic or opportunity? Rethinking the ‘SaaS apocalypse’

**Nadine Blaney** [00:00:20] AI panic or opportunity? Well, markets are pricing a SaaS apocalypse, if you hadn't heard the term yet, but is the sell-off overdone? Well, Airlie Funds Management, Ray David is here to explain. Ray, nice to see you. Look, AI is obviously such a dominant theme. Companies perceived as being exposed are being aggressively sold off while others are being bid up. So, what are investors getting right or wrong about this so-called SaaS apocalypse?

**Ray David** [00:00:54] It's a great question and it's an issue that the market and investors such as ourselves are grappling with. And what we have seen is the market has been quick to price in risk into the perceived losers and also price the winners accordingly to high rates of growth. And so, when you look at the market in companies and industries in particular, there's three buckets which they now fall into. The first one is the losers and software is being seen as a potential loser, insurance companies and real estate trusts, because the market is worried that their business models are going to get competed by these new LLM models. The second bucket is the defensive AI companies, so companies with hard assets, where technology hasn't been an enabler in the past, so they're capital intensive, cyclical, you're seeing the strong outperformance of those companies. And then the winners are this is perception by the market, is companies that are enabling the growth of LLMs. So, anyone who's tied to the IT architecture infrastructure stack, such as data centres or power providers and GPU manufacturers. So, we're assessing the whole landscape. We spent a bit of time talking to executives to get a better understanding of what adoption rights are likely to be so we can develop our own research framework into assessing the winners and losers. And we've taken away some key insights, which we think differentiate our view from the market.

**Nadine Blaney** [00:02:28] Okay, so you've spent the time, you've got this framework, you've spoken with management, you're assessing the situation, so what are some of those key takeaways?

**Ray David** [00:02:36] The clear insight we took was there's significant level of conservatism amongst top executives. And the number one consensus was executives aren't about to go out and rip out legacy ERP systems in favour of these new AI models. So, what they spoke to was concerns around governance, security, data privacy. A couple of CEOs and CFOs also talked about the uncertainty of the cost of these LLMs because the model's quite variableised with token usage. And others talked about the ongoing burden required to maintain your own system. What they did talk to was layer in AI tools on top of the existing software stacks to create an ecosystem of agentic AI tools that could help improve productivity of the business. Solutions that won't disrupt the existing business. And so we took from that, that there are sectors in the market that the market's overlooking that could be real beneficiaries, particularly sectors that have a high labour intensity and sectors such as insurance, pathology, in parts of healthcare, where they could benefit from streamlined productivity, lower labour usage, if they adopt this sort of ecosystem of AI tools.

**Nadine Blaney** [00:03:59] So there's a level of conservatism you're talking to. Also, not a wholesale abandonment of these existing systems that are in there. So what business models, or flesh it out a little bit, those

business models that you think will remain defensible even as AI changes, even as customers continue to engage with providers as well.

**Ray David** [00:04:22] The clear standout to us, a sector that's been heavily derated by the market, is the online classified businesses. So, CAR Group, it's the standout for us. It's the largest online marketplace for used cars in Australia. It's got a strong business in Korea and Brazil and also a fast-growing business in the US, where they market recreational vehicles and power sports. So, when we look at, the business model of online classifieds. It's a two-sided marketplace. You need the audience and then you need the supply of goods, so cars in the case of Carsales. And that economic mote to us has always been about the audience. Audience at scale, at low cost, as opposed to technology. Technology was always commoditized and so the market has seen these LLMs come through. There's a lot of fear that these LLMs will disintermediate these audiences. And shift audiences away from a CAR Group, which will potentially impact their pricing power. We see things differently. We think these LLMs will be just a new source of audience because when we've spoken to these online classified companies, they have proprietary data sets that are very unique to their businesses. They are engaging with these LLMs to share this data and so when someone's inquiring on ChatGPT, I want a Mitsubishi Triton, that's black with some orange stripes, big wheels, find me that with 20 kilometers or less. ChatCPT will use the Carsales listings data and direct traffic to Carsales and that's how they're working with these LLMs. So, we think the derate in some of these companies has been aggressive. Stocks have fallen by 40, 45% in total. Yet they're still delivering investors sort of mid-single digit growth, and what protects them is these proprietary and unique data sets.

**Nadine Blaney** [00:06:18] So how does CAR Group then use that data that you referenced and develop these Large Language Models to further monetise that data and then create long-term value?

**Ray David** [00:06:30] Yep, it's a great question and something we've spent a bit of time with management to get a better understanding of their products and their mote. Some of the products that they've spoken about, and as has dealers, is AutoGate and LiveMarket. So, these are products that sit within the dealer network. They help dealers manage their inventory, they upload pricing, they manage queries for cars. But CAR Group is getting that data. It's getting real time pricing data, days on market, time to sell, and using that data to develop other products that help car dealers manage their inventory more efficiently. So, they're quite integrated within the dealer network. They're not just providing an audience and connecting buyers and sellers, they're providing these other services. And they're also evolving deeper into the transaction ecosystem. So... Two products they've rolled out, which we're quite excited by is number one is Instant Offer. So if you want to list your car, you may get an instant offer from CAR group at an agreed price. You may accept that offer and a dealer will take that inventory on the other side and then relist it back on CAR group. So, becoming a source of inventory for the dealer and also facilitating a transaction. And they've also just recently launched online payments. So you can see. CAR Group, it's evolving beyond just the marketplace, it's providing other services, and that proprietary service, that data set, is really enabling them, which we think increases the mote, particularly in this LLM world. And at the same time, CAR Group is also invested in their own AI solutions to roll out across the dealers, and that's helping dealers adopt AI without having to code their own systems or programmes and just taking it off the shelf from CAR Group.

**Nadine Blaney** [00:08:18] I see. So I guess what comes to mind is what are the key risks to CAR Group? You know, is there anything that would change your view about the SaaS apocalypse and its impact on CAR?



**Ray David** [00:08:30] The risk is always about audience disintermediation. So, if we do find that audiences are declining over time because there's a better mousetrap somewhere else that someone's created through an LLM, then that potentially breaks the thesis. Having said that, we have confidence is instilled because we know these online classified models are working with LLMs to share the data and getting that source of traffic back to their models. The second risk to the thesis is always the economic cycle, you know, if dealers are under pressure or there's less dealers about or dealers consolidate, it does, I guess, weaken car groups' pricing power to some degree. But we have seen these models trade through a number of cycles over the past, and typically what happens is when the car cycle improves, listings improves, and dealers are always incentivised to advertise, to sell their product on the portals.

**Nadine Blaney** [00:09:30] So if we step back from all of the noise around AI, all of disruption and as AI of course continues to evolve, what excites you most about the opportunities that are potentially on offer for investors?

**Ray David** [00:09:46] It certainly has been a volatile time, but when we sort of step back and hear what our research is telling us is AI adoption is likely to be more evolutionary as opposed to revolutionary. And that compares to the market expectations where the market is oscillating between pricing in these strong rates of growth for these perceived winners and pricing in near disruption for incumbents. And that's providing price dislocation and opportunities for us. So, the areas that we're focusing on is, number one is we're looking for companies that are adopting these solutions that are driving productivity-led earnings growth. And typically, these are companies and industries that are traditional industrials or insurance, which I talked about earlier, online classifiers where the market is actually seeing them as losers. The second area we're excited by is companies that have proprietary and rich data sets are more valuable in this world because data is the new gold. These LLMs they feed off data, they've got to be trained and so someone has to create that data to start with. And media companies in particular have rich data set. So that data becomes more valuable, in the LLM world, because the LLMs need that data, to train their models. But, at the same time, we sort of step back. We're looking at the billions of dollars of investment that's happening in AI. So, you've got open AI, anthropic, they're losing billions of dollars between them, investors are cutting checks and when we look at what the investor will require at some point, it's a rate of return, which means a profit. And so, at some points, these companies will have to make a profit, which means they've got to increase their prices on ChatGPT or Claude. And you've seen that today with open, or ChatGPT, is throttling back usage through pricing. And so that could actually slow the adoption of AI and the perceived loser bucket all of a sudden may not be losers after all. So, we're thinking about that, and we don't think the winners will be the companies necessarily building out these LLMs, because it's capital intensive, they're competitive. We think it'll be companies that are just applying AI within the business, getting efficiencies, driving productivity-led growth and that's traditional sectors, and even software which have been derated pretty significantly.

**Nadine Blaney** [00:12:18] Ray David, thank you so much.

**Important Information:** This material has been delivered to you by Magellan Asset Management Limited ABN 31 120 593 946 AFS Licence No. 304 301 trading as Magellan Investment Partners (**Magellan Investment Partners**) and has been prepared for general information purposes only and must not be construed as investment advice or as an investment recommendation. This material does not take into account your investment objectives, financial situation or particular needs. This material does not constitute an offer or inducement to engage in an investment activity nor does it form part of any offer documentation, offer or invitation to purchase, sell or subscribe for interests in any type of investment product or service. You should obtain and consider the relevant Product Disclosure Statement (**PDS**) and Target Market Determination (**TMD**) and consider obtaining professional investment advice tailored to your specific circumstances before making a decision about whether to acquire, or continue to hold, the relevant financial product. A copy of the relevant PDS and TMD relating to a Magellan



Investment Partners financial product may be obtained by calling +61 2 9235 4888 or by visiting [www.magellaninvestmentpartners.com](http://www.magellaninvestmentpartners.com)

Past performance is not necessarily indicative of future results and no person guarantees the future performance of any financial product or service, the amount or timing of any return from it, that asset allocations will be met, that it will be able to implement its investment strategy or that its investment objectives will be achieved. This material may contain 'forward-looking statements'. Actual events or results or the actual performance of a Magellan Investment Partners financial product or service may differ materially from those reflected or contemplated in such forward-looking statements.

This material may include data, research and other information from third party sources. No guarantee is made that such information is accurate, complete or timely and no warranty is given regarding results obtained from its use. This information is subject to change at any time and no person has any responsibility to update any of the information provided in this material. Statements contained in this material that are not historical facts are based on current expectations, estimates, projections, opinions and beliefs of Magellan Investment Partners or the third party responsible for making those statements (as relevant). Such statements involve known and unknown risks, uncertainties and other factors, and undue reliance should not be placed thereon. No representation or warranty is made with respect to the accuracy or completeness of any of the information contained in this material. Magellan Investment Partners will not be responsible or liable for any losses arising from your use or reliance upon any part of the information contained in this material.

Any third-party trademarks contained herein are the property of their respective owners and Magellan Investment Partners claims no ownership in, nor any affiliation with, such trademarks. Any third-party trademarks contained herein are the property of their respective owners, are used for information purposes and only to identify the company names or brands of their respective owners, and no affiliation, sponsorship or endorsement should be inferred from such use. This material and the information contained within it may not be reproduced, or disclosed, in whole or in part, without the prior written consent of Magellan Investment Partners. (080825-#W17)

