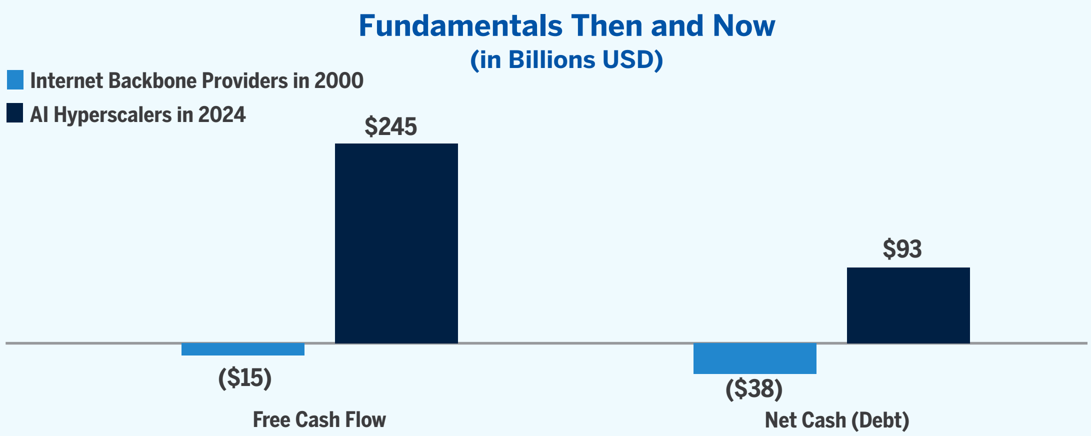
ALGER

Alger On the Money

AI vs. the Internet Bubble

Does the internet bubble of the late 1990s/early 2000s, which included strong investor sentiment and elevated valuations, bear some resemblance to the current enthusiasm around artificial intelligence (AI)? We believe there are significant differences between the two periods, and that today's AI investment landscape appears much more sustainable.



Source: FactSet and company data. Internet Backbone Providers in 2000 include Global Crossing Ltd., Sprint Corporation, AT&T Corp., WorldCom Inc., and Verizon Communications Inc.[1] AI Hyperscalers in 2024 include Microsoft, Amazon, Meta, Alphabet, and Oracle.[2] Free Cash Flow (FCF) represents the cash generated by a company after accounting for operational and capital expenses. Net Cash (Debt) reflects a company's financial position by subtracting total debt from cash and cash equivalents, indicating a surplus (Net Cash) or a shortfall (Net Debt). FCF, reflecting calendar-year data, and Net Cash (Debt) data are aggregated for each group: Internet Backbone Providers as of 12/31/00 and AI Hyperscalers as of 12/31/24 (data post-9/30/24 is based on consensus estimates).

- One key difference between today's AI infrastructure build-out and the capital expenditures made in the late 1990s/early 2000s internet bubble is the degree of investment sustainability, in our view. During the internet bubble, companies that were building out the telecommunication infrastructure (e.g., fiber-optic cables, communications equipment), such as WorldCom, were often free cash flow negative (capital expenditures exceeded operating cash flow) and took on considerable amounts of debt to fund the internet build-out.[3] However, overinvestment relative to demand created an oversupply of bandwidth, resulting in low capacity utilization (unused cables and equipment). As a result, many companies with unsustainable debt burdens and no viable path to profitability eventually went bankrupt.
- Things are quite different today. In the chart above, companies providing the necessary AI infrastructure (i.e., hyperscalers) are generating substantial free cash flow—a trend that is estimated to continue through 2026.[4] Moreover, AI hyperscalers' balance sheets appear much stronger, with excess cash reserves compared to the internet backbone providers of the 2000s.
- In addition, AI infrastructure providers (see our AI Investment Map) are achieving higher capacity utilization, with data center operators reporting record-low vacancy rates throughout the U.S.[5] Accordingly, we believe today's AI build-out is more sustainable because it is driven by internal cash flow rather than the debt-fueled internet roll-out. In our view, companies supporting today's AI infrastructure through sustainable cash flow generation give us greater confidence that the current AI deployment is more durable than the internet build-out at the turn of the millennium.

[1] The five internet backbone providers mentioned were, in our view, the largest companies by market cap specifically focused on fiber optic cable networks during the late 1990s/early2000s.
[2] AI Hyperscalers are defined as providers of scalable AI cloud infrastructure and services for large-scale digital applications. The five AI Hyperscalers mentioned were, in our view, the largest companies by market cap specifically focused on providing AI cloud services in 2024.
[3] WorldCom, Inc. was a major telecommunications company that collapsed in 2002 due to industry overcapacity, excessive debt from aggressive acquisitions, and an $11 billion accounting fraud that masked its financial struggles, leading to bankruptcy. Executives achieved this by misclassifying routine operating expenses, such as network maintenance costs, as capital expenditures, artificially boosting earnings and masking financial troubles, leading to one of the largest bankruptcies in U.S. history.
[4] Consensus estimates of AI Hyperscalers' FCF through 2026 are from FactSet as of 12/31/2024.
[5] CBRE Group North America Data Center Trends H1 2024.

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Capital expenditure (Capex) refers to the capital a company spends to acquire, upgrade, or maintain long-term assets such as buildings, equipment, or technology to support its operations or growth.

FactSet is an independent source, which Alger believes to be a reliable source. FAM, however, makes no representation that it is complete or accurate.

The following positions represent firm wide assets under management as of October 31, 2024: Amazon.com, Inc., 5.6%, Microsoft Corporation, 9.7%, Alphabet Inc. 1.9%, Meta Platforms Inc, 5.1%, Oracle Corporation, 0.2%, CBRE Group, Inc. 0.0%, Global Crossing Ltd., 0.0%, Sprint Corporation, 0.0%, AT&T Corp., 0.0%, WorldCom Inc., 0.0% and Verizon Communications Inc., 0.0%.

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