



Insigneo Weekly Dispatch

# Scouting Potential Players in the Artificial Intelligence Industry

A potential “shopping list” of ideas that investors looking to get exposure to the AI industry could consider after a market pullback.

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## Scouting Potential Players in the Artificial Intelligence Industry

Whether we are talking about soccer, American football, baseball or basketball, most professional sports teams, tend to have “scouts” looking for the next Lionel Messi and Tom Brady. Some teams even have “feeder-schools”, developing the next generation of talent. The practice of scouting or developing a list of prospects is also useful in the world of investing. Whether it is athletes or stocks, such a grouping of prospects, by definition, is one that is worth keeping a close eye on to consider for the future.

In our Monthly publication issued last week, we addressed the question: [“Are we in a bubble?”](#) Our conclusion was that, although we do not believe that the general market is in a bubble, a small subset of stocks in the AI industry could be approaching bubble territory. Additionally, we also stated that, in light of the recent rally, we would not be surprised by a 10% to 15% pullback in the general market, as such pullbacks are normal occurrences, particularly after strong rallies. However, much like professional sports teams constantly scout for talent, we also value the importance of staying ahead of the game. As a result, we have compiled a stable of companies in the AI industry that, although may appear expensive at the time, could potentially be attractive investment ideas after a market pullback, after their valuations reach more reasonable levels.

We have divided these companies into two groups, the “enablers” of AI that allow for the technology to develop, and the “users” that are benefiting from this technology. The group of companies below is only a small sample set of ideas and is by no means exhaustive, as there are many other companies that could be meaningful beneficiaries of the Artificial Intelligence revolution.

## **The Enablers**

### **Taiwan Semiconductor Manufacturing (TSM):**

Taiwan Semiconductor is one of the world’s leading manufacturers of chips used across various industries. It is estimated that the company produces as much as 30% of the semiconductors on the planet and is expected to control as much as 90% of the AI chip supply industry. Although it is already a dominant player in the High-Power Computing chip end market, JP Morgan expects that approximately 25% of the company’s revenues will stem from the AI industry by 2027. TSM is also well positioned from a financial standpoint, with strong cash flow, and operating margin metrics, as well as a reasonable level of debt. Additionally, the company trades at reasonable valuation levels in the 20x range, lower than its industry peers.

**ASML Holding NV (ASML):** Based in the Netherlands, ASML is a global leader in the manufacturing of equipment used to create semiconductor products used for Artificial Intelligence. The company is the undisputed leader in EUV (Extreme Ultraviolet) lithography, a technological process that etches the complex circuitry required by advanced semiconductors

onto semiconductor wafers. Much like Taiwan Semi above, ASML provides the building blocks used by companies like Nvidia to manufacture their end-products. With little competition in this specific niche, the company is experiencing exponential growth in earnings and revenues. At the same time, ASML also enjoys a high degree of financial stability, with strong cash flow, and operating margin metrics, as well as a reasonable level of debt. However, because of its dominance of this specific niche, the stock trades at 42x earnings, representing a 30% premium to peers.

**Cadence Systems (CDNS):** Cadence Systems provides software technology and consulting services used in design automation. The company is a leading provider of software design solutions used in different end markets, such as semiconductor design. In fact, Cadence is a leader in the Electronic Design Automation and Semiconductor Intellectual Property industries, two key sub-industries in the development of Artificial Intelligence. As one of the best positioned companies in this space, its strong backlog and quarterly bookings also provide a degree of stability for future revenues. Much like TSM and ASML above, CDNS is also well positioned from a financial standpoint, with strong cash flow, and operating margin metrics, as well as a reasonable level of debt. However, as a leader in its space, the stock trades at 49x earnings, representing a 45% premium to peers.

**Broadcom (AVGO):** Broadcom manufactures devices used in the semiconductor industry. In a nutshell, Broadcom manufactures the technology infrastructure such as processors, controllers,

sensors, storage and other devices needed by semiconductors. The company's diversified product base makes it an important player in the AI revolution, with revenue streams stemming from various end markets. In fact, Wall Street expects that Broadcom's AI-related revenues could reach \$10 billion in fiscal year 2024. Additionally, the company appears to be on solid financial footing, with strong operating cash flow and operating margin metrics. Its relatively high level of debt is something that we continue to monitor but appears manageable at this point. Trading at 25x earnings, the stock trades at a discount to its industry peer group.

## The Users

**Salesforce (CRM):** CRM is a cloud-based software company with a strong presence in data management. In its most recent quarterly earnings report, the company announced a push further into the AI industry, as it is looking to combine its data-cloud and AI solutions into one offering. In fact, recent customer survey research conducted by Wells Fargo showed that CRM's customers expect to increase their spending on the company's services as a result of its growing exposure to AI, which should translate into increased revenues for Salesforce. From a cashflow perspective, the company stands on solid financial footing, with a strong cash position and operating cash flows. From a valuation perspective, trading at 31x earnings, CRM trades in line with industry peers.

**Snowflake (SNOW):** Snowflake is a cloud-based data management company. One of the company's main competitive advantages is the

high degree of scalability in its services, increasing the size of its potential end markets. JP Morgan recently named the company a "disruptor" in the cloud data management market, particularly the nascent Data Cloud industry. The company recently announced the retirement of its CEO, Frank Sloatman, who was well known in the industry. That being said SNOW's new CEO will be Sridhar Ramaswamy, Snowflake's ex-head of AI research, who has already emphasized the company's strong push into AI in the future. Snowflake has high levels of cash generation and low levels of debt. However, trading at a P/Free Cash Flow Basis of 60x, the stock trades at a high premium relative to peers.

**Globant (GLOB):** Globant is a pure-play company in the Digital IT Services industry. Exposed to fast growing end-markets across various industries, Globant's modular business model allows it to have flexibility and client-focused customization. There are a number of IT Services companies that will likely be increasing their use of AI. However, we believe that Globant's modular business model will allow it to set itself apart from the competition when utilizing AI to enhance its service offering. Additionally, as a leading user of AI in Latin America, it is also a beneficiary of increased near shoring in the region. The company is seeing increasing operating and free cash flow metrics, and trading at 32x earnings, it trades in line with industry peers.

**Palantir Technologies (PLTR):** Palantir develops software used in the analysis and aggregation of data. Approximately 55% of the company's revenues stem from government contracts, with

the balance coming from commercial end-market demand. Revenues in domestic commercial end-markets grew 70% in 2023, a trend that could remain in place, given the company's strong push into AI. Its government business line appeared to slow a bit last year, but limited competition in this end market could also lead to further revenue growth over time. From a financial perspective, Palantir appears to be well positioned, with strong cash flow, and operating margin metrics, as well as a reasonable level of debt. However, trading at a P/Free Cash Flow Basis of 45x, the stock trades at a high premium relative to peers.

As evidenced on previous pieces we have written, ([Quarterly Call Q1 2024](#), [Quarterly Call Q3 2023](#), [Quarterly Call Q2 2023](#)), we believe that the Artificial Intelligence revolution is here to stay, creating significant impacts on the markets, the economy, and the world. That being said, we are not advocating going out and chasing these stocks higher at this time, as many appear extended and trade at high valuations, potentially leaving them vulnerable to pullbacks in the market. On the contrary, this group of stocks is simply intended to provide a possible "shopping list" of

ideas that investors looking to get exposure to the AI industry could consider as potential investments after a drop in the market, when these stocks trade at more reasonable valuations.

As always, it is also important to consider that the individual equities mentioned here can exhibit high degrees of volatility and are not suitable for every investor. These investments are best considered on a case-by-case basis, based on a particular investor's willingness and ability to tolerate risk. If you need more information or would like to discuss these or other potential ideas in more detail, please do not hesitate to contact your financial advisor. ■



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