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U.S. SMID-Cap Software

Software: Will Anthropic Claude Cowork disrupt SaaS vendors?

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Anthropic's "Enterprise Agents" event last Tuesday the 24th was a source of incremental worry after the bear case laid out by Citrini Research two days earlier. Not surprisingly the market plummeted, and we spent Monday the 23rd in the middle of a real and proverbial blizzard (our blast email is below). But relief! The Anthropic enterprise event was sanguine, and further sharpened our perspective on the evolving landscape of LLM providers and their interaction, competition, and collaboration with SaaS.

The Anthropic event showed that GenAI/LLMs are end-user productivity focused. Whether we look at LLMs or SaaS vendors the current core offerings use GenAI's natural language search and synthesis capabilities to improve the productivity of end users. Perhaps we will have Agentic some day, but for now the simple value proposition makes sense as we think this is very valuable for most white collar workers' day-to-day jobs. **...and reinforced they have no core role in infrastructure.** For instance, the building blocks of applications and LLMs are still unique technology valuable and critical in their own rights such as the access to compute (e.g., hyperscalers), databases, middleware, or the CDNs. This includes the specialized operations software built on top of those to operate applications (e.g., containers, observability, service mesh / artifact repository). It also doesn't replace spaces where non-language focused alternative ML foundational models are much more efficient and effective, e.g., cybersecurity.

We think Anthropic's "Switzerland" strategy is smart, safe, more valuable than trying to replace individual desktop productivity or LoB SaaS. The Anthropic event seemed to go out of its way to be collaborative. Their message appeared to be that they play nicely across the ecosystem to help end users be immediately more productive. We think this is a very smart strategy for two reasons: 1) being Switzerland is a competitive advantage for Anthropic, 2) end user tools has been a tough business over time, with A LOT of turnover. As roles change there are new entrants all the time. Not to mention, by avoiding LoB takeouts Anthropic also avoids a highly challenging battle against entrenched incumbents with significant switching costs. Customers need an independent Switzerland they can trust to help coordinate across applications. We think this gives Anthropic a MUCH longer duration and offloads the risk of individual applications to the ecosystem. This emulates the successful long-duration strategy of ServiceNow or Atlassian.

OpenAI's planned direct vendor competition may relegate them to mainly consumer / SMB use. OpenAI's reported latest investor pitch includes a plan to directly replace vendors "including Salesforce, Workday, Adobe, Slack and Atlassian". This seems to be a risky, if history is a guide — just look at AWS or Google. We think the biggest challenge for OpenAI to succeed is this takeout strategy requires a lot of distracting non-core executive focus to get right. There is little related IP in the OpenAI business they can leverage as they build these new products. The even harder part will be building new targeted commercial, support, and channel engines. This effort more likely becomes a distraction to the more important core business, thus it is likely to struggle. In the end, history says their executives won't put the required effort in to build something differentiating, and their commercial team won't focus on selling (nor will they be able to get the channel focused) relative to the core massive LLM revenue opportunity.

BERNSTEIN TICKER TABLE

			2 Mar 2026		TTM		Adjusted EPS			Adjusted P/E (x)		
			Closing	Price	Rel.							
Ticker	Rating	Cur	Price	Target	Perf.	Cur	2025A	2026E	2027E	2025A	2026E	2027E
TEAM (Atlassian)	O	USD	73.80	290.00	(89.6)%	USD	3.68	5.33	6.51	20.1	13.8	11.3
NET (Cloudflare)	M	USD	181.02	146.00	9.0%	USD	0.92	1.36	1.86	195.8	133.6	97.5
CFLT (Confluent)	M	USD	30.70	31.00	(18.8)%	USD	0.42	0.62	0.88	72.9	49.5	35.1
CRWD (CrowdStrike)	M	USD	384.86	353.00	(16.8)%	USD	3.24	3.69	4.93	118.8	104.4	78.1
DDOG (Datadog)	O	USD	111.11	180.00	(20.2)%	USD	2.05	2.56	3.43	54.1	43.4	32.4
FTNT (Fortinet)	M	USD	79.18	83.00	(42.3)%	USD	2.76	3.13	3.81	28.7	25.3	20.8
GTLB (GitLab)	O	USD	26.19	70.00	(72.1)%	USD	0.74	0.95	1.37	35.3	27.5	19.1
OKTA (Okta)	O	USD	73.97	129.00	(33.8)%	USD	2.81	3.47	3.86	26.3	21.3	19.2
PANW (Palo Alto Networks)	O	USD	150.15	209.00	(36.7)%	USD	3.34	3.97	4.45	44.9	37.8	33.7
S (SentinelOne)	O	USD	13.13	21.00	(51.9)%	USD	0.04	0.20	0.38	292.6	65.1	34.2
NOW (ServiceNow)	O	USD	109.42	219.00	(56.7)%	USD	3.50	4.27	5.15	31.2	25.7	21.3
TWLO (Twilio)	M	USD	123.81	126.00	(12.3)%	USD	4.89	5.66	6.57	25.3	21.9	18.8
ZM (Zoom)	M	USD	72.72	88.00	(16.9)%	USD	5.92	6.50		12.3	11.2	10.4
ZS (Zscaler)	O	USD	148.58	228.00	(39.9)%	USD	3.28	4.20	5.23	45.4	35.4	28.4
SPX			6,881.62									

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

ZM base year is 2026;

Source: Bloomberg, Bernstein estimates and analysis.

INVESTMENT IMPLICATIONS

[no change to our models, investment recommendations, or price targets]

The latest LLM desktop copilot productivity tools raise the competitive bar to monetize the Agent… our coverage has both winners, and those with challenging setups. Most software vendors are touting their AI agent offerings of one type or another, and many of them hope to monetize these agents directly. But we think this will be more or less fruitful depending on their usage in a customer. As we discussed above, we really like the role of a "Switzerland" AI-copilot on the desktop. In this case, any of the desktop tools would have a greater challenge monetizing their offering. If we take our logic to its natural conclusion we think:

- Winner: Platforms: we think those vendors who are the end-to-end platform themselves for a customer function, or at least a role within a function, are likely to be able to monetize significantly. A Switzerland isn't a natural value proposition in those cases, and the platform vendor can sometimes offer better AI agents due to proprietary existing customer data on which to train specialized mini-model GenAI agents. Not only can these optimized mini-models be more effective than the general purpose LLMs, this data may not be readily available outside the platform, making it a protectable advantage vs. LLM owners or other startups. For a software vendor, it may be true that not all their customers are platform users, but for those who are, this could be more easily monetized. In our coverage we think the vendors with this platform characteristic for a broad set of their customers, thus large monetization potential, include: **Datadog** (Bits AI for SRE and Cloud Operations), **ServiceNow** (Service desk, IT operations, cross organization workflows), **Palo Alto Networks** (SOC agents to priorize alerts and help automate cyber responses within their platformization cybersecurity customers). A final example in our coverage is **GitLab**'s Duo integrated in its CI/CD platform, which has unique access to the customer organization's context of deployed infrastructure and security posture required for testing code — because this context isn't readily accessible by code suggestion tools, it will be difficult to replace Duo's value for the developer or DevOps role to perform quality, performance, and security testing.

- Winner but hard to monetize? Protectable workflows (not in end-to-end platforms): In the prior bullet we argued enterprise line-of-business (LoB) SaaS platforms appear to be able to monetize their GenAI features while seeing limited competitive risk. But we also see GenAI features being added and successfully adopted within non-platform desktop applications — i.e., this GenAI feature is included in a tool used in just piece of someone's daily activity. We think this reflects situations where an important end-user workflow is trapped in a non-platform application, creating an opportunity for value-add GenAI feature(s) for that vendor (i.e., customers prefer using it to 3rd party alternatives). Although, we are seeing evidence it is hard to charge for this value incrementally in our coverage. **Zoom**'s AI Companion is one example — they have several GenAI value-add features around end-user collaboration (e.g., note-taking, summarization, search in discussion) and the reported usage trends are positive, but they aren't able to charge incrementally. Another example in our coverage is **Atlassian**'s Rovo which has all the context of project workflows and decision-making, meaning product team members find it remains value-add (even if aspects of the platform, like documentation or status updates are more easily served by whatever code suggestion tool is in use). Rovo's reported usage is rapidly ramping, but Atlassian has held back on enforcing direct pricing (we do not include upside for it in our models).

- Challenged: one-of-many tools: Software vendors who are just one tool in a set of many used by end users may find full monetization of their agents harder. Similar to the case of Anthropic used across a knowledge workers desktop, in our coverage we could see similarities in: the cybersecurity organization for **CrowdStrike**'s Charlotte AI or **SentinelOne**'s PurpleAI. In some cases these tools may be used by a specialist, in which case a Switzerland would be less valuable. But in the case of a Security Operations Center employee who is responsible for signals across many different tools and needs to prioritize and do root cause analysis across them might find a "Born in AI" Switzerland like one of the VC-backed born-in-AI vendors more attractive.

Beyond monetizing the Agent itself, the latest LLM vendor offerings (and visionary demos) drive IT budget priorities, and tailwinds for some of our coverage. We think IT budgets are going to remain constrained, and how all this value gets paid for will favor some vendors. Even Claude Cowork (or other new entrant) won't displace current vendors or current vendors' add-on AI Agents, current vendors need to be in a priority IT / product team spend category otherwise they may find limited resources available (time, money, and attention). Within our coverage, we see three areas generally well positioned to drive strong spend tailwinds, and one that is unclear:

- Winner #1: Infrastructure modernization to prepare for AI: this is frequently about modernizing legacy applications in legacy mainframe or client/server architectures (i.e., pre Service Oriented Architecuture or "SOA"). Think things like legacy DIY banking or healthcare applications, or even slowly modernizing vendor provided solutions like ERP. Why? Because without an API interface at the least, and even an AI-specific MCP interface, these applications can't easily be included in the AI productivity workflows for employees and the Agents they use. These AI interfaces require either a Windows/Linux (SOA) or Java (Cloud Native) application. Thus, this modernization grows both Windows/Linux and Cloud Native (i.e., Web/Mobile app) infrastructure requirements, helping the hyperscalers, databases, and middleware, as well as operations software on top of them. In our coverage this is a positive for: **Datadog** (observing Cloud Native workloads), **Cloudflare** (last mile delivery and internet security for Cloud Native workloads), **CrowdStrike** and **SentinelOne** and **Palo Alto** (cybersecurity that scales with the number of cloud containers/virtual servers), **Zscaler** (cybersecurity that simplifies requirements of a cloud-first global organization), and **Confluent** (cloud-native middleware that underpins Agent's "data in motion").

- Winner #2: AI-agent tooling: these are components used by software vendors or enterprises to build their agents. In our coverage **Twilio** (AI voice infrastructure) and **ServiceNow** (enterprise IT Agent coordination platform) are on the right side of budget priorities. In addition, the AI-agents' underlying infrastructure will benefit the vendors in the prior bullet as it drives scale (e.g., **Datadog**, **Cloudflare**, **Confluent**).

- Winner #3: Cybersecurity for cloud: broadly cybersecurity budgets are rising to protect from increasing attacks, and we see cybersecurity budgets continuing to rise as a percentage of IT as a result. But these budgets are particularly focused on securing the latest architectures (as we pointed out in the first bullet) or identifying breaking more rapidly (e.g., **CrowdStrike**'s threat intelligence capabilities). It also emphasizes the platformization necessity for customers without the scale or sophistication to keep up (e.g., **Palo Alto**'s end-to-end offering).

- Unclear: Cybersecurity for AI: We are not yet calling the "securing AI" opportunity, as there generally needs to be some agreement on how AI will be implemented before it is clear how we want to secure it. Clearly topics like Data Protection/Auditing and Identity are top of mind in the AI-Agent world. But in the past new technology approaches did usher in new vendors, so we are not as optimistic that our covered vendors in the "best of breed" categories are likely to get a lot of the incremental upside. With that said, in the near term **Okta** does seem to benefit from their use in identity for software vendors' agents, we just are less clear if this continues as a tailwind. On the other hand, platforms like **Palo Alto** are likely to keep adding the latest technology and being relevant to their "good enough" buyers.

Left out of the discussion? In our coverage we didn't call out **Fortinet** above as it is less clear to have any real headwinds/tailwinds specifically because of AI.

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DETAILS

LLMS EXCEL AT LANGUAGE, BUT HAVE NATURAL LIMITS IN SOFTWARE

Anthropic recently hosted its Enterprise Agents event to highlight Claude Cowork's capabilities and enterprise use cases. What stood out most was how deliberately the company avoided positioning Claude as a replacement for incumbent software vendors. Instead, Anthropic framed Claude as an **intelligence layer** that augments the existing software ecosystem, enabling smarter employees, faster workflows, and more capable products. The feature announcements reinforced this positioning: expanded connectors to major enterprise applications, new job-specific plugins, and strengthened enterprise-grade security and compliance controls.

This aligns with what we have observed broadly: LLMs excel at language generation, summarization, synthesis, and pattern recognition, making them highly effective for tasks like summarizing notes, drafting communications, or accelerating code development. And because these capabilities improve with richer context, Claude's strategy makes sense: to become the "thinking engine" for the enterprise, it must maintain a Switzerland-style neutrality and integrate as widely as possible. The greater the number of systems Claude can see across, the higher the quality of its reasoning and the more valuable it becomes as an enterprise intelligence layer.

LLM PROVIDERS DON'T COMPETE IN INFRASTRUCTURE SOFTWARE

LLMs' strength in language understanding and information synthesis also defines where they can and cannot disrupt the software stack. Their natural language foundation makes them well suited for the application layer and end user tools, but far less competitive below that layer. Infrastructure categories, such as middleware and databases, are designed to serve other applications, not human operators. Because their value is not driven by natural language interaction, LLMs have no structural advantage there. As a result, the layers beneath the application tier remain largely insulated from AI-driven displacement. For our analysis, we can set those infrastructure vendors aside, including Twilio, Confluent, and Cloudflare's CDN and Workers businesses in our coverage, as they are not meaningfully exposed to LLM-based disruption.

LLMS IN THE APPLICATION LAYER: NATURAL FITS VS. HARD LIMITS

LLMs are naturally suited for end user applications where the core value is information synthesis and pattern recognition. Many desktop productivity tools fall into this category: note-taking, documentation, communication, file summarization, and project management / tracking. Previously these workflows require users to manually process and restructure information, but tools like Claude Cowork can do this synthesis far faster and at far greater scale, creating a strong value proposition. However, many enterprise applications deliver value beyond simple synthesis. Completing those workflows requires structured actions, state changes, permissions, and integrations that go deeper than language understanding. With that in mind, we see three broad categories with different levels of disruption risk:

1. WORKFLOWS THAT ARE PRIMARILY NATURAL LANGUAGE SYNTHESIS WITH NO ENTRENCHED VENDOR

This is where Claude Cowork shines. The use cases Anthropic showcased, such as file management, receipt processing, data clean-up, and auto-generation of presentation slides, all rely heavily on what LLMs do the best, which is search and synthesis. Because these tasks are previously handled manually by users, there is no incumbent vendor with a defensible moat here. Because these use cases depend heavily on cross system integrations, so a vendor who can be the independent "Switzerland" provider will be the natural winner in this category. Within our coverage, Zoom is the most exposed. While its core Meetings product remains defensible with its infrastructure advantages, Zoom's ambition to expand into broader workplace productivity faces tougher competition from frontier model providers offering superior synthesis capabilities.

2. WORKFLOWS THAT ARE ALSO SYNTHESIS HEAVY BUT ALREADY DOMINATED BY STRONG INCUMBENTS

Here, LLMs can add value, but they do not enter a greenfield market and will face competition from the existing vendors. In our coverage, **Atlassian** is the clearest example. Jira and Confluence are prime candidates for LLM augmentation, but LLM providers do not have a structural competitive advantage over Atlassian. Atlassian's value proposition has been an independent "Switzerland" provider. It supports an open ecosystem and maintains tight integrations with all the other tools and software its users may use. Atlassian's existing marketplace ecosystem also supports more customization and will take time for LLM providers to replicate. In this case, LLM providers no longer have a frictionless easy entry, especially when Atlassian is giving away Rovo for free. The only advantage LLM providers have is its frontier models, but LLM providers also need to license out their models for monetization, and as long as Atlassian has good enough AI capabilities, it makes switching a less attractive option. Atlassian's products therefore remain durable, though the presence of LLM vendors raises the bar for R&D velocity and creates a natural ceiling on how much AI monetization Atlassian can extract.

3. WORKFLOWS THAT REQUIRE MORE THAN SEARCH AND SYNTHESIS AND ALREADY HAVE END-TO-END OWNERS

This third category applies to these names in our coverage: **ServiceNow, Datadog, GitLab, and Palo Alto Networks**. In this category, completing the workflow requires structured actions, orchestrations, policy enforcement, or remediation steps that go far beyond language synthesis. LLM providers can enhance parts of the workflow, like richer search, triage, summarization, but cannot replace the platform. The incumbents' ownership of the full workflow, combined with deep integrations, security controls, and operational context, gives them defensibility that LLM-only entrants cannot easily breach. Some incumbent vendors, including ServiceNow and Datadog, also benefit from a meaningful data advantage over LLM providers. They possess high quality, domain specific data that is tightly coupled to the workflows they own and enriched with deep operational context. Because of this, their proprietary small models can often outperform general purpose frontier models for these targeted tasks while also being far more cost-efficient to train.

Expanding on each of the names:

- **ServiceNow** owns end-to-end service management across IT, employees, and customer workflows. Its platform requires structured actions such as routing incidents, enforcing controls, orchestrating remediation, and automating cross-functional processes. Because ServiceNow already integrates deeply with enterprise systems and maintains a unified data foundation through its CMDB, LLMs cannot replicate the full workflow without significant time and R&D investment. Instead, AI augments parts of ServiceNow's workflows by automating search and summarization, accelerating triage and task creation. The company's growing asset inventory, combined with acquisitions like Armis, further strengthens the data context that its proprietary models can leverage.

- **Datadog's** platform provides telemetry ingestion, observability pipelines, alerting logic, and automated remediation, all requiring structured system level actions. The company's competitive edge lies in its massive volume of proprietary infrastructure and application data, which gives it far more contextual granularity than LLMs that rely primarily on natural-language inputs. Datadog can train smaller, task-specific models on clean telemetry data that frontier models simply do not have access to. Datadog also has the deep domain expertise and broad operational context for IT operation teams' workflows. AI enhances Datadog's workflows through faster root cause analysis, anomaly detection, and runbook generation, but the underlying observability and security operations cannot be replaced by LLMs alone.

- **GitLab** owns the full DevSecOps lifecycle—from code creation and CI/CD pipelines to security scanning, deployment, and compliance. While LLMs can assist with code suggestions, documentation, and summarization, they cannot replace GitLab's orchestration of builds, scans, merges, deployments, and policy enforcement. GitLab has also embedded AI into multiple workflow stages, with Duo Chat and Duo Agents to help users generate code, understand unfamiliar code, configure CI/CD pipelines and more. Because enterprises rely on GitLab's structured controls and integrated security to deliver production-ready software at scale, LLM-only entrants cannot disrupt this end-to-end platform with only code generation functionality.

- **Palo Alto Networks**' is adopted for individual cybersecurity workloads, so at first blush this would appear to make it a weak position to compete against a "Switzerland" type SOC Agent like Torq. In particular, it's historic strength in Network Security means it's had a lot of traction around that value proposition, and their NGS business has been strongest in relatively linked categories like SSE/ SASE and virtual firewalls with Cortex/Prisma platforms that inspect, classify, and block traffic in line. In addition, as the core starting point for many security footprints, their SecOps offerings including XIAM (modern SIEM) have gained strong traction. More recently their Securing AI offerings tied to these capabilities are showing momentum. Now they've added CyberArk for identity, and their broader suite including cloud security, endpoint, etc. starts to become truly an end-to-end platform that covers much of the cybersecurity platform of their customers — effectively becoming a "Palo Alto shop". As this occurs we think it means Palo Alto will be in position to capture the SOC Agent that can help stay on top of the vast number of alerts coming off all their product and further enhance their SecOps offering. So while there is no plausible path for LLMs to replace the core cybersecurity offerings from Palo Alto, we see growing hybrid/AI data center traffic are secular tailwinds AND Palo Alto may find opportunity in offering a productivity enhancing SOC Agent over time.

WORRY EARLY SIGNALS OF SUCCESS MAY HAVE LESS UPSIDE THAN DESIRED: CROWDSTRIKE, SENTINELONE SOC AGENTS

The one adjunct to the prior section we want to call out are the emerging agents to help users of the cybersecurity tools cut through the massive number of alerts to prioritize their manual efforts. When we heard about CrowdStrike's Charlotte AI and SentinelOne's Purple AI we were immediately excited. Our understanding is that one of the largest frustrations with security operations and Threat Intellegence is wading through the number of potential alerts to find the ones that really matter. The early feedback we heard from channel checks implementing LLMs was that even non-specialized DIY approaches would add a lot of value. So these specialty trained tools sounded like a gold mine. Then it didn't surprise us as the companies reported rapid adoption (FQ2'26 saw Charlotte AI grow 85% QoQ CrowdStrike[1], SentinelOne seeing 40% attach to FQ3'26 new deals[2]).

What we hadn't really sat back and considered, though, was whether this is a category where the SaaS vendor was likely to be the most logical owner. As we explored the space more and reflected on the dynamics where a "Switzerland" often emerges we started to get a sinking feeling that the full size of the opportunity for CrowdStrike and SentinelOne in their customer base may be smaller than we hoped. We've been watching Torq as an example of what a "Switzerland" might look like in SecOps Agents and observed they were $24MM ARR in Sept '24, then reported in their latest Jan '26 round they had grown 300% YoY for the 2nd consecutive year — it appears likely they are cresting $100MM ARR. This starts to put them rapidly in the scale of Charlotte and Purple, and perhaps shows the value of the independent. It not to say Torq will be the end winner, but that this space appears to attract competition that can get rapid traction. As a result it may be more difficult for CrowdStrike or SentinelOne to capture attach to as much of their customer base as we would hope otherwise.

BLAST EMAIL FROM MONDAY FEB 24TH DISCUSSING SOFTWARE'S AI DRIVEN NEGATIVE-BUBBLE

Subject: BERNSTEIN * GenAI / LLM software disruption framework 101 deck

Friends,

Its tough out there. The software narratives feel like the Blizzard happening in the Northeast US today. Scary, intensity appears never ending, travel / work plans disrupted, and it will be damaging. But we remind ourselves it will pass, leaving behind some beautiful vistas.

For our TMT Conference this week, our Bernstein tech team will host a debate on the AI-bubble (or negative-bubble in the case of software). As part of this, we realized a 101-style deck may be helpful specifically on the AI-bear bubble that has formed broadly in software. Perhaps it's useful for you, too? It is here: **Software: AI anti-bubble? Searching for safety**

[1] FQ2'26 earnings transcript

[2] FQ3'26 earnings transcript

At the conference we will host several panels and dinners, including one with Jeremy Schneider, Global Head of Software clients at McKinsey. We will also have a full track on "Securing AI / AI-driven Security" where we'll have leaders from ServiceNow's cybersecurity portfolio, Palo Alto, Proofpoint, Cohesity, etc. participating. Happy to connect after our conference to discuss what we learned.

A quick summary of our thinking:

Today, the market seems to believe the bear narrative: SaaS is dead, and the killer is GenAI / LLMs. Memes abound about the returns of SaaS vendors to parallel that of newspapers post 2000. Short sellers implore: ignore crazy sell side analysts like us (as we will unwisely believe these companies still have terminal value) while stocks will derate all the way down to ~0, perhaps pushed off the cliff by some GFC type event in the future.

The newspaper post dotcom analogy is a very poor comparison for software post GenAI/LLMs. Newspapers were a very dissimilar market concentration context going into the technology disruption that reshaped access and value of local vs. national/global news. Not to mention newspapers' high fixed cost manufacturing + delivery infrastructure that was a disadvantage vs. digital. SaaS, on the other hand, is generally concentrated and has very low fixed cost infrastructure.

But lets not be too flippant: there are worthwhile debates about whether or where vended SaaS remains viable vs. DIY / vibe coded or LLM platform provided offerings. Even if we convince you that that isn't an issue, there is an added important debate about whether existing or new vendors are likely to benefit from this disruption. Not to mention the seat-based risk that the target job or function is reduced or eliminated due to GenAI usage. We published notes in 2025 offering a GenAI disruption framework to software (here and here). We think these frameworks remain on point and relevant.

DIY is unlikely to replace vendor software. As we detailed in our note (here) we think competitive worries about DIY, replacement by LLM platforms, or new entrants are poorly understood, and create upside investment opportunities. We do not anticipate DIY dynamics to change — DIY has always been a large spend category (>50% of developers are not in software companies!) and really focuses on areas of strategic differentiation for the buyer (or very simplistic CRUD-apps). We think vendor software remains dominant in non-strategic areas like back office or common desktop tools. In those areas buyers can't justify the permanent R&D effort or expertise to compete vs. functional SaaS vendors. In addition, we probably don't need to worry about strategic DIY investment crowding out IT spend as the budget usually resides outside IT and is covered by a P&L.

Existing vendors appear safest in deterministic software (e.g., infrastructure, cybersecurity, select LoB)… In our earlier work (here), we argued deterministic software (e.g., infrastructure, cybersecurity, some LoB like ERP and tax) as the safest from disruption. We pointed out GenAI is not useful to replace the core value of the products given the performance and accuracy requirements are not well suited to LLM-based replacements. At most GenAI agents are a UI feature or offer argentic augmentation of these product's users.

...and it does appear the market has signaled relative agreement with the least risky category. Infrastructure (e.g., hyperscalers, CDN), cybersecurity, ERP are down but significantly outperformed the rest of software. We hear far fewer concerns from investors about these products being easily replaced or have their spend displaced. In fact, we find some cybersecurity vendors still expensive (e.g., CRWD, NET). Right now, in H1'26, we like cloud-linked infrastructure's position to re-rate up on accelerating revenue as the beneficiary of IT modernization investments to prepare for AI projects.

Although, as Friday showed, even "safe" categories like cybersecurity can get indiscriminately sold. On Friday Claude Code Security formally released after a couple weeks of preview, and it promptly turned into investor fear for incumbent cybersecurity vendors. Stocks dropped almost -10% in the case of CRWD, NET, and OKTA. In case you missed it, we published a note on Sunday mid-day emphasizing this is an incorrect read-through: **Cyber Software: Claude Code Security is not an existential risk**. We would anticipate cybersecurity stocks will rebound. But do note other cybersecurity features will be announced by LLM providers (see the preview of OpenAI's Trusted Access for Cyber) and could repeat some of these cycles of volatility.

On the other hand, non-deterministic application software has gotten indiscriminately crushed. Where LLM platforms or new "Born-in-AI" entrants have an easier angle to win is in the broad range of non-deterministic application software. This includes most Line of Business (e.g., SMB business management, CRM, HR, IT) and end-user productivity offerings (e.g., planning, creative, analytics, role-specific). What history tells us: new entrants normally find it easiest to break in if a) it is a brand-new market / new buyer, b) there is a large novel and non-replicable competitive differentiation, c) "consumerish" behavior around brands / trends. In many ways these are just the opposite of things making ex-siting vendors sticky, like high/ risky switching costs, broad well-adopted platform, established commercial credibility and relationships, access and agility to rapidly adopt latest technologies.

Net net for application software: underappreciated winner is LoB software; where investors' worry is valid is in SMB and end-user tools software.

Cheers,
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