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Head in the Cloud Future in AI

October 2025

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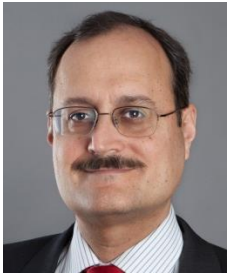
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Mark Moerdler is the Senior Research Analyst and Managing Director at Bernstein Research covering Global Software. Prior to joining Bernstein in 2010, Mark was Vice President of Strategy for Mergers and Acquisitions at CA Technologies. He joined CA in June 2006 as Vice President of Business Unit Strategy, when the company he co-founded, MDY Advanced Technologies, was acquired by CA. Mark received two Master's degrees and a PhD in Computer Science from Columbia University. Mark was named #1 in software in Institutional Investor's All-America Research Team survey in 2017.



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Firoz Valliji is an Analyst on the Global Software team. Prior to joining Global Software team, Firoz worked with the 'Computer Services and IT consulting' team at Bernstein for more than two years covering IT services and card payment companies. Firoz has more than five years of experience in Financial research and more than three years of experience in IT industry as a programmer and manager. Firoz holds an MBA in Finance and a BE in Electronics.



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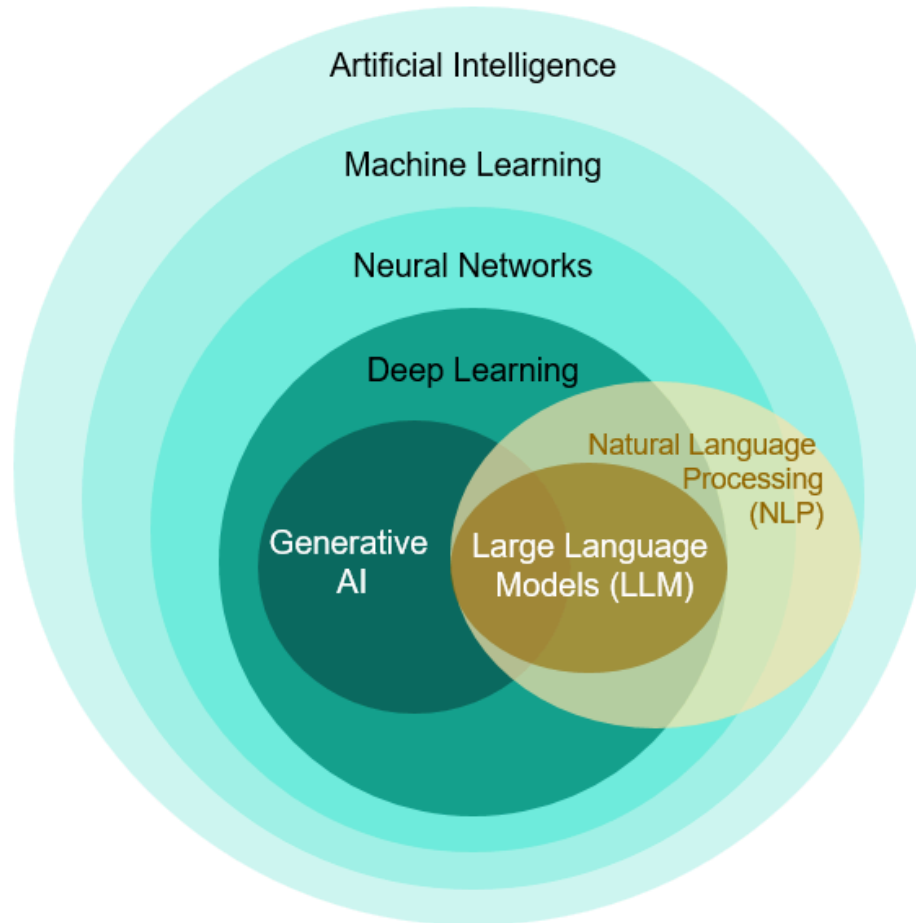
Shelly Tang is a Senior Research Associate at Bernstein on the Global Software team. Shelly joined Bernstein in 2023, after graduating from the MBA program at Wharton. Prior to Bernstein, Shelly spent four years in the finance industry focusing on credit risk. Shelly holds a B.A in economics and math from Amherst College.

The Changing Landscape of Software

- The transition to the Cloud has been the biggest driver of growth
- But that is starting to change
- Portions of SaaS market are reaching Cloud saturation
 - Sales Force Automation market
 - Email
 - Collaboration
- But not all markets are Cloud saturating (e.g. ERP)
- IaaS/PaaS (Microsoft, Amazon, Google, Oracle) is still early
- Will Artificial Intelligence be the next driver of growth?

Artificial Intelligence (AI)

AI advancement has been built on top of foundational principles



WHAT about Agentic AI?

While simple Agents exist today,

they are mostly built by software companies to perform actions in THEIR software

What is required for Agentic AI?

- **Hallucinations will, we hope, decrease due to specialized models**
- **Data needs to be better organized**
- **Trust will likely increase in AI**
- **Agents will, we hope, become better and better**

Don't believe the fiction

- **Anyone can build an Agent with no training**
- **General Artificial Intelligence**
- **Sorry no Terminator, unless due to bad programming creates unintended consequences**

Don't believe the fiction

- Everyone will be replaced by AI – well some will:
 - Many helpdesks, low level developers will be replaced
 - Financial Analysts – only the entry level ones (**I Hope**)
- Anyone can build an enterprise app using AI
- Won't happen overnight due to Gen AI
 - No rampant unemployment
 - No lack of jobs out of school

Stages of Generative AI maturation

➤ Stage 1 (Late CY22 – mid CY23): Over enthusiasm

- “Gen AI will change software”
- Software vendors will capture meaningful revenue in late 23 / early 24
- Bigger the model the better the results

➤ Stage 2 (CY23) Rush to develop and to announce

- MSFT Office 365 Copilot early release in Nov 2023
- Salesforce Einstein AI / Einstein Copilot announced mid 2023
- IT starts projects but does not understand what they want or they need

➤ Stage 3 (CY24) Reality sets in

- Tech is not mature enough
- Problems that Gen AI solve are not well enough understood
- Building Gen AI apps are taking longer than expected
- Corporate data is a problem
- Collaboration

Stages of Generative AI maturation

➤ Stage 4 (CY25): Small # of SaaS vendors will deliver visible value

- Adobe Firefly
- Microsoft Office 365 Copilot?
- Microsoft Sales and Service Copilots?

➤ IT needs to get their act together

- Corporate data needs meta data
- Data Security & privacy issues need to be resolved
- Learn what problems can be solved

➤ Stage 5 (CY25) Starting to get real

- Increasing adoption of consumer Internet Gen AI
- More valuable / monetizable use cases are built for SaaS
- IT early adopters start to build real / useable Gen AI apps
- Small Agents are built and delivered by SaaS

Stages of Generative AI maturation

➤ Stage 6 (CY26 – CY27):Adoptions goes mainstream

- Increasing use of Gen AI in SaaS
- IT starts delivering real Gen AI value

➤ Stage 7 (CY27 ...) Agentic AI goes mainstream

- Increasing use of Agents
- IT starts to trust and use Agentic platforms to build their own Agents

SaaS – Can we monetize SaaS Gen AI?

➤ 3 models exist for monetization of SaaS Gen AI

➤ Price per user / “unlimited” usage:

- MSFT Copilot model

➤ Price per “conversation”

- Salesforce Agent Force model

➤ Incremental functionality is free

- Oracle and Workday model
- But not everything is free – you can charge if disruptive functionality...

➤ Most SaaS Gen AI is not different so over time don't expect much monetization

What about the models

➤ Two approaches to models

- Bigger is much better – the frontier model arms race
- Smaller / specialized solves the problem today at reasonable cost

➤ The Frontier Models arms race

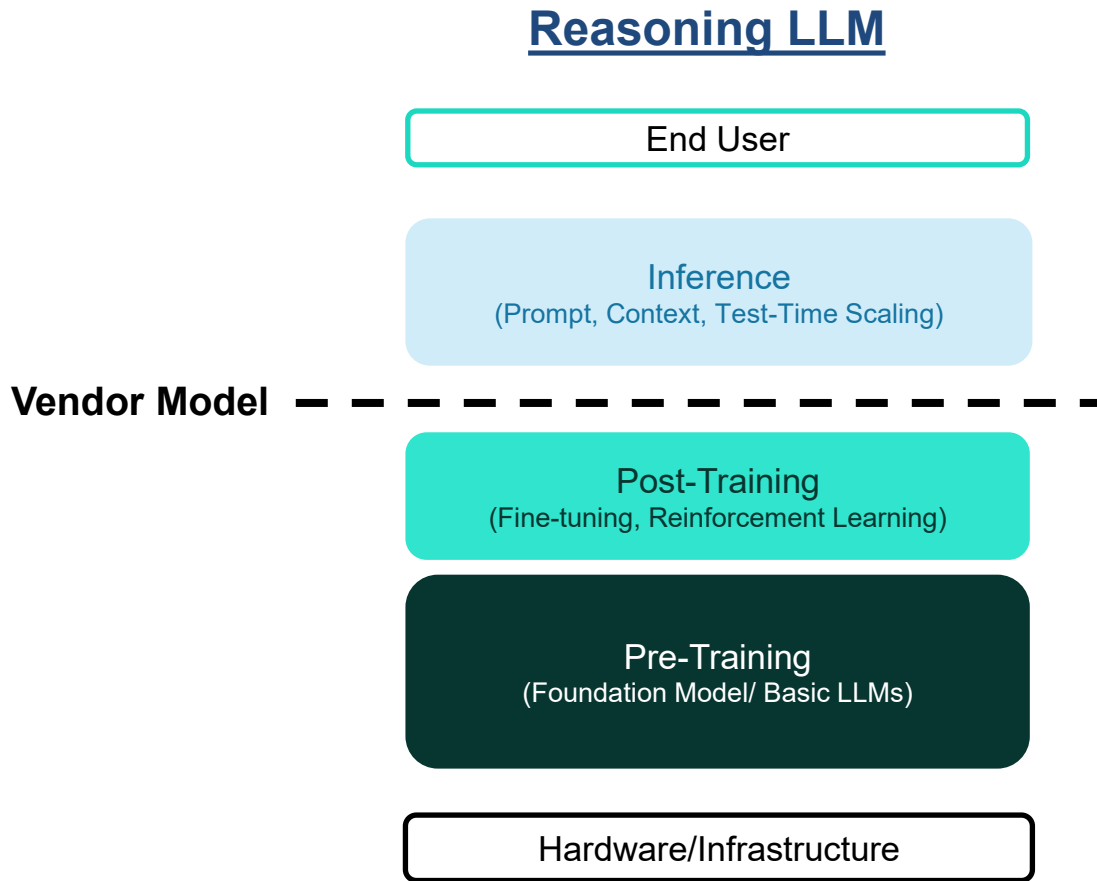
- Started in CY23
- < 10 companies trying to train bigger & bigger models
- Some hope we could see Artificial General Intelligence? Don't think so
- Cost of models going up 10x or more each generation of model
- Can someone make money off a model that cost >\$100B to train?

➤ Smaller / specialized models

- Lots of smaller models being created every day
- Different models solve different specific use cases
- Feb 2024 SAP was using 26 models across 50+ use cases
- Microsoft Copilot – 5 models by feb 2024 and likely growing
- If models are small enough, they could run on your PC or phone

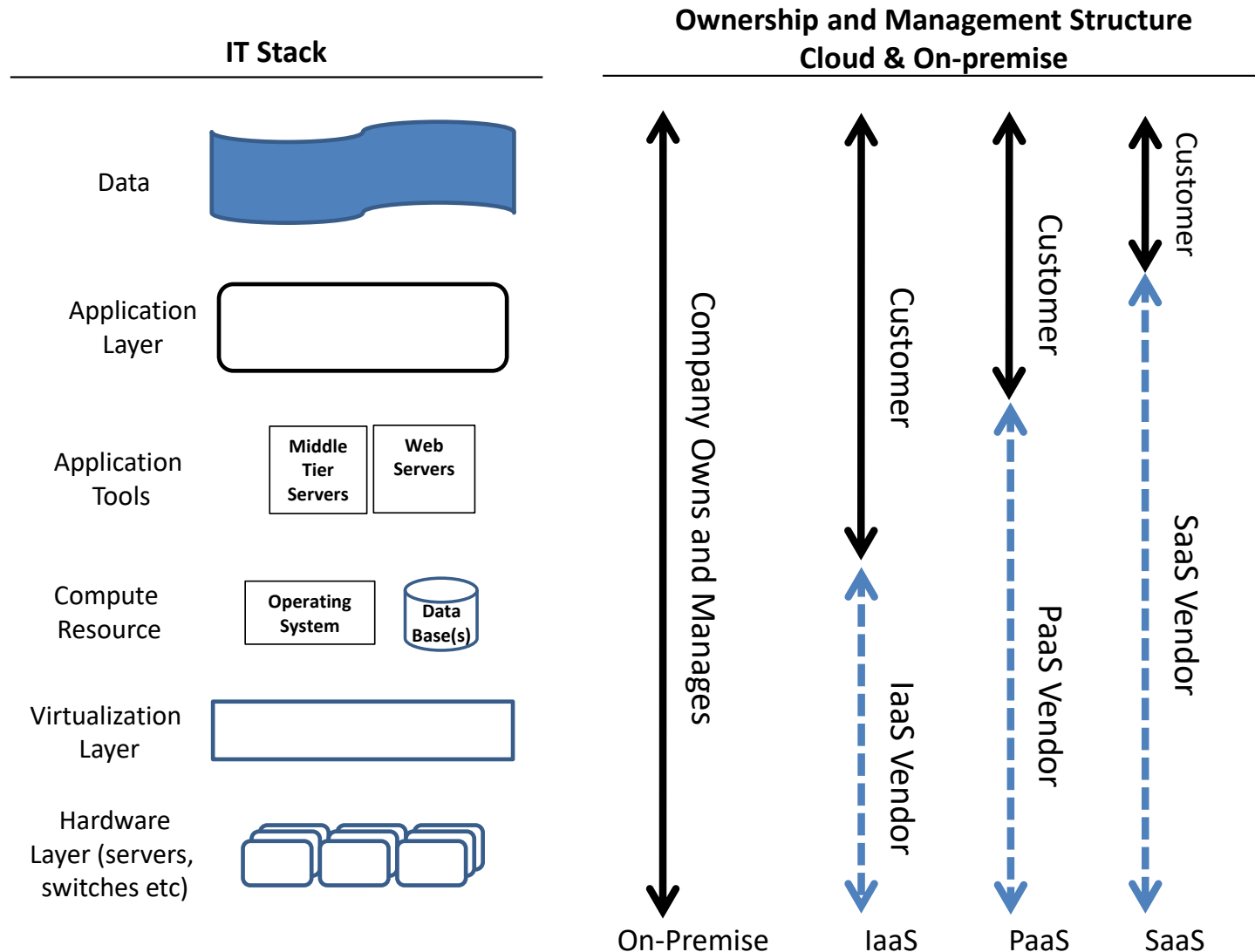
➤ Big question: Can only unique / specialized models make money?

Renting infrastructure from hyperscale Cloud providers or renting a base model as a service from LLM model vendors can be more economical

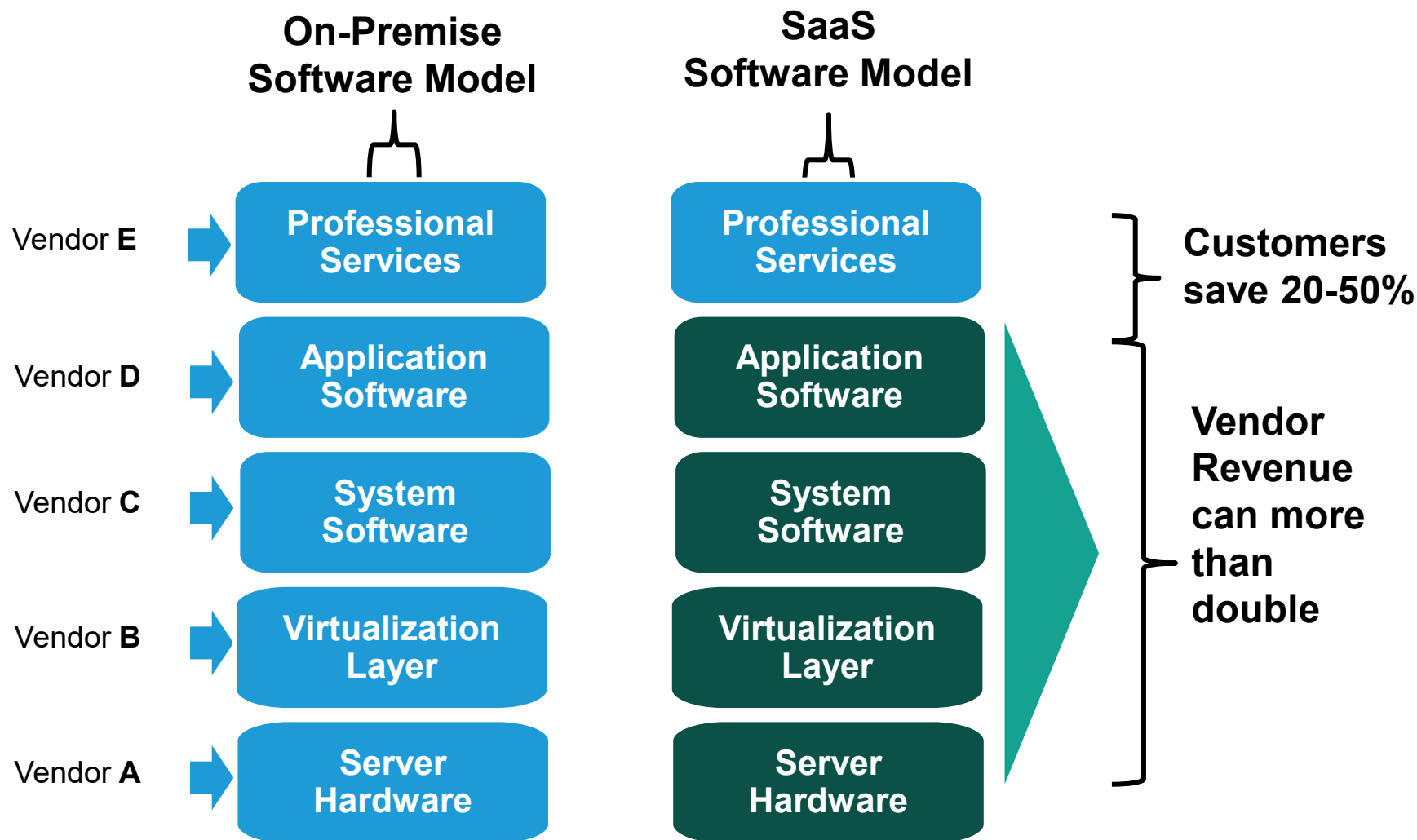


What makes the software industry tick?

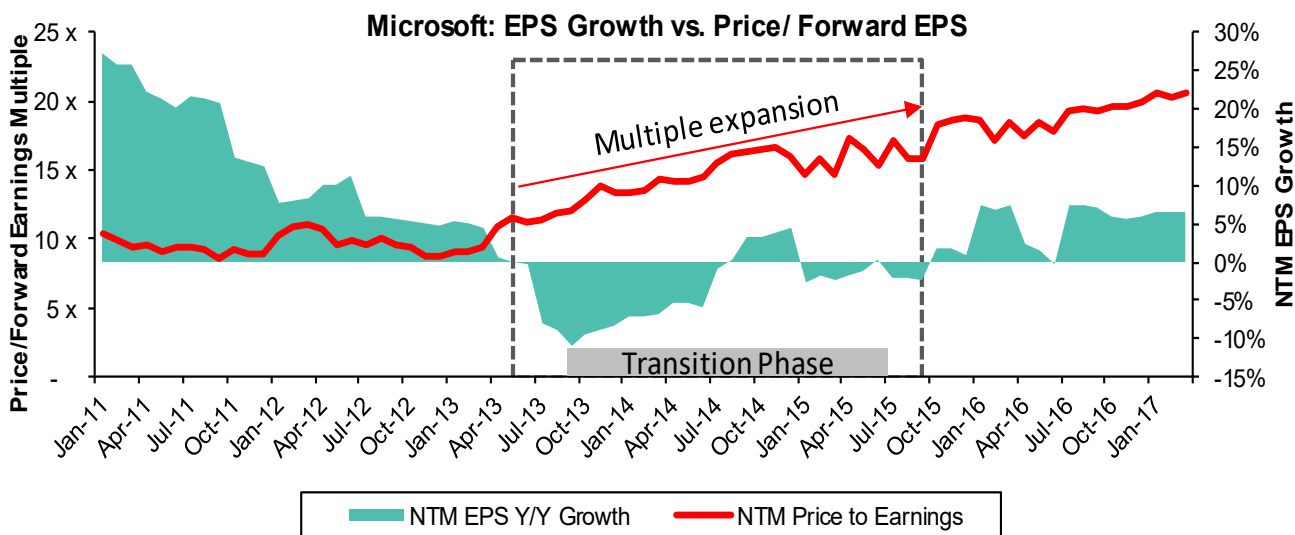
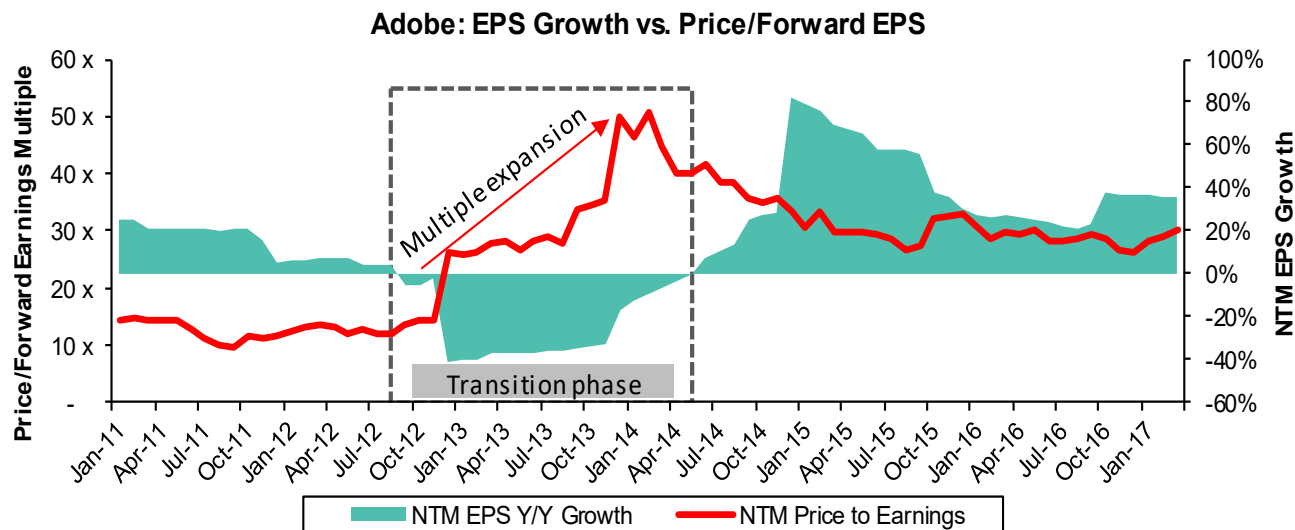
Refresher: Cloud has 3 parts — IaaS, PaaS, SaaS



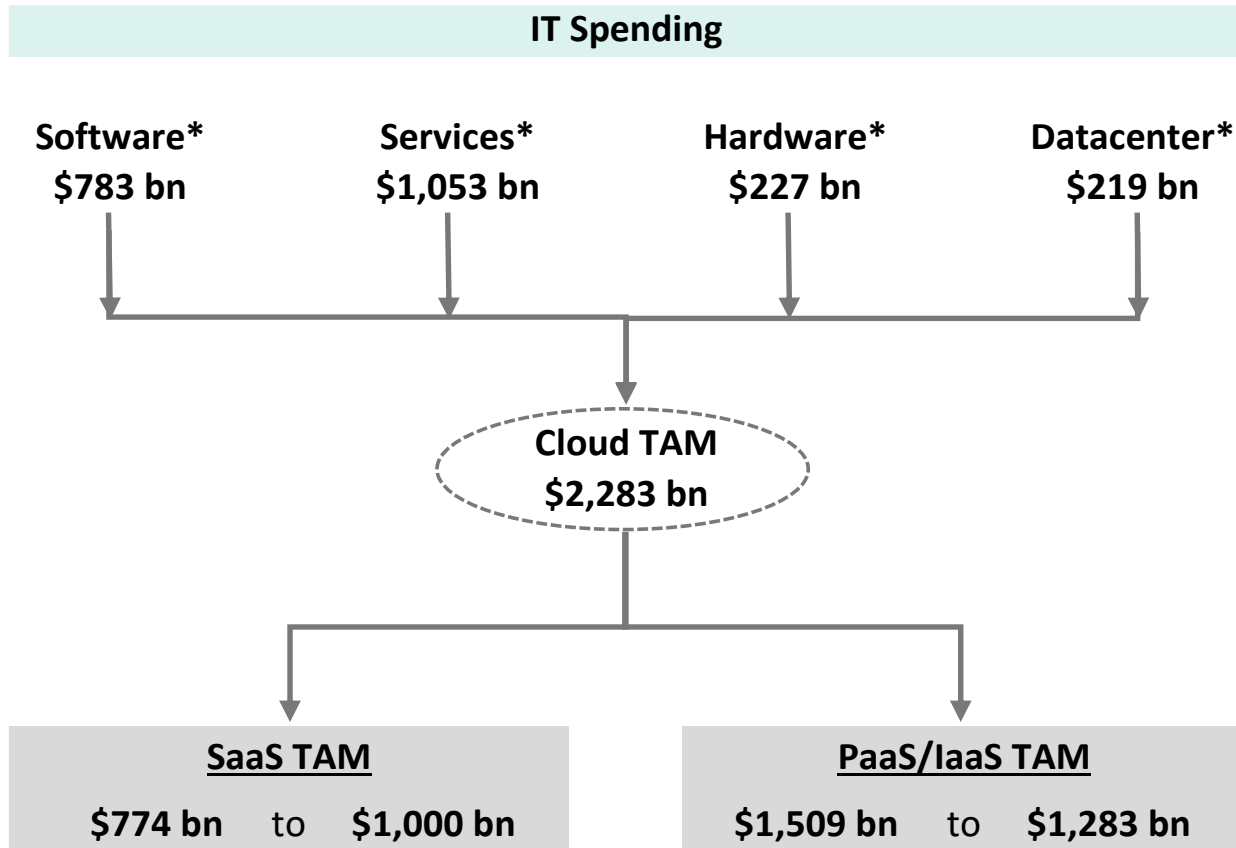
What it means for Cloud vendors



For both Adobe and Microsoft, as investors recognized the value of the Cloud transition, the company's multiple expanded



Long term Cloud could be huge markets



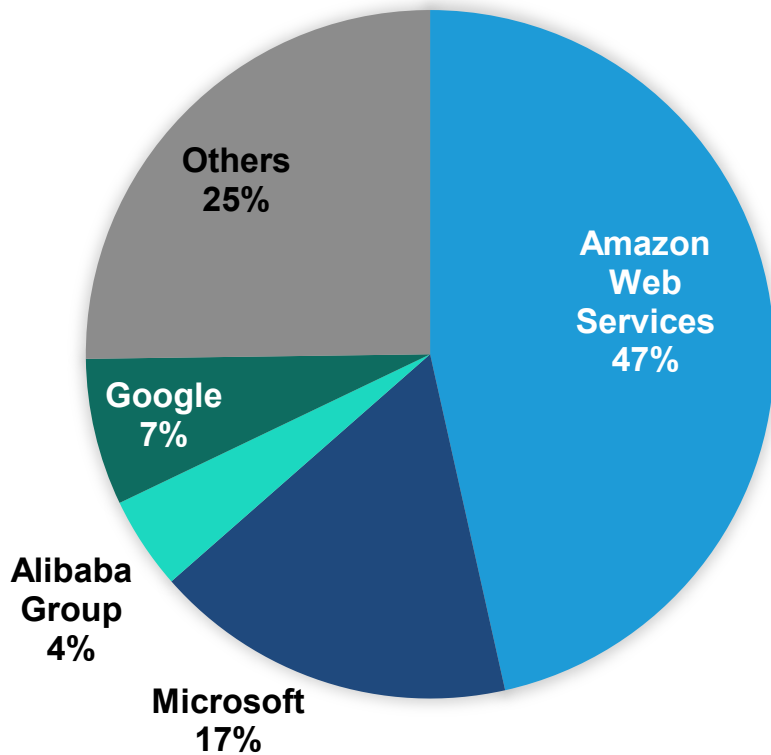
** Size of the segments - included in Cloud TAM - is smaller than their respective current market size, as we do not think that entire computing/IT spending can shift to cloud model.*

** All market size figures are for CY2022.*

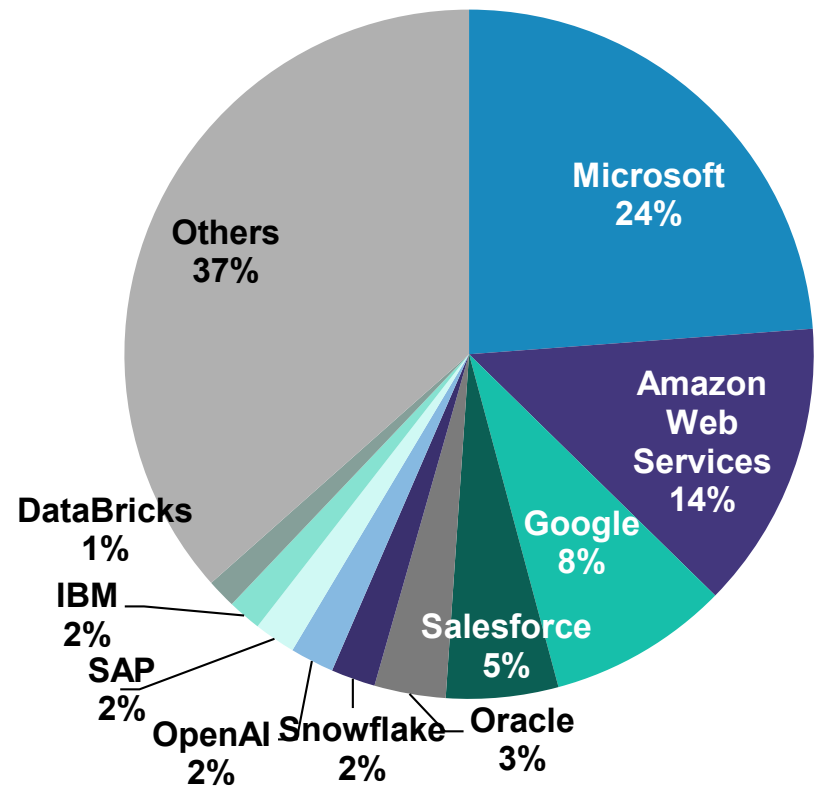
IaaS/PaaS

In 2024, Amazon had nearly half of the IaaS market but the PaaS market at the time was more segmented.

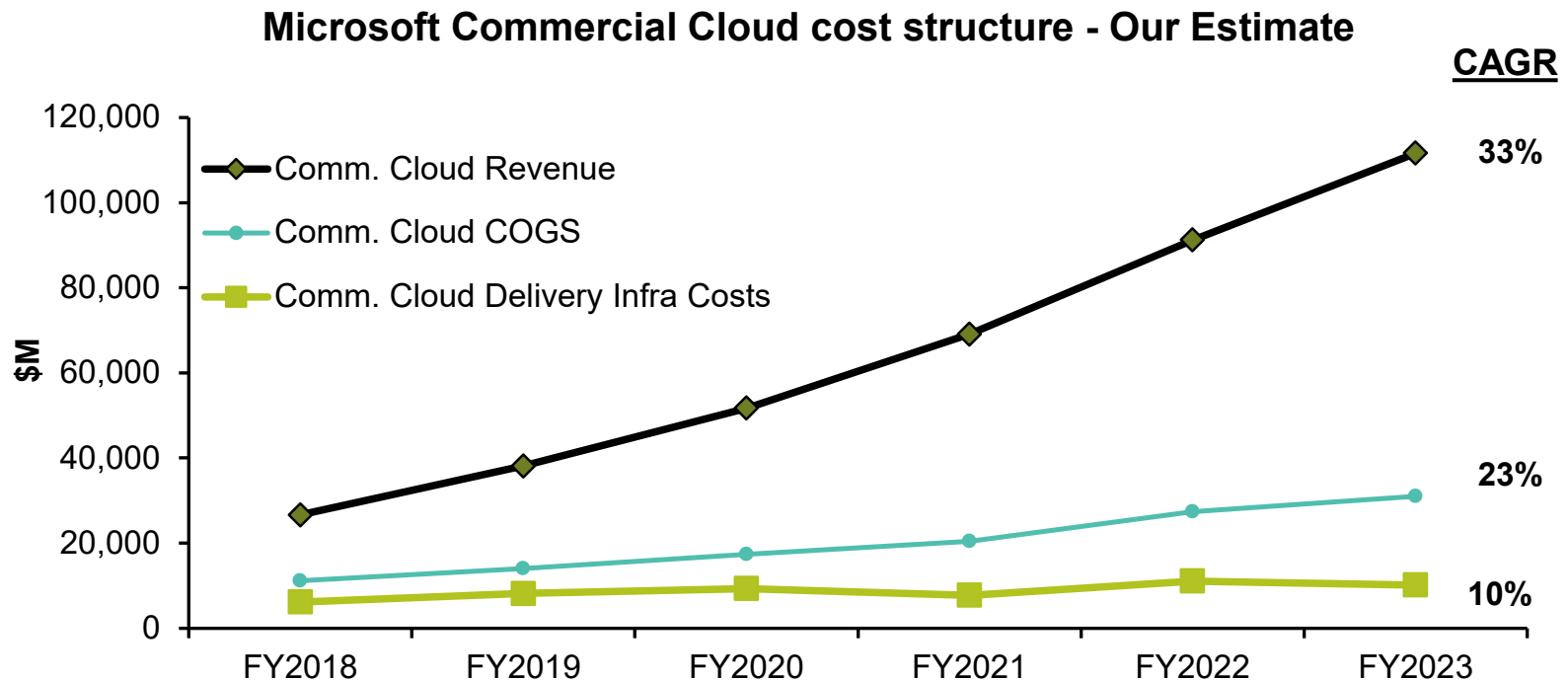
IaaS Market Share - 2024



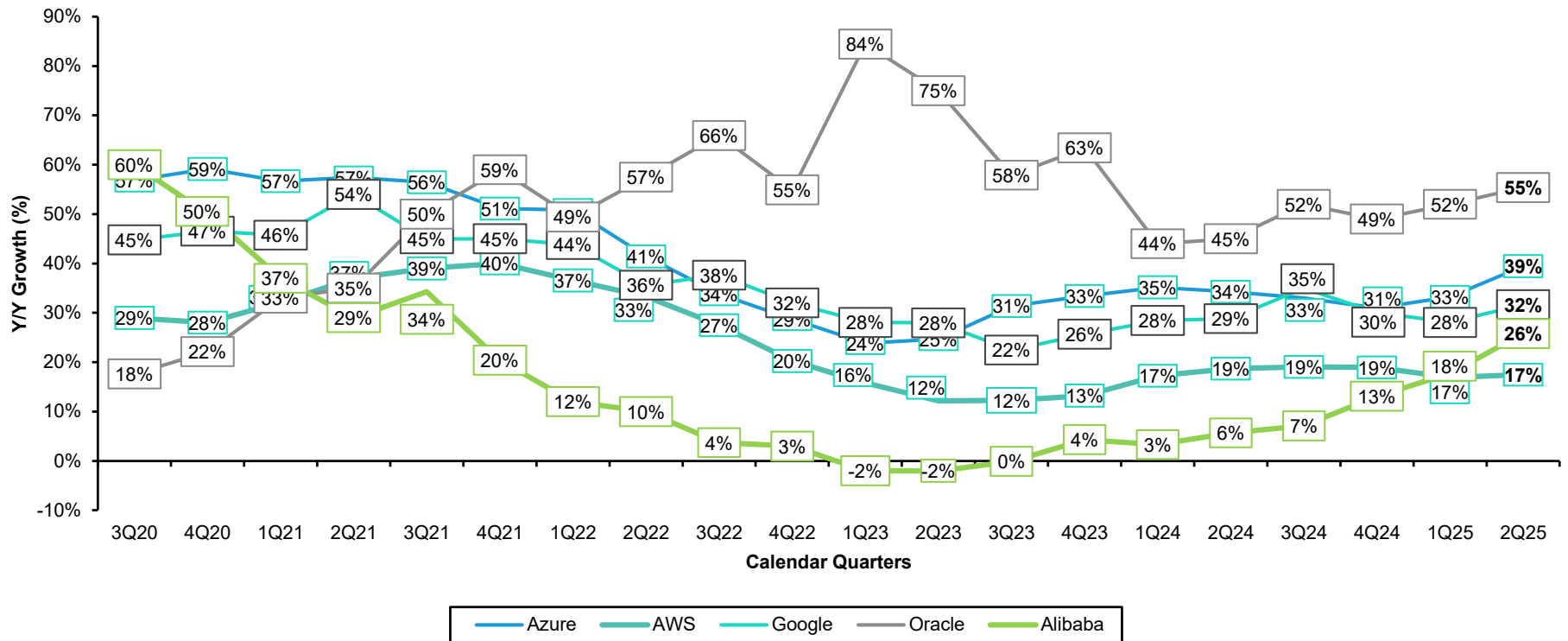
PaaS Market Share - 2024



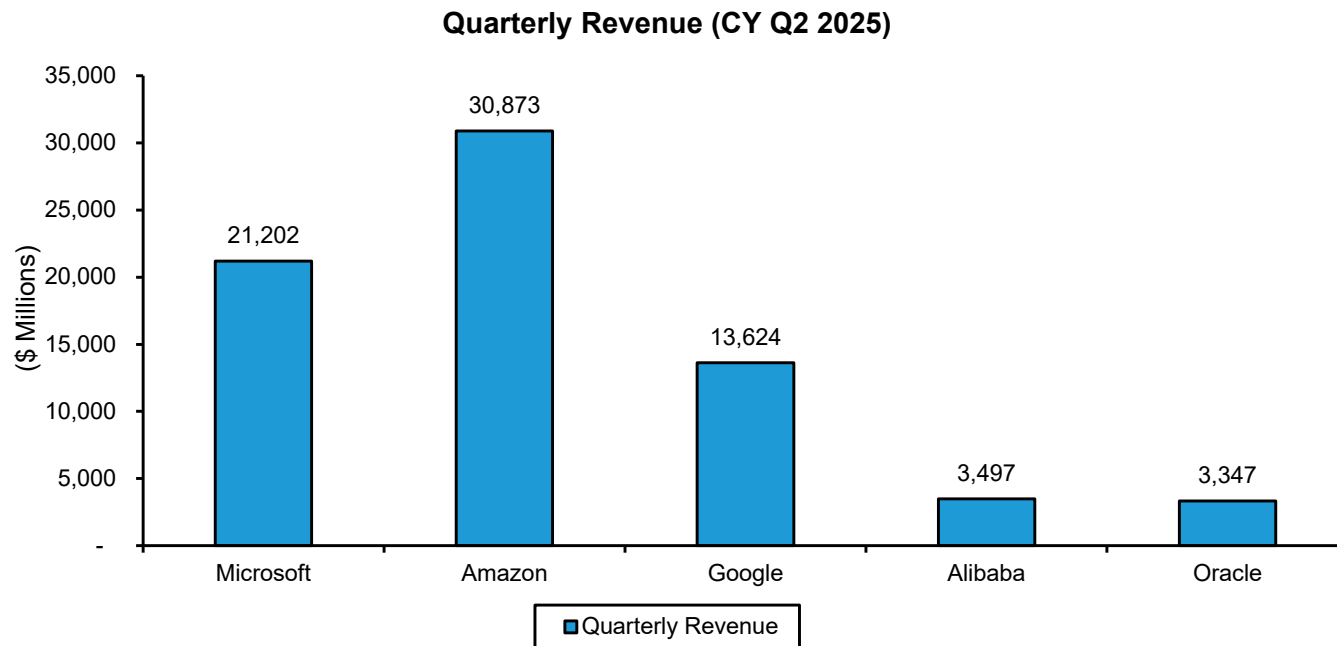
Microsoft's Commercial Cloud (incl. PaaS/IaaS) business grew at a 33% CAGR from 2018 to 2023 while COGS grew only 23% and Delivery Infrastructure cost grew only 10%.



Growth in IaaS/PaaS holds strong with AI being a tailwind, while Oracle is becoming a meaningful competitor



The 5 hyperscale providers report Cloud revenue but include other revenues, not just IaaS/PaaS



Cloud margins depend on a number of factors

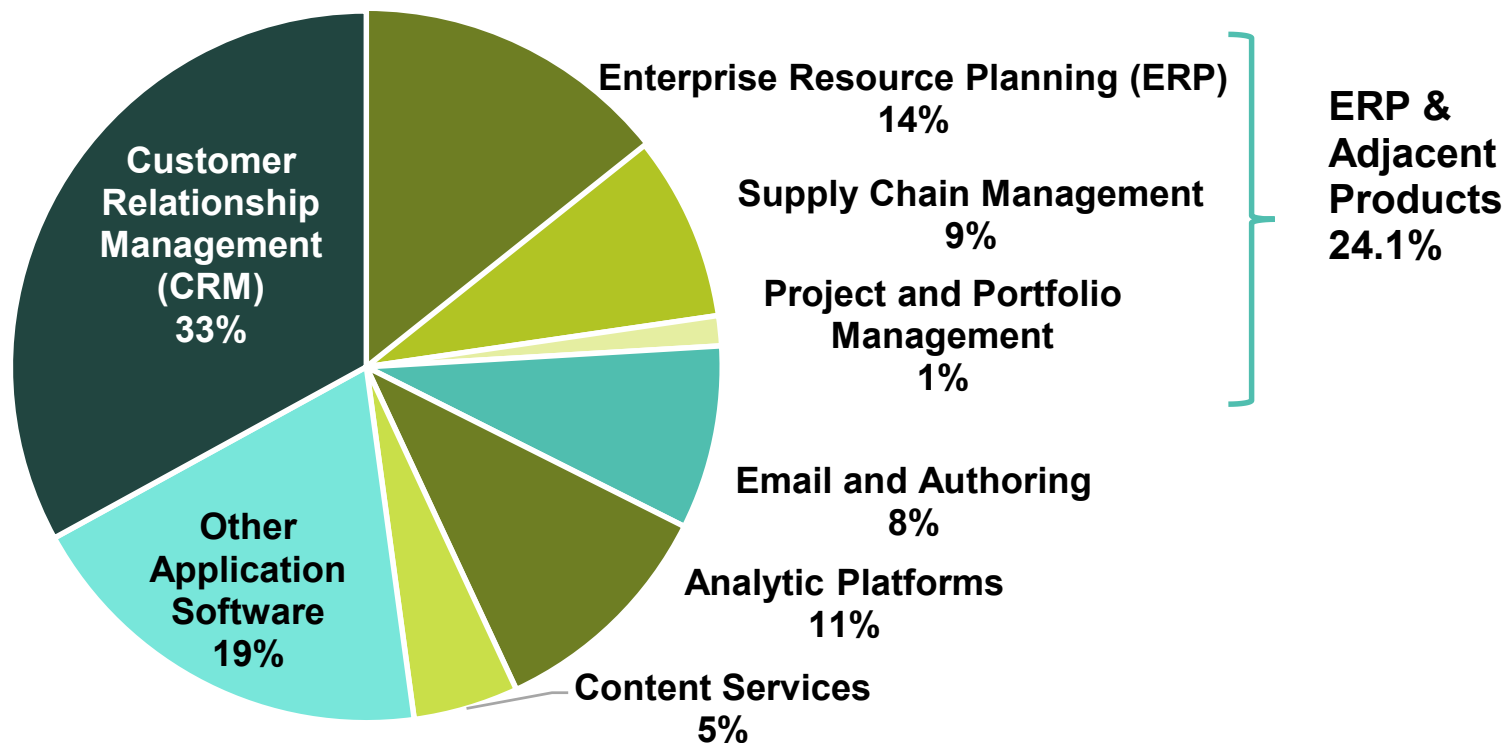
- Mix of SaaS, PaaS and IaaS
- Differentiation and competitive moats are critical
- Cloud is a scale game
- Monetization of software component
- AI could change the margins?

	Gross Margin range for estimate	
	Lower	Higher
SaaS	75%	85%
PaaS	60%	70%
IaaS	50%	60%

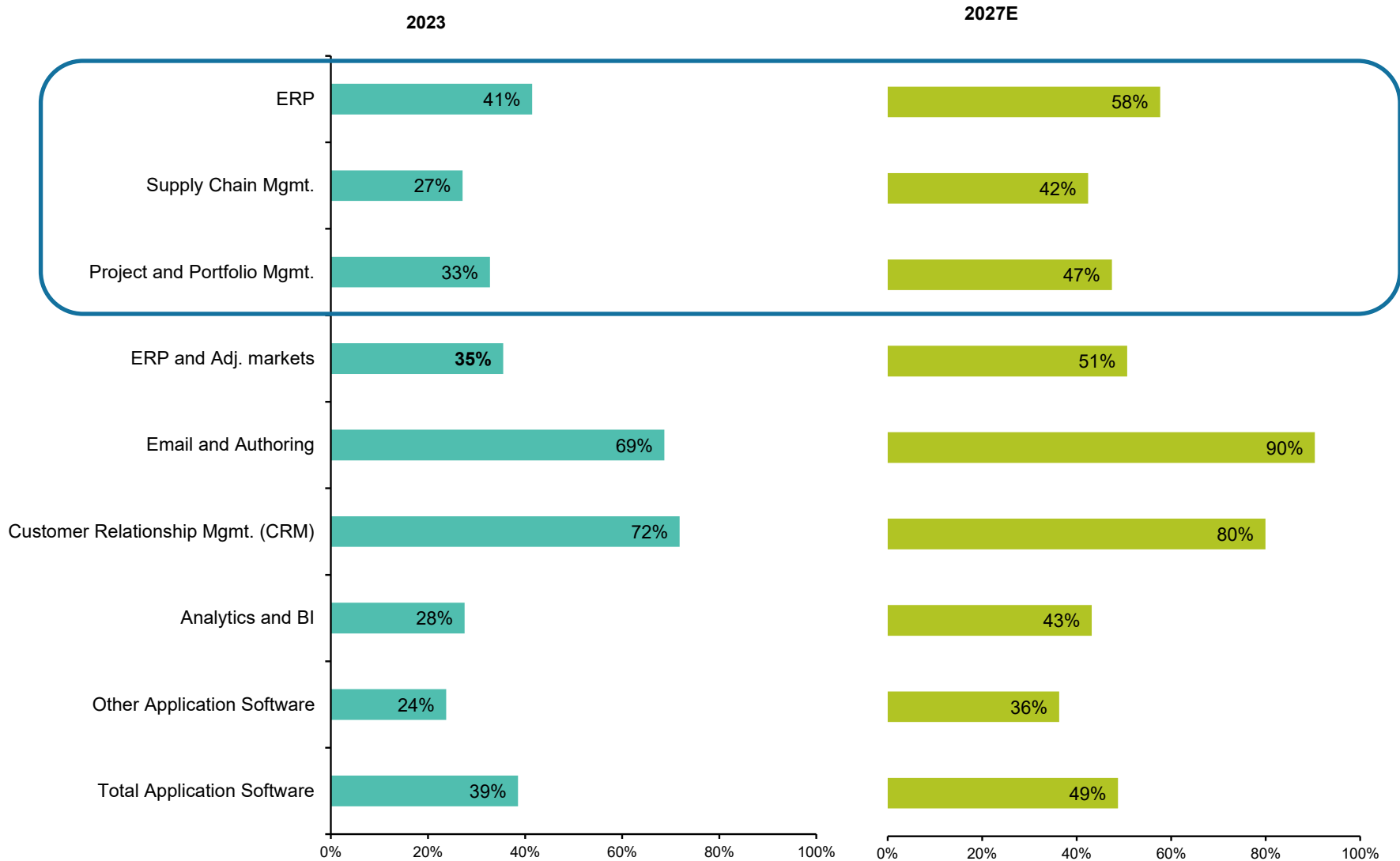
SaaS

Within Cloud, ERP is one of the largest markets

Software Market: Applications vs. Infrastructure (2023)



Cloud Penetration by Segment (assuming 2.5x lift)



Takeaways

We are late in the 3rd stage in the Cloud transition moving to stage 4

- **Stage 1: The Birth of Cloud** – new software entrants developed software to be delivered via the Internet with customers sharing resources
- **Stage 2: Legacy vendors fought back** – Via a combination of acquisitions and organic development on-premise vendors launched Cloud offerings
- **Stage 3: Drive to margins and efficiency** – Many Cloud vendors are focusing on driving sustainable long-term margins via:
 - Selling multiple solutions to the same buyer in the same company
 - Using the same development tools to develop solutions
 - Building on the same technology stack at the same Cloud hosting provider
- **You focus on margins in a maturing market when growth slows**
- **Looks more and more that AI is the driver in Stage 4?**

Overall – Cloud has changed how enterprises think about their IT environment

➤ **Increases customer TAM**

- The increased flexibility of subscription pricing.
- Mid-market can rent enterprise grade software, and everything needed to run it

➤ **The democratization of compute power opens the door for new innovative entrants focused on customer experience**

- Rise of big data
- Rise of AI
- Best of breed products can flourish

➤ **AI is a big buzz today but it is also a big opportunity**

➤ **Many workloads will still need to be on-premise – rise of Hybrid Cloud**

Overall – Cloud has changed how enterprises think about their IT environment

Beneficiaries

- **Everyone moving to Cloud / subscription**
- **Those that support both on-premise and the Cloud (Hybrid Cloud vendors)**
- **Corporate / IT**
 - Opex versus Capex
 - Scalability
 - Smaller IT staff required

Overall – Cloud has changed how enterprises think about their IT environment

Losers

- IT outsources
- Low-level internal IT staff
- Hardware manufacturers
- Long term on-premise only IT solutions

BERNSTEIN TICKER TABLE

Ticker	Rating	Cur	10 Oct 2025		TTM Rel. Perf.	Adjusted EPS				Adjusted P/E (x)		
			Closing Price	Price Target		Cur	2025A	2026E	2027E	2025A	2026E	2027E
ADBE	O	USD	337.51	508.00	(45.2)%	USD	18.43	21.01	23.97	18.3	16.1	14.1
HUBS	O	USD	439.66	606.00	(34.8)%	USD	8.12	9.50	11.69	8.3	7.0	5.9
MSFT	O	USD	510.96	637.00	9.4%	USD	13.64	15.67	18.51	37.5	32.6	27.6
MDB	O	USD	314.44	338.00	(6.0)%	USD	3.67	3.79	4.35	11.6	9.8	8.4
ORCL	O	USD	292.96	364.00	53.3%	USD	6.03	6.74	8.60	48.6	43.4	34.1
CRM	U	USD	241.68	221.00	(29.5)%	USD	10.19	11.48	12.92	23.7	21.1	18.7
SAP	O	USD	265.53	344.00	3.0%	EUR	4.49	6.30	7.63	50.9	36.3	29.9
SNOW	M	USD	242.17	221.00	81.9%	USD	0.82	1.47	2.30	22.4	17.3	13.8
WDAY	O	USD	233.18	304.00	(16.6)%	USD	7.25	9.01	10.65	32.2	25.9	21.9
SPX			6,552.51									

O - Outperform, M - Market-Perform, U - Underperform, NR - Not Rated, CS - Coverage Suspended

HUBS, MDB, SNOW valuation is EV/Sales (x); ADBE, HUBS, SAP base year is 2024;

Source: Bloomberg, Bernstein estimates and analysis.

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Neutral (Autonomous Brand)					
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