Dear Limited Partners,

In January, I sat down with our team at Percepta, our AI transformation company[1], and walked through the discontinuous progress in coding models like Anthropic's Claude. Percepta has built one of the most advanced enterprise AI engineering teams in the world. It's 40 people and only 15 months old. And yet, even this largely young, agile, frontier team was completely rethinking how software is built and deployed for the enterprises they serve. I left with two observations:

I. AI has made software abundant, fundamentally changing how value is created for society
II. Capital allocation in software will change as it becomes a commodity industry

We are watching both play out in the market now.

Of course, we have pure software investments. We are not outside the dynamics described here. We have tried to seek truth and approach this with intellectual honesty.

I have also never had more conviction in our strategy. Our persistent drive to innovate within our own business led us to institutionalize Creation, Customer Value, and Percepta years before the signals played out in the public markets. We believe these give us a structurally differentiated position for what comes next: the ability to drive alpha in a commoditizing software market while simultaneously capturing value from the AI transformation of major industries.

I'd welcome your reactions as we navigate this together. As always, we are grateful for your partnership and look forward to the future.

Hemant Taneja
CEO, General Catalyst

AI is becoming the world's new cognition capability. That shift has commoditized software. For a generation of software buyouts, terminal value was the return model. For many of those investments, it has become *terminated* value.

A Structural Shift in the Software Capital Stack

Recent advances in coding models have unleashed an era of software abundance. The scarcity that made software valuable is diminishing.

[1] A GC transformation company, not a portfolio company

This is not a surprise to us. In my 2018 book *Unscaled*, I argued that mass production was giving way to mass personalization, and that AI drives economies of “unscale” over economies of scale. Small, focused companies can now rent what incumbents spent decades building and serve narrower markets better. The coding model breakthroughs of the past 18 months are the most dramatic acceleration of that thesis yet. Every company can now access bespoke software. This will also accelerate the transformation of the workforce, with humans and AI agents increasingly working in tandem, and the boundary between the two shifting every quarter.

This raises a few questions. If the software built to support human work is increasingly abundant, and the human work itself is shifting, what happens to the value of the companies providing it? How must these businesses evolve to remain valuable? And, how must the capital structures financing them evolve to generate interesting returns?

There are two dimensions to this “software re-rating” question: the technological and the financial.

The Technological

A high volume of software companies were built in a hype cycle. Many of these products never solved a critical job to be done, or their job to be done has since been obsolesced by AI. Atlassian faces pressure as AI collapses the project management overhead its products were built around. Zendesk faces an existential challenge as AI handles the customer service interactions that justified its seat-based model. More broadly, SaaS customers are building their own solutions thanks to these model innovations, and AI-native competitors are providing cheaper, more customized alternatives. One of our portfolio companies has already eliminated 5 of their SaaS providers by rebuilding the functionally in-house, saving roughly $8M annually. Point solutions are being absorbed in real time. The per-seat model, which assumed human headcount would grow indefinitely, is structurally impaired.

There is another side of software – perhaps the larger group – that will continue to have a healthy business. These are businesses deeply embedded in regulated workflows, sitting on proprietary operational data, where AI makes delivery more powerful, rather than less relevant. The healthcare system with ten million patient cases. The financial institution with default behavior data across a full credit cycle. Stripe's $1.9 trillion in 2025 payment volume[2] is infrastructure built on an operational moat, not a technical one.

AI is deflationary for businesses whose moat was built on artificial scarcity. It is profoundly inflationary for businesses whose moat is institutional trust, deep customer relationships, and operational knowledge that compounds with increasing cognition.

The Financial

[2] Stripe 2025 Annual Letter, February 2026

The technological shift has a direct financial consequence. Software as a store of value is no longer interesting if the return model depends on a terminal buyer paying a multiple of what you paid. That assumption is broken, and unlike previous cycles, it will not correct itself. Software has simply matured and commoditized earlier than LBOs were modeled for. Paying 20-50x FCF implies a 20- to 50-year duration in a world where those cashflows would be steady when in reality the competitive landscape shifts every quarter.

Take Anthropic, one of the fastest scaling businesses in history, which grew from $1 billion to $19 billion in ARR in 15 months[3]. Its multiple has compressed as actual revenue has materialized. Legacy SaaS businesses with real but stagnant cash flows still carry multiples that haven't absorbed that lesson.

Let's say we bought a high-quality B2B software business a few years ago: sticky enterprise contracts, 90% gross margins, 25% annual growth. The entry price was 25× EBITDA (~40-50x FCF), with a portion financed through private credit and underwritten to a five-year hold. EBITDA grew 50%. The debt came down. And yet the equity still doesn't work as software becomes commoditized.

EBITDA growth added $625M in enterprise value. Multiple compression from 25× to 12× destroyed $975M.[4] The deal returned 0.68× MOIC — roughly a third of LP capital lost on a deal where the underlying business succeeded. Annualized over five years, that is a deeply negative IRR of approximately -7%. The business performed. The model failed anyway. The return was so dependent on the exit multiple that no amount of operational improvement could compensate for a category repriced underneath it.

The exit environment offers little relief. Strategic acquirers are navigating their own AI transitions and have little appetite for large software integrations at premium prices. PE acquirers realize the existing model is a dead end and hence are reluctant to buy more assets within the existing value-creation model. The public markets are effectively closed for most PE-backed companies: passive indexing has concentrated flows into mega-cap indices, and a sub-$10B company going public today faces minimal analyst coverage, no passive inflows, and chronic multiple compression. When the loans mature, the GP faces a choice with no good options: inject fresh capital into a business whose category is being repriced by AI, or hand over the keys to the lenders.

So what’s the path forward?

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[3] Anthropic Series G announcement, February 12, 2026; Dario Amodei, Morgan Stanley TMT Conference, March 4, 2026.

[4] The 25× entry multiple reflects the median software buyout transaction multiple for the 2019–2021 vintage, a period in which near-zero interest rates, abundant private credit, and sustained SaaS growth drove aggressive underwriting across the market. The 12× exit multiple reflects current conditions: public market software multiples hover around 12.7× EBITDA as of 2025–2026. A 25× EBITDA entry on a typical SaaS business implies 35–50× FCF, underwriting decades of uninterrupted cash generation for an asset being repriced in real time.

The opportunity is abundant. Capturing it requires a different architecture. The real and transformative promise of AI is not efficiency, but growth. While there is a hard floor on how much you can cut from any business, there is no ceiling on what intelligence-driven growth can produce: new revenue streams, new categories of output, capabilities that simply did not exist before. The shift from "AI is reducing our costs" to "AI is driving our top line" is where the next era of private markets returns will be made.

First, we must figure out how this industry generates returns going forward. For PE, the path forward is a hard reset. The buyout model works in every other commoditized industry — industrials, healthcare services, professional services — because returns are grounded in cash flows, not exit multiples. Software buyouts simply need to be structured the same way. Industrial buyouts have historically entered at 6–8× and earned their way to a higher exit multiple through real operational work.

Software transactions more broadly need less leverage, longer duration, and value creation that comes from the operating model rather than the balance sheet. The businesses, cash flows, and customer relationships in the current vintage are largely real. Solid assets financed irresponsibly produce bad outcomes. The next stack has to be built more responsibly, financing operating leverage and cash flows rather than terminal value.

To illustrate how the math changes: take the same business with $50M EBITDA, growing at 25% annually. Instead of entering at 25× on a terminal value bet, a disciplined buyer enters at 10× ($500M enterprise value) with modest leverage of 3× EBITDA ($150M debt, $350M equity). Over five years, EBITDA grows to $75M through genuine AI-driven operational improvement. The exit, now grounded in cash flow conversion rather than multiple speculation, clears at 14× — a modest re-rating for a business that has demonstrably transformed. Enterprise value at exit: $1.05B. Debt reduced to $100M. Equity recovered: $950M on a $350M check — a 2.7× MOIC and an IRR of approximately 22%.

Next, we must try to maximize return on existing Net Asset Value (NAV). PE has historically created value around the product by cutting costs or adding sales capacity, while treating the technology itself as a fixed asset to be realized at exit. The next era of software value creation requires rebuilding the product from the ground up as an AI-native system. The transformation *is* the investment thesis.

The playbook is clear: double down on companies with strong leadership, regulatory moats, and the potential to benefit from Jevons' paradox — the counterintuitive phenomenon where efficiency gains increase rather than reduce overall consumption, as lower costs expand the total market for a capability. Embed AI deeply, not cosmetically. Bring in technical founders, rebuild product architecture, and convert the customer base before a competitor does. Leverage scaling laws: as cognition compounds, the product itself becomes more capable and gets cheaper to operate. The alpha comes from AI leverage rather than pure financial engineering.

Talent will be a critically rare asset barrier here. The best AI talent is not looking for a head-of-AI role at a PE-backed enterprise or a firm still debating whether transformation is even necessary.

They go to the bleeding edge, where the mission is credible and the mandate is real. Firms that signal ambivalence about change will not be able to hire for it, and without the talent, they cannot execute. That cycle is vicious in one direction and virtuous in the other.

This is where the line between venture and PE blurs. The value creation playbook is venture-style: finding and backing the technical founder who can rebuild the product, identifying the adjacent market the incumbent's distribution can unlock, executing the M&A that creates a platform rather than a point solution. The returns come from re-rating a business through genuine transformation, combined with the roll-up synergies that accrue to a consolidator with real operating leverage.

The GC View: A 30-Year Supercycle

We have long held that we are in a 30-year technology supercycle that began in 2007 when the iPhone, AWS, and Facebook as a platform launched in close succession, generating the data that made AI possible. The convergence of social, mobile, and cloud trends led to a digital representation of society, the data that would eventually train LLMs and bring AI to life. We continue on the path of technology-led abundance, each wave faster than the last.

This is the environment we have fortunately been innovating toward. We have spent the last several years operationalizing three initiatives to earn the right to drive this transformation:

CVF — our vehicle for driving alpha in the software sector on a cash flow basis, without the terminal value dependency that has impaired so much of the current vintage.

Creation — our capability for transforming and rolling up established assets by partnering with great technical founders, combining incumbent distribution with startup-speed product reinvention.

Percepta — our AI transformation company and one of the most advanced AI orchestration layers for helping enterprises diffuse AI into their operations.

Together, these give us a differentiated position: the ability to capture value in software's most durable form, cash flows, while actively driving the transformation of the incumbents that will transcend this moment.

At General Catalyst, our direct exposure to pure SaaS is approximately $4B out of $42B in AuM. Much of that NAV sits in companies we believe are bolstered by AI. The strongest pre-2022 companies in fintech, healthcare, and defense that have embraced AI are scaling faster than ever. And the opportunity set for applied AI companies to reinvent industries, and for new power law companies to emerge, is greater than it has ever been.

That said, we are running a systematic review of each position, and in our existing growth business, our focus is cash flow orientation, aggressive AI transformation of the underlying business, and consolidation plays that accumulate market share rather than bet on a single asset's terminal value.

Navigating this moment requires courage. Post-COVID we marked our portfolio down by 40%, driven by prevailing market conditions at the time and evaluation of changes to each company's growth trajectory and performance. Our LPs applauded us for that proactive approach. Today we believe we are at a comparable inflection point. We are fortunate to be invested in a number of companies that we believe have the necessary moats and are accelerating at scale. But we intend to take a similar approach with our software investments that we believe will be impacted.

We are operating from a capital stack we believe is structurally suited to this moment. Identifying the businesses that remain durable and ascendant amid AI transformation — and having the capital stack and operational capability to fund that transformation — is our work for the next decade. We view this as the most critical mandate in institutional capital right now, and we look forward to doing it alongside you.

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