

Webinar:

State of Technology **with Baird's Sector Strategist,** **Ted Mortonson**



Moderated by Renn Anderson, Equity Capital Markets

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Ted Mortonson

Managing Director

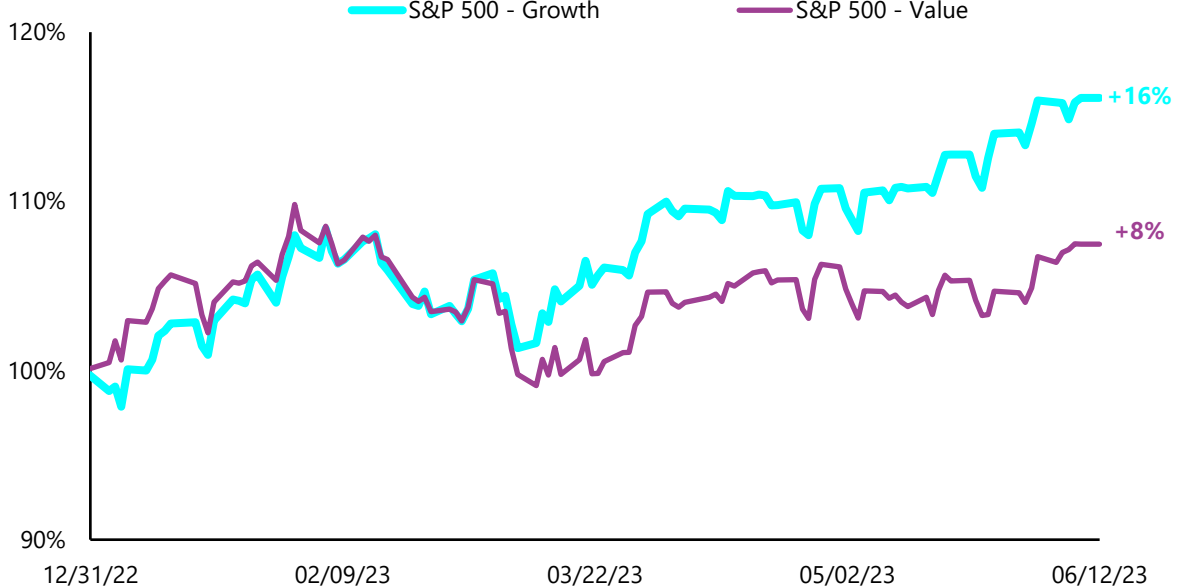
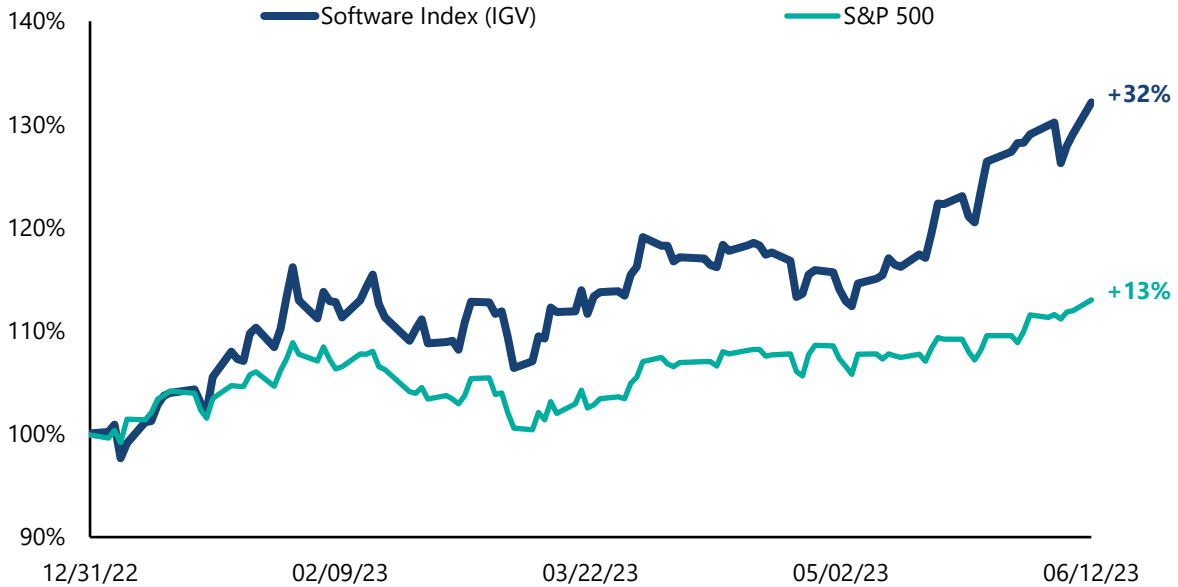
Technology Desk Sector Strategist

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- Extension of Baird's technology research platform focused on macro and trading trends
- 30+ years of technology sector experience
- Previously, managing director at Raymond James, Pacific Crest Securities and RBC
- Bachelor of sciences degree from the United States naval academy and naval aviator designation

Technology is Making a Comeback



Digital Transformation

AI / Machine Learning

- Rapid adoption and early traction across multiple industries
- Increasing demand for language and image-generating applications
- Driving investor demand for potential software beneficiaries and semiconductor manufacturers

Cloud Software

- \$21bn+ in quarterly spend across cloud titans in the private, public, and hybrid space
- Generative AI is a long-term growth driver
- Increased investor interest relative to Q1 '23

Next-Gen Semiconductors

- Combination of Cloud, 5G and next-generation semiconductors and silicon development leading to AI enablement

Key Earnings Trends in Q1

Semiconductors

- Inventory remains high despite supply chain improvements and declining lead times
- The most crowded sector in Technology

Cloud

- Sector innovators at leading nodes are in favor vs. capacity players
- Consumption models are under the microscope
- Long-term hyper cycle focus due to generative AI loadings

Software

- Focus on platforms vs. best of breed solutions
- Multiples recovering with short covering and OpEx improvements; elongated sales cycles remain in focus
- Expect rotation into software when consumption models turn positive Q/Q

Internet

- Advertising budgets are down across the board
- E-commerce growth under pressure due to higher rates and consumer behavior

Services

- IT budget declines for 2023 are now becoming evident
- Consulting starting to show weakness due to elevated labor dynamics

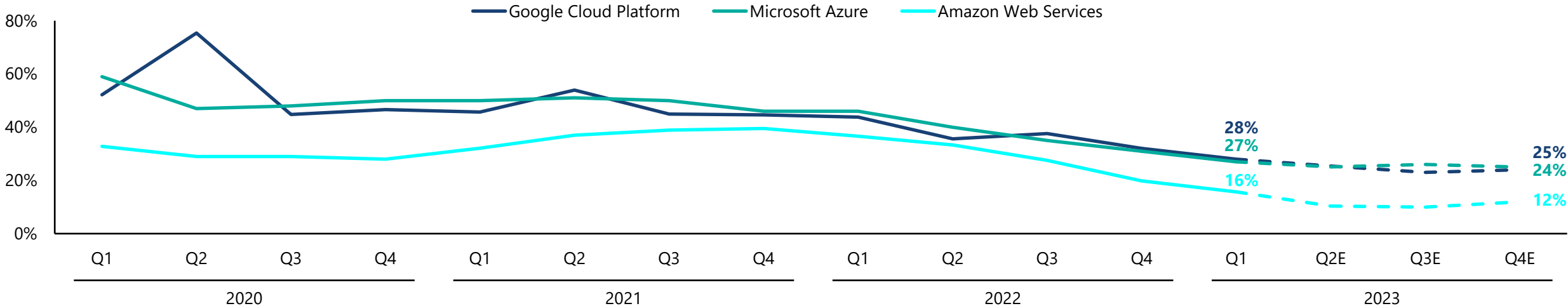
Hardware

- Enterprise server growth moderated in Q1 due to weak manufacturing and financial verticals
- Networking is strong due to cloud migration

Generative AI is driving key trends and transformation across all sectors

Cloud Revenue Growth Has Moderated – What Comes Next?

Y/Y CLOUD REVENUE GROWTH RATES




“We continue to see the world’s largest enterprises migrate key workloads to our cloud. <...> Azure took share as customers continue to choose our ubiquitous computing fabric from cloud to edge, especially as every application becomes AI-powered.”

- Satya Nadella, CEO



“Customers continue to evaluate ways to optimize their cloud spending in response to these tough economic conditions in the first quarter. <...> And having the cloud infrastructure offering with the broadest functionality by a fair bit, the best security and operational performance and the largest in partner ecosystem bodes well for us moving forward.”

- Brian T. Olsavsky, CFO
- Andrew Jassy, CEO



“I’m pleased with the ongoing momentum in Cloud. Our disciplined expansion of our product road map and go-to-market organization has helped to build one of the largest enterprise software companies in the world. <...> We are bringing our generative AI advances to our cloud customers across our cloud portfolio.”

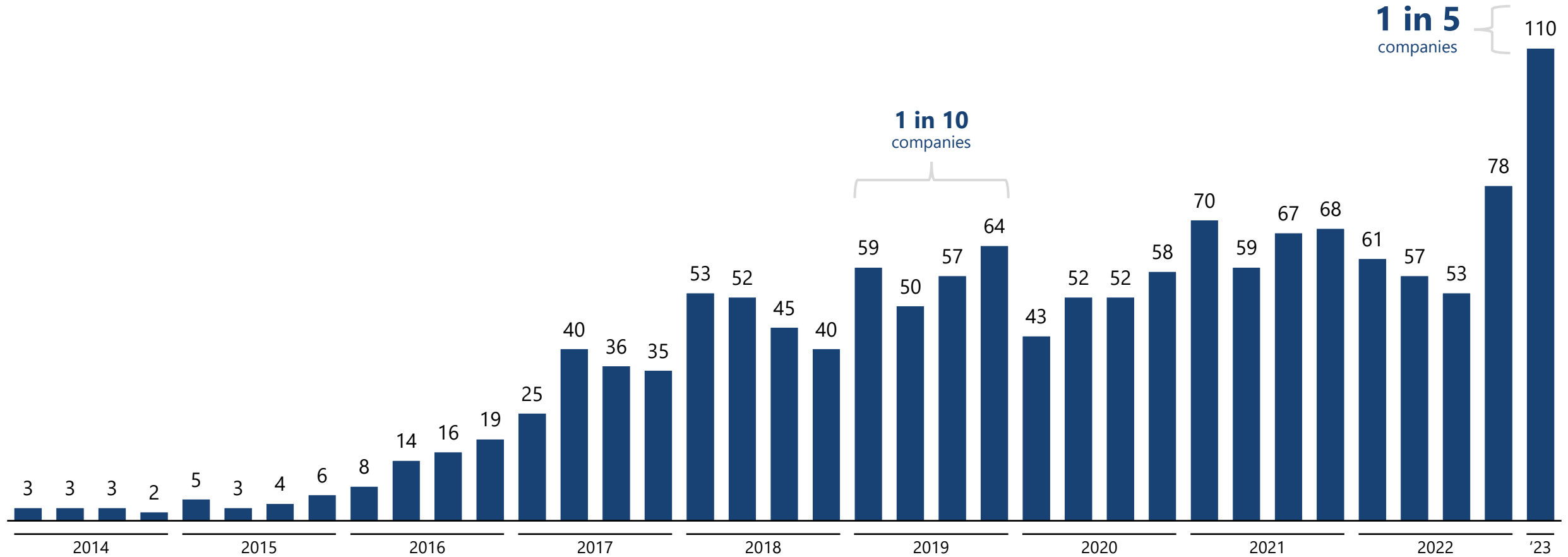
- Sundar Pichai, CEO



Source: Baird research, FactSet, Company filings and earnings transcripts as of June 12, 2023.

Mentions of AI Spiked in Q1 Earnings Calls

NUMBER OF S&P 500 COMPANIES CITING "AI" ON EARNINGS CALLS



Source: FactSet.

The AI Melt-Up

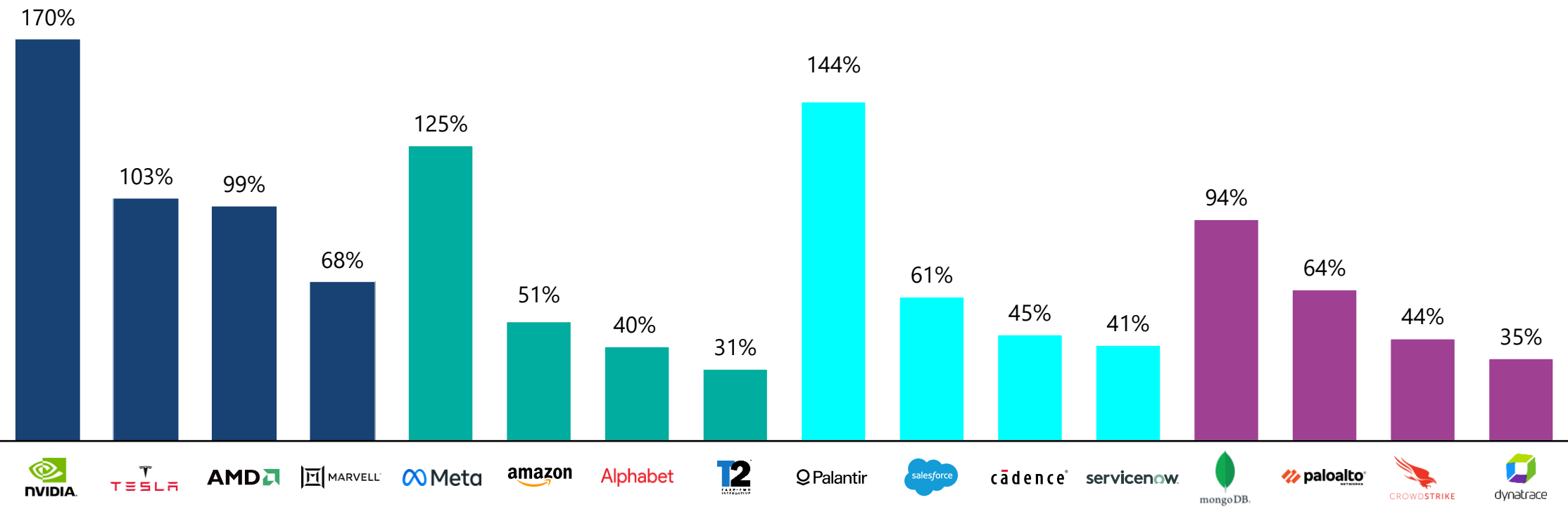
Hardware / Semis

Internet / Digital Media

Software - Application

Software - Cybersecurity / Infrastructure

Top Performers (YTD)



Other Companies to Watch

Source: FactSet as of June 12, 2023.

Technology Sector Positioning

1 Focus on ***battle-tested management teams*** that have experience in downturns

2 Companies must operate in ***key digital transformation categories***

3 ***Insulated product cycle*** in either functionality or pricing leverage

4 ***Limited competition*** with no more than three key players

5 Material ***free cash flow*** and ***low leverage*** are extremely important

6 Favor companies that ***expanded in low-rate environments***

7 ***Trade liquidity*** is required

