KEYNOTE INTERVIEW

AI drives transformational technology shift

Advances in artificial intelligence offer new use cases and productivity gains, opening up opportunities for late-stage companies, say Wellington Management's Rob Mazzoni and Matt Witheiler

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Q How are private companies advancing AI today?

Rob Mazzoni: We've observed significant activity among AI start-ups building infrastructure, models and applications, as well as traditional software companies incorporating AI technology to better serve customers. Where we're more cautious is around the hefty capital flowing into the space, with AI companies raising capital at big multiples, and plenty of copycat businesses getting funded.

Periods of investor and founder exuberance often fuel innovation, and we're spending time with incredible teams gaining real traction in areas like AI for cybersecurity, software development and legal technology, among other sectors. We feel fortunate to focus on later-stage investing, where we can wait for leaders to emerge before investing, then help companies along that 'last mile' of their journey towards becoming public companies. Many AI companies will likely prove to be features versus platforms or lose to public incumbents, but we believe several huge companies will emerge.

Q How are AI developments impacting investment theses, in terms of where value is being accrued between tech incumbents and start-ups?

RM: We're thinking deeply about where AI will be an enabler or disruptor. AI appears to be unlocking opportunities in sectors that were previously untouched by technology because they were too services-heavy, such as law firms and customer support. It's also now possible to challenge entrenched businesses: maybe AI can do the work of a sales development rep, but also build a modern, automated customer relationship management system.

We debate where value will accrue, both among various sectors, and between incumbents and start-ups. When it comes to AI, incumbents seem to have data and distribution advantages. Big public companies have amassed data over decades to build and train AI technology, and they have hundreds of millions of customers to distribute it to.

Like in the mobile era – when Google and Apple had massive advantages, but entirely new use cases emerged in the cases of Uber and Airbnb – the AI wave could see huge public companies sprout from modest start-up roots.

Q What does AI mean for value-creation strategies and where will jobs be most impacted?

RM: AI has the potential to be a massive accelerant to growth and productivity, maybe even more so than the microchip, PC and internet. There will likely be dislocation – we might see companies replacing large customer service staffs with AI that understands all prior customer interactions and never sleeps – but particularly for knowledge workers, AI should make them better at their jobs.

What's impossible to predict is how exactly things will unfold. AI may unlock new jobs to be done, and humans will adapt to fill them. Historically, waves of technology-led disruption have created more opportunities than they removed, and my guess is the AI wave will follow suit.

Q Looking more broadly, how would you describe the current market environment for tech investors?

Matt Witheiler: On the late-stage private side, today's market environment feels unique and potentially quite favourable. Deal activity is up as more companies are raising money. Many late-stage private companies last raised capital in 2020 or 2021, but there is often a constant need for more money, so they now have maybe only 12-18 months left of cash.

At the same time, valuations and valuation expectations appear to be down. When you consider that competition seems to have thinned out, it could create an interesting environment. This might be especially true given the backdrop of technology-led disruption, which seems to be continuing at an accelerated pace with technologies such as AI. Finally, if you look at the public markets where many of these companies aspire to be, those markets appear to have stabilised and deal activity is up there.

Q What does the IPO market look like today, and how is that impacting late-stage growth strategies?

MW: The IPO market is beginning to open back up. Last year there were three technology venture-backed IPOs and this year we saw five or six in the first half, so the pace has accelerated.

If we look at the last 50 years, on average the IPO window has been below historic norms for one to three years at a time – that is typically how long the window closes, when issuance volumes come down. We have seen volumes down in 2022, 2023 and now 2024, so we are in the third year. Late-stage private companies are actively planning for IPOs, which was not the case a year ago.

Those delayed IPOs are likely creating investment opportunities because companies are raising private money. Meanwhile, as IPO activity comes back, it could provide a benefit to our part of the market from a liquidity perspective.

Q What are the biggest headwinds facing tech investors right now?

MW: We are still digesting the hangover from 2021 activity levels. There is no lack of innovative companies, but the impediment is that many don't need to raise money yet. Still, as every quarter passes, a new company may find itself needing capital to do something.

RM: We have seen a clear bifurcation in the market, where there is a large class of companies that raised capital in 2021 and early 2022 that have found that – in a new market environment where perhaps capital preservation is being valued more than growth – they have cut cash burn but also cut growth, leaving them in a challenging position. They are not of a scale that is interesting to public markets, and they are also not growing fast enough.

On the other hand, there are companies that have persistent attractive attributes, which are continuing to grow quickly, but are overvalued. AI valuations seem especially frothy. Tech investors are willing to pay premium multiples for businesses that are truly best in class, but the challenge is to discern which those are and where there will be desirable growth.

Q Where will the most exciting opportunities be in the next 12 months?

MW: We are opportunistic; the benefit of working at a $1.2 trillion asset manager is that we have investors with deep expertise in every sector, so we can go wherever we see the best risk/rewards.

The consumer sector has been interesting. It suffered during covid, especially experience-based businesses, and has since seen acceleration. In software where many companies that raised money in 2021, we are now seeing them come back to market.

Finally, AI is a particularly interesting opportunity. There was a lot of exuberance around digital currencies in 2019, but at the time that felt a bit irrational. With AI, we are believers that this is a transformational technology shift. ■

Rob Mazzoni is technology sector lead and Matt Witheiler is consumer and technology sector lead for Wellington Management's Private Investing platform