

Investment Focus:

Not all software is created equal

For years, the enterprise software industry has been prized for its sticky customer base, recurring revenues, healthy margins and scalable business model. These attractive characteristics have delivered outsized gains for investors over the last two decades and earned the industry a lasting premium over the wider market.

Now, artificial intelligence (AI) is threatening the lucrative business models and high returns on invested capital that have underpinned that premium. Rapid advancements in AI have investors questioning how durable enterprise software's competitive advantages will be, and who will capture most of the value in this AI era.

While these AI advances raise legitimate questions investors cannot ignore, not all enterprise software companies are equally vulnerable. Some are more structurally exposed and are likely to struggle to remain relevant, while others with more durable business models that are actively incorporating AI into their products may ultimately thrive. By painting the whole industry with the same brush, investors risk overlooking the high-quality companies among them.

AI disruption fears

Hyperscalers and the software industry have borne the brunt of market scrutiny this year. While hyperscalers have come under pressure amid growing concerns that their massive investments in AI infrastructure may not generate sufficient returns, the software industry has been grappling with fears that the rise of "vibe coding" and autonomous AI agents could displace established software providers.

These concerns are nothing new. Disruption fears have simmered for years as large language models (LLMs) and related tools from leading AI labs have continued to advance rapidly. They came to the forefront in early 2026 after Anthropic released its new agentic AI tool, Claude Cowork, and its industry-specific plugins, giving tangible form to what had previously been a theoretical concern. AI tools are moving beyond conversational

interfaces towards systems capable of planning, executing and managing multi-step workflows with minimal human intervention.

What followed was an abrupt, indiscriminate sell-off across the software industry as investors envisioned a future in which AI would erode software's pricing power and strategic relevance. The iShares Expanded Tech-Software ETF, a barometer of the broader software industry's health, lost close to a quarter of its value in the first quarter, marking its worst quarterly performance since the fourth quarter of 2008. The breadth of the decline suggested that investors saw the entire industry as at risk of obsolescence, and the market dubbed the episode the "SaaS apocalypse."

Among the leading concerns at the heart of the sell-off was that AI would democratise software development through a practice known as "vibe coding", significantly lowering the barriers to entry that have historically protected the industry. The argument is straightforward: if enterprises can use natural language prompts to build bespoke in-house applications quickly and cheaply, why would they continue paying for expensive subscriptions from established software providers?

Another concern centred on how software providers monetise their platforms, given the erosion of the seat-based pricing model. This pricing model historically underpinned the industry's elevated valuations because of its highly recurring revenue streams with minimal incremental cost per user. With agentic tools now capable of autonomously completing a growing share of the work, fewer people are needed to achieve the same or even greater levels of productivity, resulting in fewer seats to sell.

Will AI end up eating software?

The narrative that AI will render large segments of the market obsolete rests on a misunderstanding of where the value of enterprise software actually lies. The true value is not in the underlying code. Security, compliance, domain expertise, auditability, embedded workflows and integrations are what matter. While AI has significantly lowered the incremental cost of writing code, these attributes remain difficult to replicate.

Enterprises are often reluctant to switch from software providers that already meet their core needs given their inherently risk-averse nature. A competing product may be cheaper, but the time, execution risk, and organisational disruption that come with migrating years of accumulated data, business logic and governance across multiple systems of record can easily exceed those savings. Moreover, the high cost of failure combined with software's relatively small share of the average enterprise's cost base means that enterprises are likely to prioritise risk-minimisation over cost-optimisation.

As AI models become increasingly interchangeable, the proprietary, structured and governed data embedded within existing software systems is emerging as the key differentiator. Models in isolation are inherently probabilistic, whereas most enterprises require auditable and deterministic outcomes, which the proprietary data and business logic in their software systems help to deliver. Even the most advanced AI models will deliver suboptimal results if they are not grounded in each enterprise's unique context.

The transition away from seat-based to usage- or outcome-based pricing is also significantly changing enterprise software's economics by aligning costs more closely with customer value. While the erosion of seat-based pricing makes revenues less predictable, the transition could ultimately unlock more value for those adopting hybrid pricing models. If agents enable enterprises to get more work done, then usage, which software providers can now directly monetise, could potentially grow faster than the decline in seats.

Some established enterprise software companies have durable moats and are well positioned to incorporate AI into their products, but the same is not true for the industry as a whole. The most vulnerable layers of the software stack are those with limited integrations into systems of record and whose differentiation mostly resides in the user interface.

Resilient fundamentals amid AI disruption fears

After a tumultuous start to the year, software stocks have regained momentum since late June as resilient fundamentals and growing evidence of AI monetisation have eased AI displacement concerns. Investors have become more selective, rewarding companies with durable moats, deeply embedded workflows, and clearer monetisation paths.

Salesforce, the leading customer relationship management platform, found itself at the epicentre of the "SaaSocalypse" at the start of the year. Its forward earnings multiple fell to 10.64x at the end of June, down from 20.34x at the end of 2025 and well below its average of 25.44x between 2023 and 2025. Its latest results, however, showed minimal evidence of AI displacement. Net new annual order value growth was at its strongest level in four years, signalling that underlying demand remains intact, and attrition rates were near record lows.

Salesforce is also not sitting on its hands waiting to be rendered obsolete. It is actively embracing AI by incorporating the technology into its product offerings and forging deeper partnerships with the leading AI labs. Agentforce and Data 360 annual recurring revenue reached nearly \$3.90 billion, more than tripling over the past year.

Alongside its quarterly results, Salesforce and Anthropic unveiled Claudeforce, an expanded strategic partnership that brings Salesforce's customer data, workflows and business logic directly into Anthropic's Claude. This partnership is mutually beneficial: Anthropic can draw on Salesforce's authoritative repository of customer data, governed workflows and encoded business logic, which

are difficult and costly to replicate. Salesforce, in turn, gains access to Anthropic's advanced reasoning models.

ServiceNow, which automates enterprise workflows and provides IT service management solutions, is another software company that has continued to deliver robust financial performance despite concerns about AI disruption. In its latest quarterly results, all its top-line growth and profitability metrics came in ahead of the high end of its guidance, and management also raised its full-year subscription revenue outlook for the second time this year. There is also tangible evidence of AI monetisation, with its AI products crossing \$1 billion in annual contract value. By 2030, the aim is for around 30% of annual contract value to come from AI.

As enterprises increasingly adopt AI throughout their organisations, governance and oversight are becoming more complex. Through its AI Control Tower, ServiceNow provides a centralised command centre that allows enterprises to govern, manage, and secure AI across the enterprise. This represents a sizeable opportunity, with the Cloud Security Alliance (CSA) finding that 82% of

organisations surveyed have AI agents operating in their infrastructure that they are unaware of. Additionally, the International Data Corporation (IDC) estimates that the number of active AI agents in enterprises will balloon to 2.50 billion by 2030, nearly 80 times what it was in 2025.

Conclusion

While the "SaaSocalypse" narrative may appear compelling at first glance, the notion that swathes of the industry will be rendered redundant is overly simplistic, as different companies face vastly different levels of AI disruption risk. The future is unlikely to be binary, with either AI displacing software or software emerging unscathed. Instead, it is likely to be more nuanced, with AI producing winners and losers.

For investors, the key is not to get caught up in short-term noise but to focus on distinguishing between software providers that control proprietary data, are deeply embedded in mission-critical workflows and are actively incorporating AI into their products to defend their market positions, and those that are more structurally exposed.

