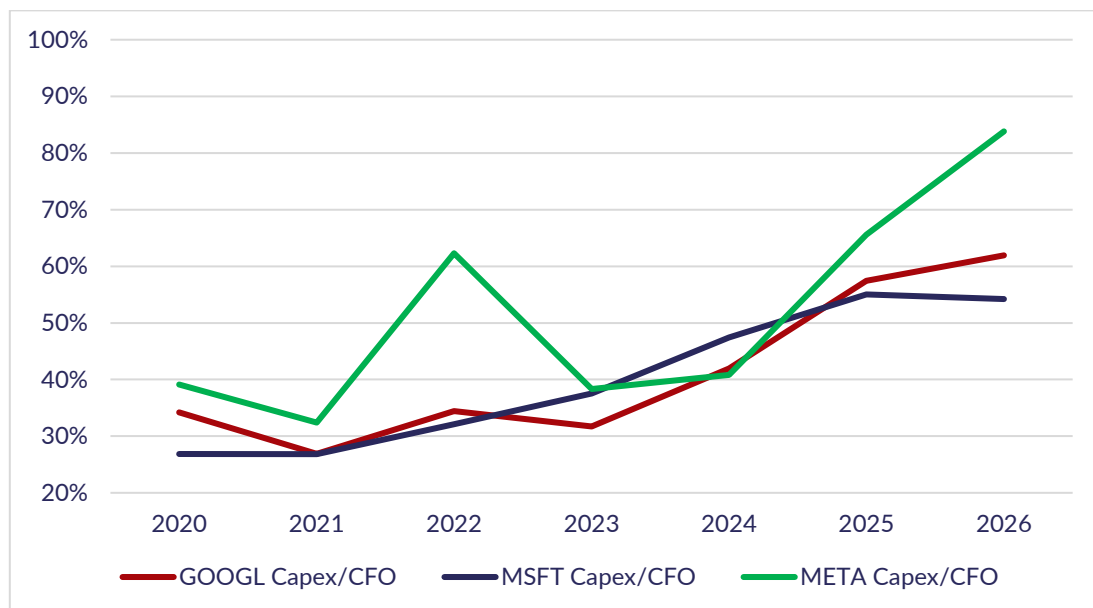


AI and the Capex Conundrum

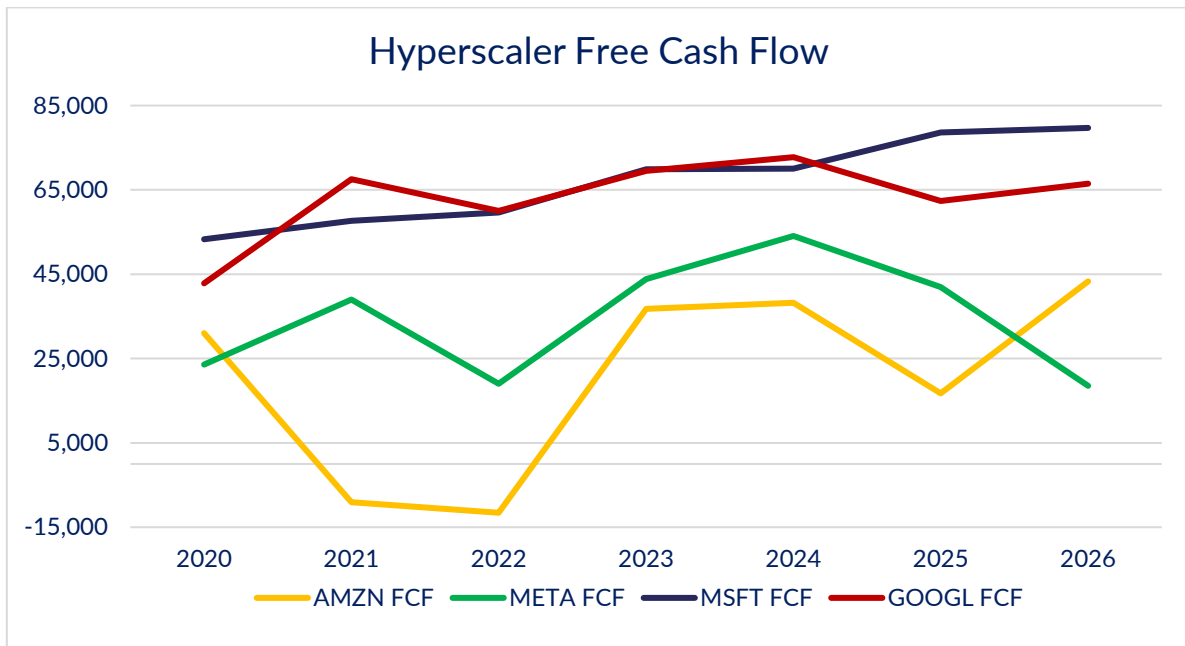
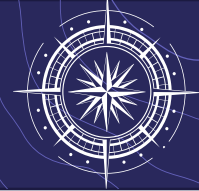
Results season has brought a fresh wave of AI enthusiasm but also some concerns about margins, with the key hyperscalers continuing to ramp up their capex in a familiar fashion to previous quarters. Much of this increase was justified by very strong operational performance, with Microsoft and Alphabet increasing their cloud revenues by 40% and 34% respectively, while Meta's core advertising business grew 26%. This type of performance has been an integral driver of AI capex spending, with hyperscaler operating cash flows accounting for 60% of AI spend. Given the strong performance of the hyperscalers, this has given investors renewed faith that the beneficiaries of all this spending will continue to perform well.

The numbers themselves certainly support this thesis, with Meta, Microsoft, Alphabet and Amazon expected to spend north of \$480bn in capex during FY26, a number which many expect to ramp further as we close out the year. This is obviously a huge absolute figure, but a closer look at how its funded by operating cash flows provides a fresh perspective. The below chart illustrates this by showing each company's estimated capex divided by their cash flow from operations, showcasing the increasing capital intensity over the past 3 years. What really stands out though is the significant jump from Meta, who's capital intensity is expected to more than double from ~40% to over 80% in FY26.



Source: Bloomberg

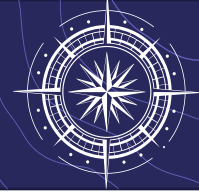
The scale of this commitment sent the shares down more than 11% post report, with many questioning the end goal of the AI spend and likening it to Mark Zuckerberg's 2022 pursuit of the 'metaverse'. This concern is not without merit, as the weight of spending is now starting to eat into the free cash flow numbers shown on the chart below. Again, what stands out here is Meta's falling numbers against an expected increase for the other names during FY26.



Source: Bloomberg

Contrast with Alphabet, Microsoft and Amazon, whose cloud businesses are only limited by capacity and worthy of further investment, and it becomes clear why investors, including ourselves, have shifted from Meta into the other names. The next question is whether this combination of a slowing core business and increased investor scrutiny of spending is the first signal that the capex growth trajectory will slow. Given the importance of companies like Meta in the AI funding ecosystem, it would likely serve as an early indication of a pause in the AI trade and add to valuation concerns.

The response this results season marks a clear shift in mindset, with investors no longer viewing all capex as equal. Even with strong core businesses, the increasing capex intensity is beginning to play on investors minds where no clear road plan exists. While we view it as unlikely that the AI spending frenzy will end in the near-term, this shift in sentiment gives us an indication of how the investment community might force the hyperscalers to rationalise their spending. As a result, the continued performance of the Mag-7 looks vital for AI momentum to continue and should be watched closely for any indications of an incoming demand air pocket. We remain underweight the Mag-7, but their impact on investment returns is impossible to ignore.



Biography

Tom Dalrymple | Investment Analyst



Tom joined Aubrey in 2024 as an Investment Analyst, working across both the Global and Emerging Markets strategies.

Previously, Tom worked at J. Stern & Co. in London for 4 years, where he undertook a broad range of work across client relations and performance analysis.

Tom has a degree in History from the University of Newcastle, holds the Investment Management Certificate and has passed Level 3 of the CFA program.

Further Reading

If you would like to read further articles, please select the following link - [Aubrey Research](#)

If you would like to receive more articles like this, [sign up to the Aubrey mailing list now.](#)

Important Information

This is a marketing communication issued by Aubrey Capital Management Limited, which is authorised and regulated by the Financial Conduct Authority and registered as an Investment Adviser with the US Securities & Exchange Commission. You should be aware that the regulatory regime applicable in the UK may well be different in your home jurisdiction. Aubrey Capital Management has taken reasonable care to ensure the accuracy of this information at the time of publication but it is subject to change without notice and it does not in any way constitute investment advice or an offer or invitation to deal in securities. The Fund is not registered for sale in the United States and is not available to, or for the benefit of, U.S. persons as defined by U.S. securities laws.

Past performance is not a guide to future returns and may not be repeated. Aubrey Capital Management Limited accepts no liability or responsibility whatsoever for any consequential loss of any kind arising out of the use of this document or any part of its contents.

The MSCI information may only be used for your internal use, may not be reproduced or disseminated in any form and may not be used as a basis for or a component of any financial instruments or products or indices. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each other person involved in or related to compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties (including, without limitation, any warranties of originality, accuracy, completeness, timeliness, non-infringement, merchantability and fitness for a particular purpose) with respect to this information. Without limiting any of the foregoing, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including, without limitation, lost profits) or any other damages. (www.msci.com).