Who moved my margins? Short-term margin pains for long-term AI efficiency gains

Blog

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With tech stocks ending 1H25 on a strong note, focus has shifted to upcoming results. While we expect steady growth trends and potential currency-related tailwinds in general, the bar to impress has been clearly set high. We see more debates around tech margins given the strong near-term investments required for AI.

The good news is despite expected near-term margin pressure from heavy investments, AI's strong automation should drive other operating costs lower in the medium to longer term due to solid efficiency gains. As a result, we expect the Big 4's operating margins to temporarily dip from 27.6% in 2024 to 27.0% in 2026 before rebounding to 29% by 2030. Against this backdrop, we continue to maintain a balanced exposure in our AI portfolio. Any excess correction due to temporary margin weakness should be a buying opportunity, in our view, given margins for platform companies should eventually recover.

Fig. 1: Tech margins should eventually recover driven by automation keeping a check on other operating costs
A snapshot of Big 4's P&L account (USD bn)

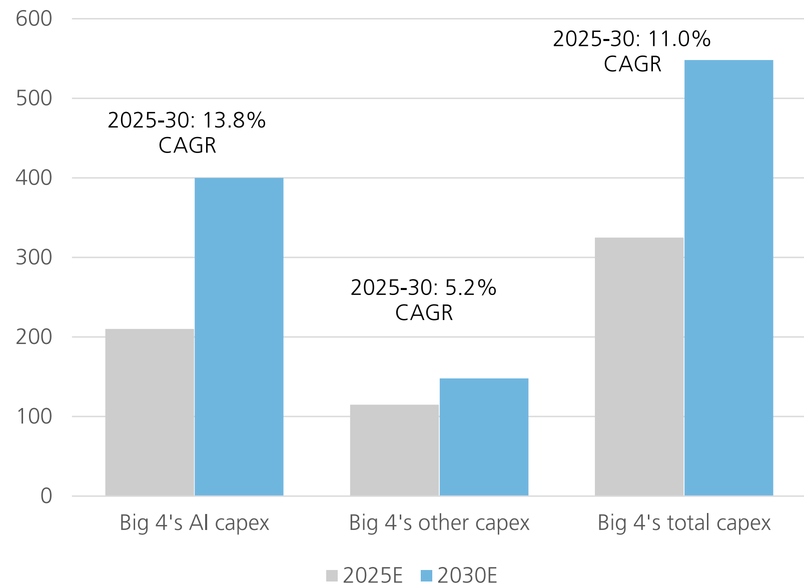
	2020	2025E	2030E	2020-25 CAGR	2025-30 CAGR
Big 4 revenues	807.0	1556.5	2506.7	14.0%	10.0%
Other operating costs	583.3	992.5	1492.3	11.2%	8.5%
EBITDA	223.7	564.0	1014.4	20.3%	12.5%
Depreciation	57.8	137.1	287.4	18.9%	16.0%
EBIT	165.9	426.9	727.0	20.8%	11.2%
EBIT margins	20.6%	27.4%	29.0%	135 bps	32 bps
Capex	93.2	325.0	548.1	28.4%	11.0%
Capex intensity	11.5%	20.9%	21.9%	190 bps	20 bps

Source: Company reports, UBS estimates as of June 2025

The structural outperformance of tech versus broader markets over the past two decades can be partly explained by the sector's strong margins due to pricing power and an improving software mix. This phenomenon is best described by the following excerpt from the book *The Business of Software* written by Michael Cusumano: "*In how many businesses does making one copy or one million copies of your product cost about the same? … Get the strategy and the management side right, and the software business can be like having a license to print money.*"

Fig. 2: Big 4's capex trends remain solid with AI continuing to gain share

Note our total global AI capex forecast is USD 360bn in 2025 and USD 960bn in 2030 (USD bn)

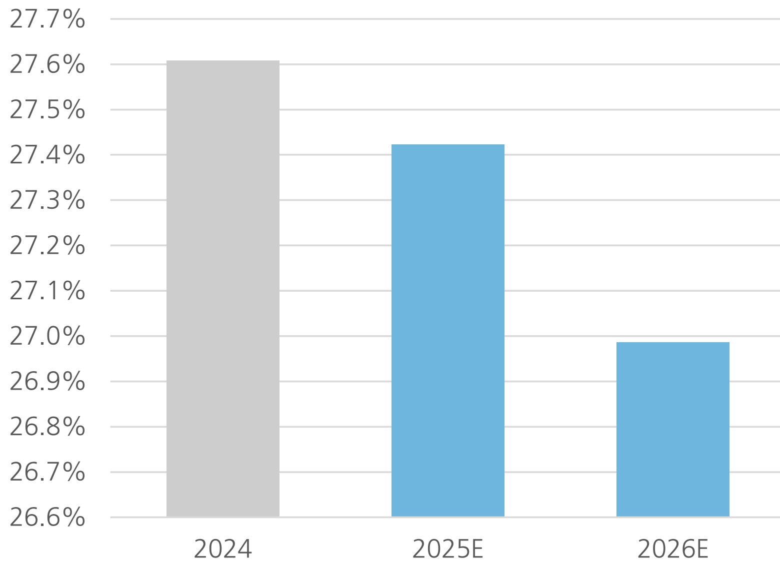


Source: Company reports, UBS estimates as of June 2025

With tech valuations reaching recent highs, all eyes are on upcoming results, and in particular, commentary around margins amid elevated AI capex. We already raised our 2025 AI capex estimates and introduced our 2030 estimates (see Fig 2) in April. The short-term challenge, however, is what the increased capex means for Big 4 and broader tech sector margins in the near term.

For background, the AI theme has entirely changed the dynamics of the tech sector over the past few years, given the strong upfront investments required in AI compute (and the related investments to support the infrastructure) for both training and inference. As a result, the Big 4's (Microsoft, Meta, Alphabet, and Amazon) capex intensity (capex/revenues) increased from 11.5% in 2020 to 20.9% in 2025 and should stay elevated at around 22% levels till 2030, in our view. Despite ongoing improvement in AI monetization, we think the front-loading of AI investments means margins for tech companies will likely come under pressure in the near term given the substantial increase in AI capex over the past few quarters.

Fig. 3: Moderate near-term margin pressure for Big 4 due to heavy AI investments
In %



Source: Company reports, UBS estimates as of June 2025

As seen in Fig. 3, we expect the Big 4's operating margins to decline from 27.6% in 2024 to 27.4% in 2025 and 27.0% in 2026, which could spur some near-term volatility. However, any excess correction is a buying opportunity, in our view, as we believe the margin weakness will be short-lived. To understand the margin trends for tech, we provide a snapshot of the Big 4's P&L account in Fig. 1, comparing the performance across 2020, 2025, and 2030 and highlighting the average growth rates (CAGR).

Our view of an eventual rebound is based on AI driving extreme automation for the Big 4, keeping other operational costs in check. Many media reports already reveal how Big 4 companies are automating key tasks like coding, content generation, office productivity, and marketing. Hence, despite faster growth in depreciation expenses (around 12% of Big 4's total expenses), we expect the bigger chunk of other operating costs (remaining 88% of Big 4's expenses) to grow only at only an 8.5% CAGR from 2025-30, or at a slower pace versus total revenue growth of 10% CAGR. Our estimates may prove to be conservative if AI drives faster-than-expected automation or stronger monetization and faster revenue growth. In summary, as seen in Fig. 3, after a temporary near-term drop in Big 4's operating margins due to upfront investments, we expect an eventual margin recovery to 29.0% levels by 2030.

Against this backdrop, we continue to recommend a balanced positioning within AI exposure across the three layers and recommend investors take advantage of structures if there is heightened volatility during the upcoming reporting season.

Appendix

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