Alphabet Inc (GOOGL)

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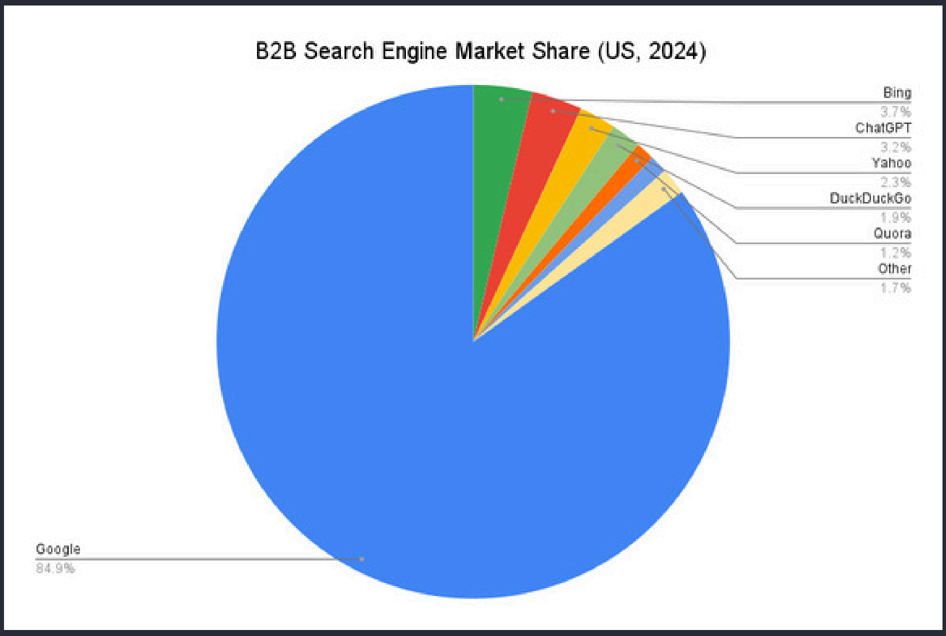
Company Brief & Thesis

Alphabet Inc. (GOOGL) is the parent company of Google and the key player in digital advertising, cloud computing, and, of course, search. Over 90% of the search market is dominated by Google Search and, in the video search segment YouTube is king. Alongside advertising, Alphabet has a growing presence in cloud computing (Google Cloud) which, could see rapid net income growth, and is at the forefront of other bets such as quantum computing and self driving cars.

Google's advertising business, driven by Google search engine and YouTube platform, provides the company with a highly profitable and defensible revenue stream while their Cloud segment represents a growth opportunity. Demand for Google services isn't expected to go down anytime soon even with the rise of AI tools or with an antitrust lawsuit, so their dominance is still expected to be maintained, and at today's prices it may represent a buying opportunity.



Company Dive In

Alphabet's dominance in the search and online advertising business is unparalleled. Google search controls around 90% of the searches done in the internet, mostly through google chrome but also through third party interfaces, such as Apple's Safari, which uses google's technology to do its research. Furthermore, their dominance in video is just as impressive. Through YouTube, Alphabet controls pretty much all of the medium-long form content online (by medium-long I mean content longer than TikTok but shorter than Netflix, for example), and thus they have great opportunities to offer advertisement slots in basically every video circulating online. And advertisers will buy it, because they have no other option if they want to reach their desired target audience.

This dominance creates a network effect. Everything is on google, and if you want to add anything to the internet, google is the place to do it because that's where everyone is. Same thing works for YouTube if you're in the video space. This allows them to sell advertisement space for a higher price and improve margins as well as profit from advertising support software, such As Google Pixel, that helps users track their Ad Performance.

Company Dive In

Google offers a fantastic platform for businesses to advertise. B2B companies like to advertise on businesses and have a google company page where they look very approachable and professional, while B2C companies will always have their website in the google engine search so their customers can look them up and buy products. This is a great duality that no other social media network was able to recreate; no B2B company will seriously advertise on Instagram reels just like no serious B2C company will advertise on LinkedIn, but, of course, both companies will have a website and advertise on google.

When any company is turned into a verb and used in a day-to-day situation, that’s when you know you have an economic MOAT in your hand. So everything I hear “google it”, it proves that the company has a strong control of the market.

On other fronts Google is also making great progress. Google Cloud, their cloud platform and the google workspace side of the business is also taking off. Although it doesn’t have the same market share as Amazon’s AWS or Microsoft Azure, Cloud is growing fast, making almost 12 billion dollars in revenue in 2024 (around 12% of the company’s revenue).

Company Dive In

However, with how easy it is to use Google cloud's products and how easy they are to integrate among devices and people, they've become the standard for younger people, especially in college campi. As young professionals grow using Google Docs and not Microsoft Word, Google will slowly but surely take market share in the office space segment and cloud will keep growing almost indefinitely

Google also generates revenues from operating services such as Android, The default operating system of billions of smartphones around the world, most commonly associated with the Samsung Galaxy. This offers google a strong stake in the smartphone market without actually taking many risks of selling the products themselves, allowing them to have a stream of income and being protected from ciclycalities.

Their "other bets segment" is their sandbox for every experiment they have, and, surprisingly, they have been paying off. Waymo, Google's self-driving initiative counts for a fifth of the Bay Area ridesharing services market and has taken the world by storm with its effectiveness. Furthermore, their advances in quantum computing, with google making advancements in the market, have been exciting and enough to boost the company's popularity and P/E multiple, though they will take a while to be put into practice and offset their R&D

Crux of the problem

However, the Two biggest causes of concern for the company comes in form of government regulation and AI & generative search.

Let’s start with government regulation, or Antitrust laws, that aim to break down Alphabet into two different companies: Google Search, which houses Chrome and their search engine capabilities, and everything else, from youtube, to cloud to waymo and android. Talks of a breakup always scare shareholders away, but I don’t believe that is a bad thing

As a lover of history, I love to remind myself that Rockefeller was richest after the breakup of standard oil, not before. I believe that just like Standard Oil, Google’s different segments could be worth more if they were valued separately. Google trades at a reasonable P/FCF, even though it has super high growth segments inside the company that could be trading for double the price. A breakup in which the current shareholders of the company get shares in the two new companies could increase the value of the overall portfolio, cause multiple expansion in the companies and allow for efficiencies to be found by better micromanagement of resources. Something that is priced in negatively could be actually good for shareholders long-term.

Crux of the problem

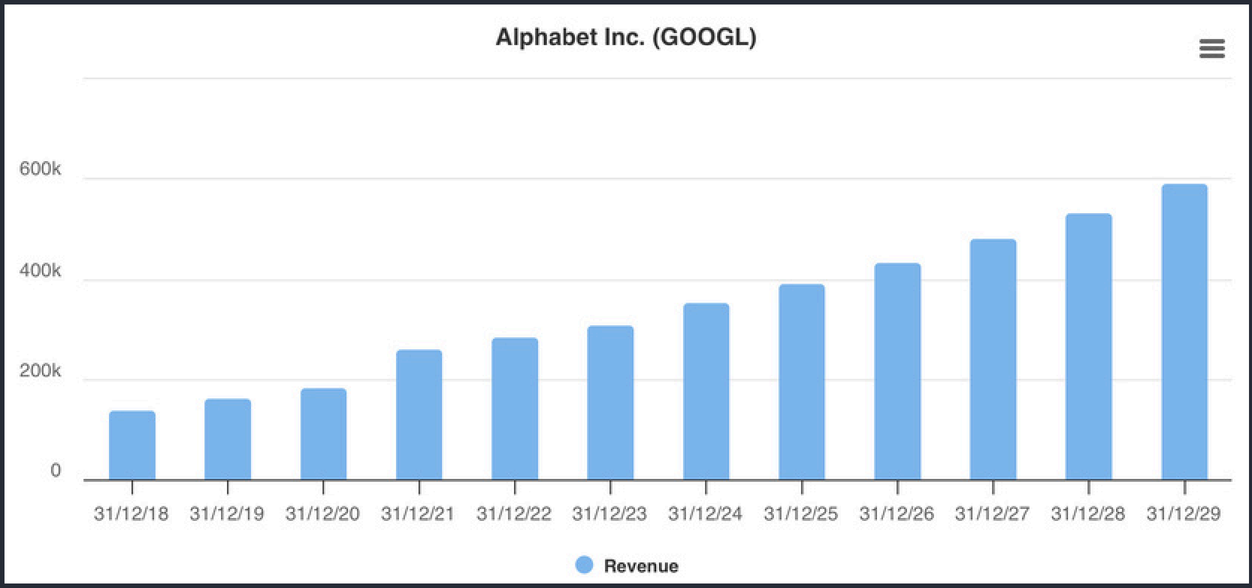
AI is seen as a threat to Google's search dominance, with experts arguing that people will start using AI tools, such as chat gpt or deep seek instead of Alphabet's search engine. This is, in my opinion, a misconception for two main reasons. The first one is that people don't go on AI tools to find things they can find fast. If one wants to find a restaurant or buy a Christmas gift, they will go on google to access a store's website or look on google to search for a restaurant's address. As long as businesses maximize their advertisement for Google's search engine optimization, there will always be a demand for people going into the website to look for stuff they want.

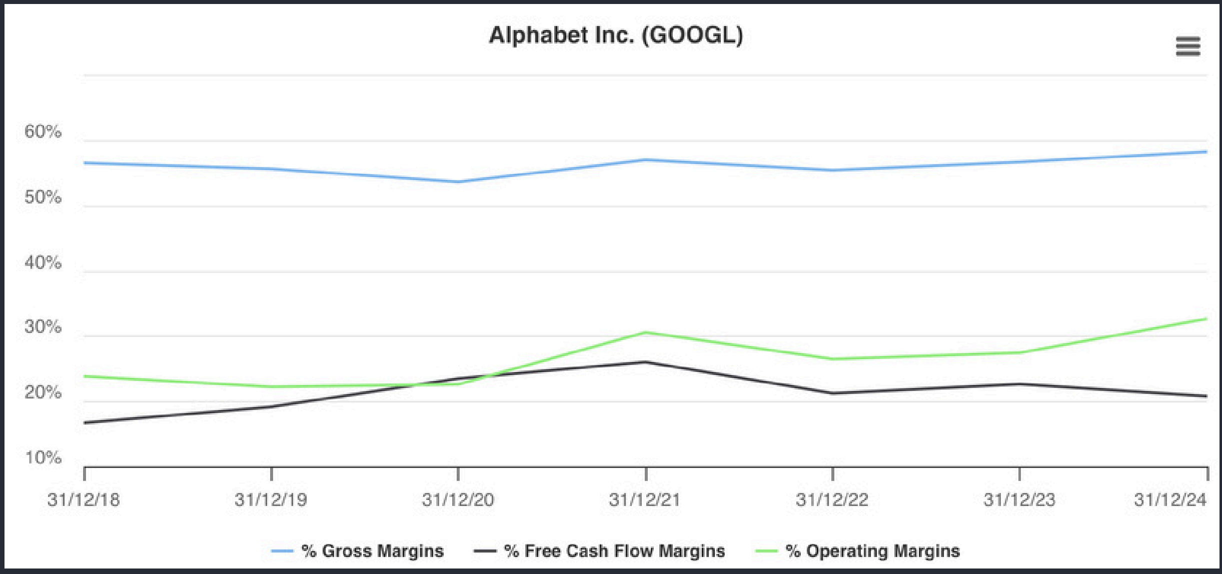
The second aspect is using AI tools for deep research. This feature is something that Chat GPT and other AIs currently have an edge over Google, which indeed could threaten their market share. However, Google has been making great progress in integrating their own AI, Gemini, into google search. This integration is smoothly familiarizing users with Gemini and, with Google's resources and data capabilities, they can become a serious contender for the top generative AI Software if they perceive it as a good enough investment.

Company Dive In

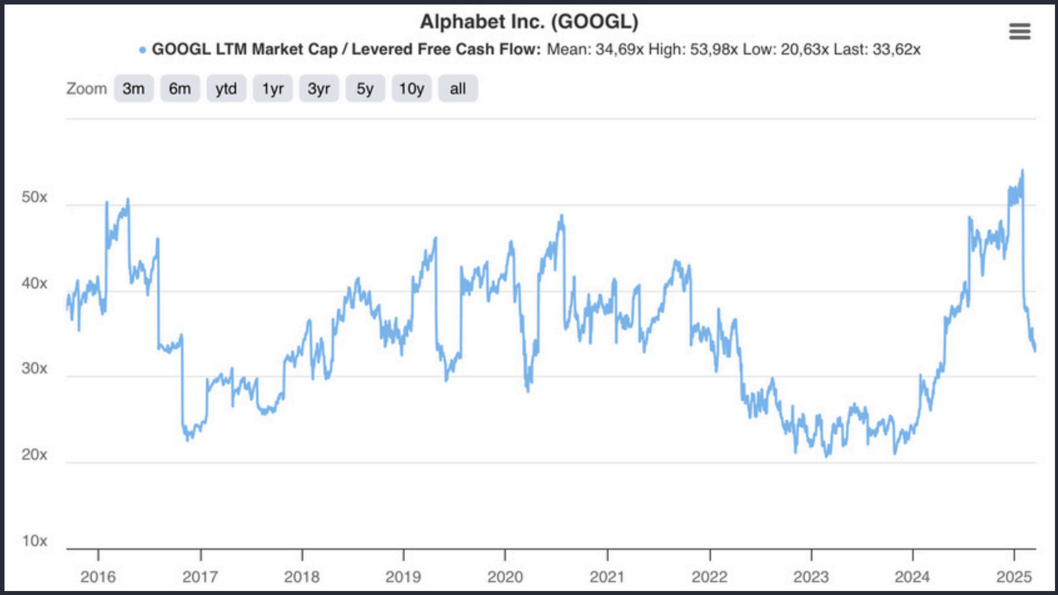
As it stands, Alphabet is one of the strongest companies in the market: with a dominance in web search and digital advertisement and growing segments of the business through cloud and their other projects, they seem to be poised for a great future and stable shareholder returns.

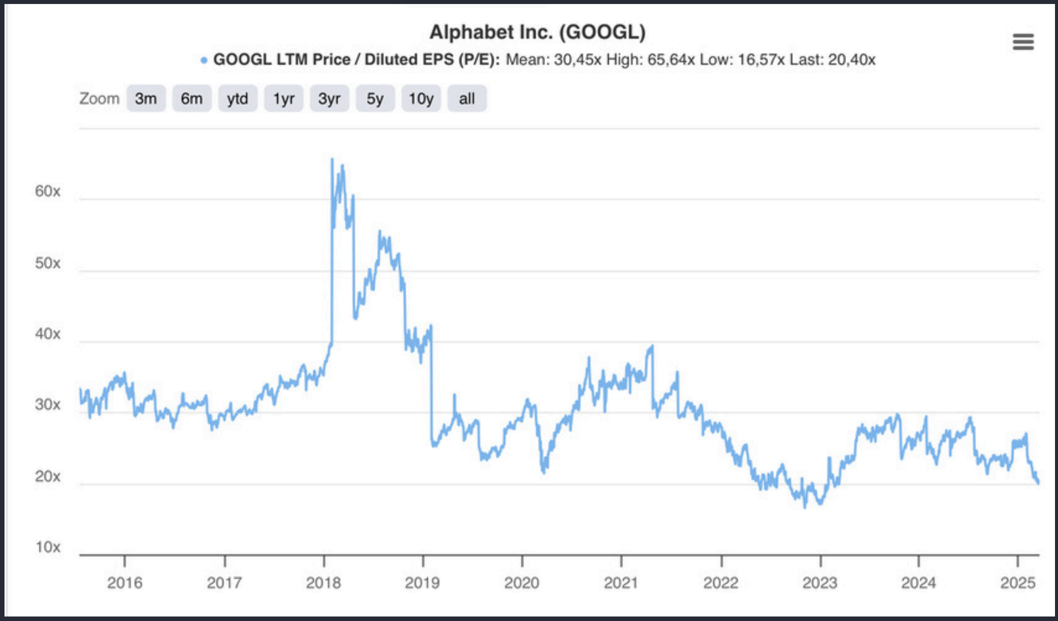
With all their segments even the “other bets” one on the rise, the cruxes of the problems seem minuscule when compared to the opportunities Alphabet has in front of them, especially at these record low prices.

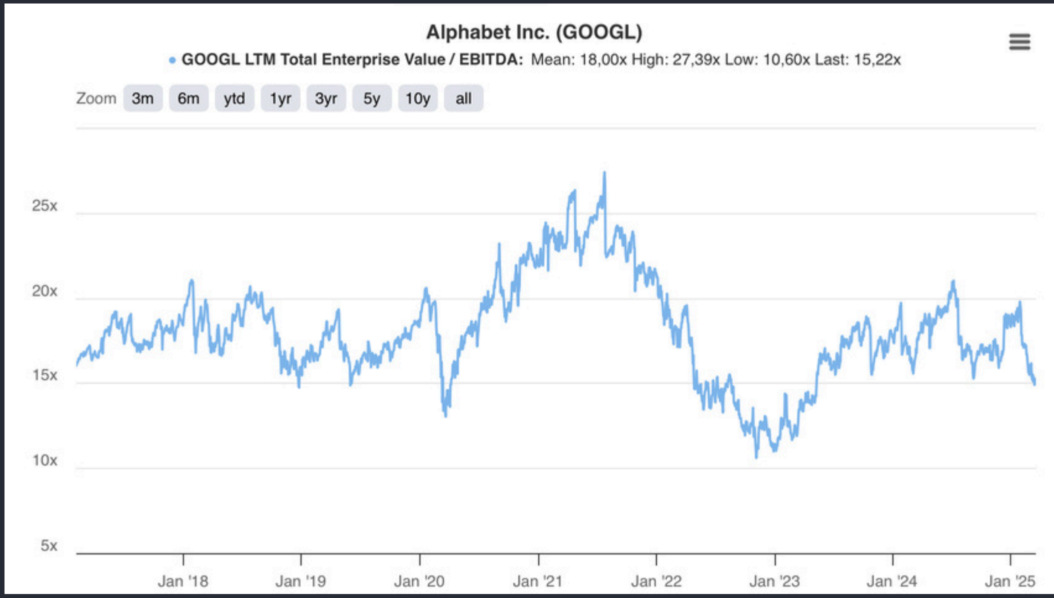




Multiples and Margins







Fair Value

In terms of valuation, I estimate the following for Alphabet:

Revenue Growth: 10%

Free Cash Flow margin: 23%

Exit Multiple (P/FCF): 32

Applying this to the following current data of

350 Billion in Revenue

2,060 Billion in market cap

I calculate a CAGR of 15% for the next 5 years, which is a good return to achieve for such a stable company with solid growth potential.

Alphabet, through its absolute dominance in the industries that comprise most of their revenue and a fierce determination to become a serious player in the other sectors they are involved in, presents a great investment opportunity as of today. Especially when compared to other companies in the Mag 7, GOOGL trades at a very reasonable price and has solid foundations for sustained growth.