

AI – The Business

Given that a lot of investors have a difficult time understanding market behavior, I have, for quite a long time, advised business owner clients to view equity investing as they would buying a business. An old Wall Street adage suggests that markets are, in the short-run, a voting machine; and, in the long-run a weighing machine (principally of earnings). Warren Buffett, as well as quite a number of other legendary investors have often counseled investing in a stock as one would buying into a business. The distinction being, in part, is that viewing it in this way takes one somewhat beyond the notion of simply being in the market or in stocks and returns one's focus to realizing that they are simply becoming a business owner, albeit through fractional ownership in an operating enterprise. Adopting this perspective can be helpful in not only looking past current events and market moves, but also in leading one toward the kind of financial analysis and rigor that is used in the acquisition of a business and further away from making short term decisions that might be highly influenced by a stock's price action.

Given that one can scarcely go thirty minutes into any financial news broadcast without hearing about AI, it might be worthwhile to sneak around the obvious sound bites to uncover some recent news that seemingly, largely escaped the headlines. While the stories overwhelmingly center around AI's impact on all industries and jobs, there hasn't, yet, been a lot of general discussion about the competitiveness of the landscape nor the economics of the businesses. There have been some recent reporting, however, highlighting some aspects of the business of AI that goes beyond its scale and transformative impacts.

One of the more notable reports recently was that the world's largest software suite company is considering utilizing the Chinese AI DeepSeek in its AI agent to reduce costs. DeepSeek was founded in the middle of 2023. By 2025, it was making news as a much lower cost competitor to OpenAI. In a similar story, it was reported that a major ride sharing service reported that its programmers had blown through their entire 2026 budget of Claude tokens within the first four months of the year. Similarly, Large Language Models were at the center of discussions in AI initially. Now, small models are taking up share in enterprise efforts to reduce costs. OpenRouter is a company that routes requests to any of a hundred or so AI engines, with some 65% of request now going to open, sometimes entirely free models. All the while, literal trillions of dollars of investment are being poured into compute capacity.

Returning to the notion of viewing an investment as buying a business, one may be struck by the fluidity of the business model. It is reasonable to assume that the businesses competing in AI created pro formas with certain assumptions about pricing and margins. Their technical, product, marketing, finance and legal teams, no doubt, worked to forecast sales, margins on those sales, payback periods and the like. As highlighted above, the margins, distribution channels, pricing, sales forecasts, costs, partnerships and procurement are all changing very

rapidly. In a dynamic, virtual world, these factors can change literally and figuratively at the speed of light. They do so against a backdrop of competitors for whom the outcomes are viewed as existential – lose in AI and your business could be cannibalized overnight. Many of these companies are not shoveling cash into an AI furnace because they enjoy the crackling sound of paper money. They are doing it because success or survival are presumed to lie on the other side. And, notably, while the focus in the US media has been overwhelmingly on big US providers, the participants are global. The Korean market is up about 170% over the trailing twelve months, largely on the backs of memory and chip manufacturers. Taiwan is up nearly 100%, also on the back of hardware demand. China is aggressively seeking to improve chip manufacturing, lower AI costs and grow market share, generally.

An investor seldom has the luxury of investing in anything because it is obvious and certain. What is clear in the AI space is that few things are certain, nearly none permanent. An obvious use case for AI does not seamlessly translate into assessments of which companies will win and which lose. The analogy will fail some, but it is not too terribly unlike the early years in automobiles or trains- many competing companies, many models, technical advantages and obstacles, disadvantages, economic and supply constraints, efficiency gains and such. It is not, yet, entirely clear what competitive advantage will garner a company defensible leadership. Factory efficiency was a driver in the auto industry, while branding became a bulwark for many consumer goods. Ecosystems benefited certain tech companies. Lower cost manufacturing drove the rise of China. What will prove durable in solidifying leadership in AI?

One thing is very clear: there are a lot of companies and countries with the capital and the willingness to pursue winning in AI. Who will win and how is not entirely clear. In the framework of evaluating the purchase of a business, it is not easy at this point to ascertain with confidence who the near-term winner will likely be nor easy to determine if the advantages will be persistent. There are just a few simple 'knowns' in this case. It is known, for example, that the businesses are being offered at very high prices. The competition is fierce. The profitability is unknown with any degree of certainty. The addressable market of users/buyers for the service is likely huge.

The investor who looks beyond the prices of stocks and into the business might see things differently than the trader. In the relatively short term, the prices will be what they will be and the path there will be as it is. Before engaging, it might be wise to ask first, "What kind of buyer am I?" This could serve an investor well should things, as I expect, take some more unexpected turns over time.

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