

# Beyond Fundamentals: Where to Next for Generative AI

## How Polen's Large Company Growth team distinguishes robust investment cases from the hype in a rapidly growing market



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**Q: How should investors separate "traditional" AI from the more recent phenomenon of Generative AI (Gen AI)?**

**A: It's important not to conflate the two. We've had AI for a long time, which is basically using data to get better-informed decisions through analytics. Generative AI is taking information from a data source, whether the internet or another subset of data, and creating something new with it.**

ChatGPT marked the first time the world saw this on a grand scale. People started to play around with it, and it was exciting to see the detailed answers it could produce without users having to conduct their own research. The utility is substantial; if you can trust the data, it can make you far more efficient.

Our team spends significant time examining the implications of Gen AI. What kind of use cases can we find in business that will be either for creating new products or services or lowering costs? What's investable there? Today, even though it's early days, the market has taken the idea of Gen AI and run with it.

In some directions, there may be too much excitement. In other areas, the market hasn't yet figured out the potential for important business applications.

**Q: What is the outlook for hyperscale cloud companies? How do you see them as AI beneficiaries?**

A: Hyperscale cloud companies, like Amazon's AWS, Microsoft Azure, and Google Cloud, are essentially renting technology infrastructure. They buy servers, memory, and interconnect equipment and then rent it to others to use in their cloud. It's not surprising that many consider Nvidia to be the first "winner" in this space because Gen AI is highly computing-intensive. Traditional data center chips cannot perform the computation required to run something like ChatGPT; Gen AI requires the kind of horsepower Nvidia chips offer. One way to think about Nvidia is that they sell the supplies to construct a building. That "building" is the cloud services of Amazon, Azure, or Google, which will eventually rent it out for recurring revenue indefinitely.

Companies like Microsoft are also developing their own Gen AI capabilities called copilots. Copilots help users create things. For example, if you want to create a PowerPoint presentation, you can now use Microsoft Copilot and point it to an Excel spreadsheet. It will create a PowerPoint presentation that just needs some editing and saves the user the time to create it from scratch.

Cloud service providers have many interesting permutations of Gen AI that we think are attractive because they represent repeatable, recurring revenue. And it's still not certain to us how big they may be.

**Q: How do you see Microsoft's position vis-à-vis Amazon and Google?**

A: Microsoft has a little bit of a jump start through their investment in OpenAI, which is the company that developed ChatGPT and DALL-E. With OpenAI's legacy already in large language models, Microsoft could essentially port it into their business.

We think other companies also have compelling opportunities ahead. For example, can Gen AI deliver a better buyer experience on Amazon's e-commerce site, or could it serve up more engaging ads in some of its Prime properties? Can Google make search better through its own generative AI-powered chat function? Our research indicates that there are so many possibilities and potential benefits in store for these companies. The cloud services will likely look pretty similar to each other, but the other sides of their businesses have unique revenue drivers.

**Q: What companies do you believe are in a favorable position to monetize AI?**

A: Adobe and Accenture are two examples we have studied. Adobe has already created its own generative AI product, Firefly, which is now incorporated into many creative tools. It can quickly create content, text-to-image or text-to-movie, using its own stock image library as the learning mechanism. It is already doing this in the market today.

According to our extensive research in this space, most companies know they want to do something in Gen AI. Very few of them know exactly what they want to do, and even fewer have their data organized properly to do it. So, we think they're quite likely to hire companies like Accenture to help them get their data organized, properly scrubbed, and then effectively use Gen AI, whether they're doing it to create new products and services or to lower the cost of running their businesses.

**Q: Many companies today have interesting narratives around Gen AI, but that doesn't necessarily mean they will make money from it. How do you separate what you think is truly an investment case from the hype?**

A: For us, it's paramount that we invest in things that we think are obvious. We may be surprised to the upside by Gen AI doing something that we did not expect for a business, but we don't really want to bank on that.

We want a fairly obvious investment thesis, which is what we see in the case of the cloud service providers we discussed. We know exactly what they're trying to do with Gen AI. We just don't know how big it can be. So, it's important to keep following the developments of Gen AI and be mindful that there are some risks.

For example, Adobe has an enviable position in the creative software market, but generative AI has now catalyzed a new generation of start-up, Gen-AI-centric competitors. They're relatively low-end products today but could improve over time. We think their search could be much better with Gen AI for Google. However, is it as monetizable as search is today? That's still an open question. So, we need to monitor all these factors.

**Q: It's worth noting that when you look at the market share of search and Google's share—it hasn't really changed much. You might be able to notice a slight decline relative to Bing over the past year, but it's not very noticeable.**

A: Correct. We have not seen a noticeable change in Google's market share. But, we have seen that ChatGPT has created a new type of search function on top of what we see with Google Search today. People perform tasks in ChatGPT that they just don't in other forms of search. So, it's not that the search market share has declined; instead, a new class has been created.

Our research suggests it is not a foregone conclusion that Google will dominate search forever. That said, we do think that the company sits in a very good position, and it's unlikely that any other company on the planet has better data and more signals about all of us than Google. Still, that doesn't necessarily mean that its business will always be the best because monetizing search is the business. Even if Google maintains its commanding market share, we don't know exactly if the monetization of Gen AI-based search will be as good.

As long-term investors with a business-owner's mindset, we focus intently on monitoring these important opportunities and risks as they evolve.

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