

8/3/2024

Initiating Coverage:

# Alphabet Class C (\$GOOG)

A “Cloudy” Future

**Key Take-Away:** Google has continued to deliver excellent earnings and revenue growth through Google Search and Advertising. We believe that GOOG will be a huge net benefactor of the long-term trends in AI. Gemini AI has continued to be successfully integrated within the Google ecosystem providing notable growth within Google Search. However, investors are growing weary of the increasingly higher projected CapEx necessary to compete in the AI & Cloud Arms race.

In Q2 2024, Alphabet saw strong revenue growth within Search (+14% YoY), Cloud (+29% YoY), and impressive operating margins of 32.4%. Despite this, GOOG stock dropped more than 10% in after-hours trading following the earnings call. We believe this does not affect our long-term thesis due to management citing short-term headwinds within CapEx. Notably, YouTube missed expectations (13% YoY vs. Estimated 16%).

**Continued Dominance in Search and Advertising:** GOOG has continued to remain the largest player within Search and Digital Advertising with no signs of slowing down. Despite their clear-cut dominance within Search, its growth has continued to outperform Street estimates through the integration of Gemini AI. While investors were concerned that products such as ChatGPT may gain search market share, it seems that this is not yet the case. GOOG believes AI integration is driving greater usage rates, monetization, and engagement on their platforms. Macro conditions picking up with potential rate cuts in the coming months will create tailwinds for digital advertising spend.

Conversely, it should be noted that GOOG was charged with antitrust and the monopolization of the search engine industry earlier this week, leading to potential uncertainty in the future of their search engine sector. While GOOG was initially charged, they have already appealed the ruling, likely pushing any repercussions a couple of years down the line – if ever.

## Promising AI & Cloud Growth:

GOOG's cloud computing and AI sector saw strong growth in Q2 2024 (+29% YoY), gaining significantly on its competitors in the space (AWS and Microsoft Azure both +19% YoY). We believe that with GOOG's continued increasing CapEx dedicated to growing their AI and Cloud capabilities, they will continue to gain on their competitors. As of Q2 2024, GOOG holds a significant market share in the cloud industry at 12%.



Consortium Equity Research  
TMT | Software, Cloud  
August 3<sup>rd</sup>, 2024

Stock Rating: Overweight

Price Target: USD \$200.00

Price: \$160.40

Potential Upside/Downside: 24.58%

Ticker(s): \$GOOGL (Class A)  
\$GOOG (Class C)

Market Cap: \$2.01tn

Shares Outstanding: 12.31bn

Dividend Yield: 0.48%

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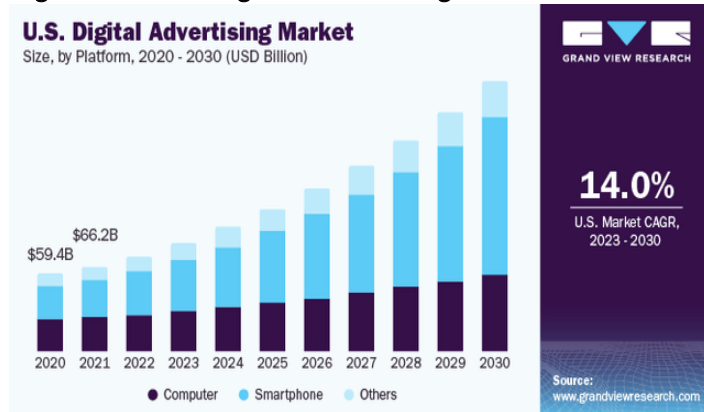
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**Valuation:** We initiate coverage with a \$200 PT.

## Peer Comparisons & Competitive Landscape

Ticker	Mkt Cap	EV	P/E	Revenue	EBITDA
Meta Platforms Inc. (\$META)	\$ 1,356,260	\$ 1,335,773	29.53x	\$ 142,712	\$ 651,004.56
Amazon.com Inc. (\$AMZN)	\$ 2,079,140	\$ 2,154,626	54.69x	\$ 590,740	\$ 340,978.98
Microsoft Corporation (\$MSFT)	\$ 3,465,313	\$ 3,491,529	39.44x	\$ 236,584	\$ 1,847,011.62
Pinterest Inc. (\$PINS)	\$ 29,199	\$ 26,577	191.76x	\$ 3,193	\$ 1,927.11
Netflix, Inc. (\$NFLX)	\$ 292,000	\$ 301,466	45.16x	\$ 34,932	\$ 68,620.05
Reddit, Inc. (\$RDDT)	\$ 11,348	\$ 9,702	-	\$ 883	\$ (69,280.00)
Tencent Holdings (SEHK:700)	\$ 452,963	\$ 456,176	30.16x	\$ 85,220	\$ 145,400.96
Alphabet Inc. (\$GOOGL)	<b>\$ 2,370,915</b>	<b>\$ 2,291,201</b>	<b>28.98x</b>	<b>\$ 318,146</b>	<b>\$ 817,965.50</b>
Ticker	EV/ EBITDA	Gross Margin	EBIT Margin	EBITDA Margin	EBITDA Growth Rate
Meta Platforms Inc. (\$META)	23.70x	81.5%	39.5%	48.0%	63.23%
Amazon.com Inc. (\$AMZN)	45.59x	47.6%	8.0%	16.4%	66.24%
Microsoft Corporation (\$MSFT)	32.80x	69.9%	45.0%	53.3%	27.18%
Pinterest Inc. (\$PINS)	138.74x	78.1%	6.0%	6.6%	-
Netflix, Inc. (\$NFLX)	38.36x	43.1%	22.5%	23.5%	43.61%
Reddit, Inc. (\$RDDT)	-14.72x	87.3%	(74.6%)	(73.0%)	-
Tencent Holdings (SEHK:700)	18.65x	49.9%	28.7%	32.1%	34.47%
Alphabet Inc. (\$GOOGL)	<b>23.61x</b>	<b>57.5%</b>	<b>30.5%</b>	<b>34.5%</b>	<b>29.86%</b>

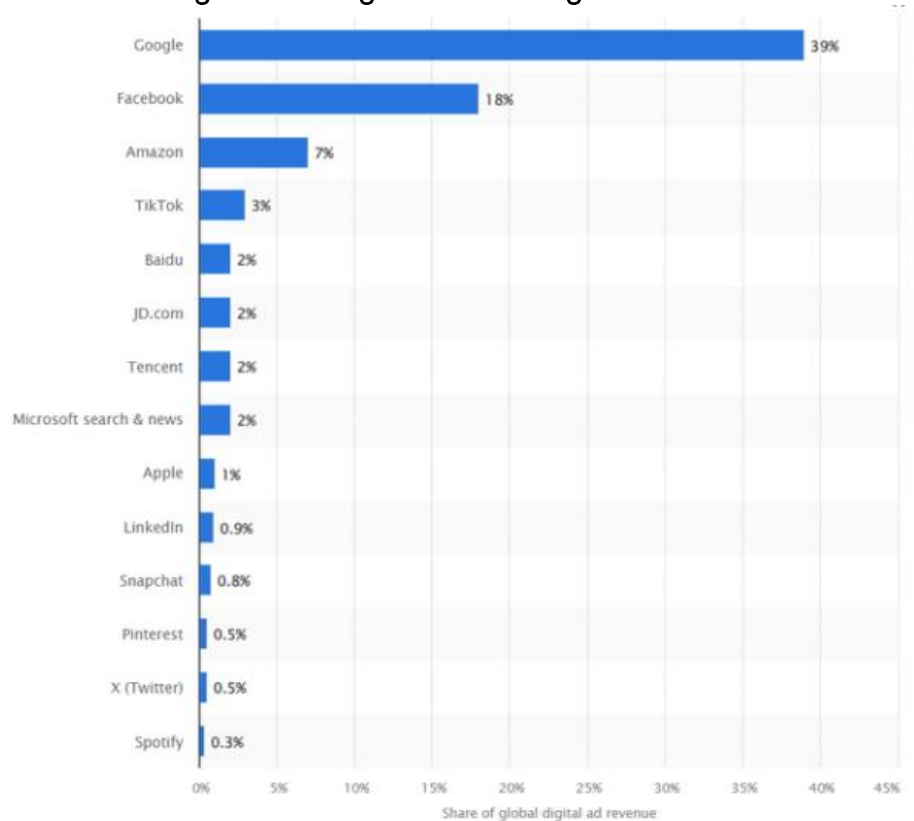
Figure 1: U.S. Digital Advertising Market



Source: Grand View Research

**Continued Digital Ad Spend:** Google enjoys the industry leading market share within search and streaming advertising that has made them incredibly well positioned to capitalize off an increase in digital advertising spend. American search ad spending growth is expected to grow at 9.8%. With the Paris Olympics, Euro 2024, and the United States Presidential Elections ongoing/ upcoming, Google will have tremendous tailwinds moving through Summer 2024 and into the Fall.

Figure 2: Google's Advertising Market Share



Source: Statista

**Gains in Cloud:** Google's suite of Cloud Computing services run on the same internal infrastructure that hosts Google Search and YouTube. They face stiff competition from Amazon and Microsoft and gain market share through the price-undercutting of competitors, making them a favorite among unicorn startups (70% of Gen AI unicorns use Google Cloud). They're currently the fastest growing hyperscaler through smart investments in line with Google's strengths in security and data analytics. Cloud Services have been growing in-line with competitors while Cloud margins lag behind, there are large runways for improvement as Google is a newer entrant to the space.

## Industry Overview

**Internet Search and Advertising:** Within Google's primary revenue stream, there has been a continued shift from traditional to digital advertising as companies look to leverage consumers' ever-increasing screen time to generate sales. Advertisers are increasingly turning to AI to evolve and generate successful marketing campaigns, thereby decreasing Customer Acquisition Costs (CAC). The rising internet penetration, advancements in AI and machine learning, targeted advertising, and data analytics are driving growth in this sector. This industry is cyclical and macro-dependent, as advertisers tend to scale back during economic downturns when consumer spending decreases. It remains essential for

businesses and consumers for information retrieval and advertising, though it is significantly impacted by regulatory changes, data privacy laws, and shifts in consumer behavior.

**Video Streaming (YouTube):** Online streaming has begun to replace traditional television, with streaming services growing at a CAGR of 25.3% year-over-year, while cable viewership is dropping by a CAGR of -12.5%, according to CNN. Providers have leveraged AI and machine learning to enhance targeted advertising and user analytics. The proliferation of high-speed internet and smart devices, along with the shift towards on-demand content, are key drivers of growth. This industry is less cyclical, maintaining consistent demand for entertainment and content consumption. It is important for entertainment, education, and marketing purposes, though it faces unique impacts from content regulation, copyright issues, and competition from other streaming platforms.

**Cloud Computing:** The cloud computing industry is witnessing the adoption of hybrid and multi-cloud environments, an increasing use of AI and machine learning, and a significant shift towards remote work. Enterprises rely on cloud solutions for their scalability and flexibility. Digital transformation across various industries, demand for scalable IT solutions, advancements in cloud technology, and the necessity of remote work solutions are driving growth in this sector. Unlike other sectors, cloud computing is non-cyclical; enterprises continue to invest in cloud solutions regardless of economic conditions, ensuring steady growth and stability. Cloud computing is critical for modern IT infrastructure, data storage, business continuity, and disaster recovery. Unique impacts in this sector include data security and compliance requirements, with regulatory changes potentially affecting operations, and continuous technological advancements driving the need for innovation and adaptation within the sector.

## Investment Thesis

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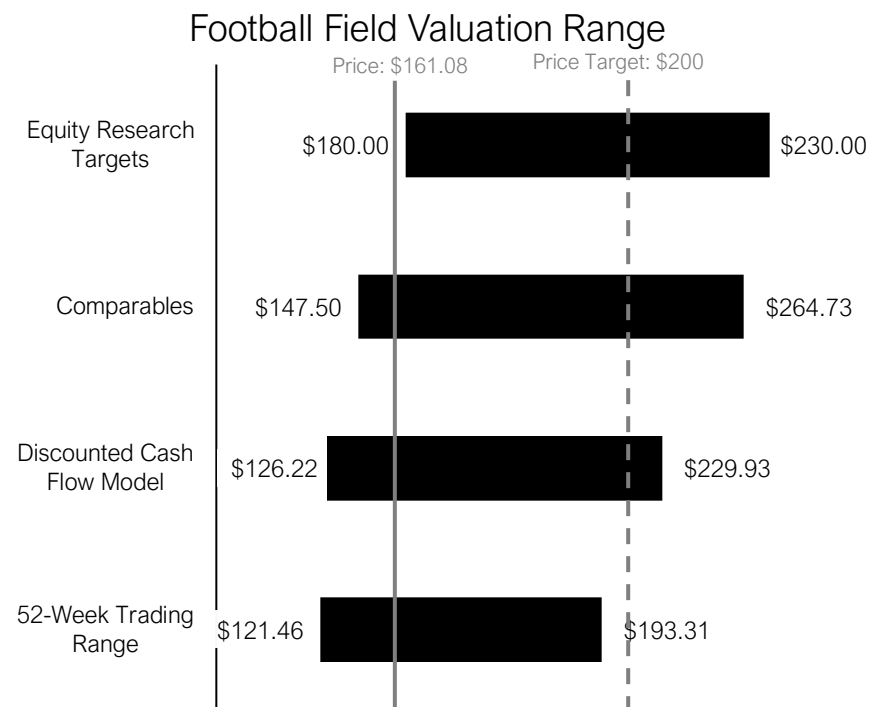
**Clear Market Leaders:** Google is a digital advertising powerhouse with a global 39% market share. Through the deployment of Gemini AI within Search, Google has continued to cement its dominance in space, surpassing competitors such as Bing. Google Search revenues grew 12.7% last quarter, while Bing's grew 8% (7% on a constant currency basis). Google has also quelled concerns of rising competition. On a traffic basis, Google is also holding steady: Bing's market share peaked at 3.59% in October 2022. It sits at 3.43% today.

**Short-Term Mispricing:** After GOOG's Q2 earnings call, GOOG stock dropped by over 10% despite exceeding earnings and posting strong growth. GOOG stock's correction was largely an emotional result of the market's reaction to their increased CapEx dedicated to AI growth. GOOG's correction paired with the market's recent movement from tech to less volatile stocks have positioned GOOG's stock well for a future runup, even compared to its Magnificent Seven peer set.

**Long Runway for Growth Within Cloud:** Despite its now 12% market share, GOOG's cloud sector only recently became profitable, with 10% margins compared to AWS and Microsoft Azure's 25%+ margins. This reveals a potentially profitable opportunity for GOOG as it seeks to improve upon its operating margins. Additionally, GOOG has the fastest growing cloud sector posting +29% YoY growth, over 10% higher than AWS or Microsoft Azure. Lastly, GOOG has proven to be the most popular provider for unicorn AI startups, with, according to Forbes, over 70% of AI startups using Google Cloud.

## Price Target & Valuation

Our analysis gives \$GOOG a price target of \$200 and an Overweight rating.



## Potential Downsides to Our Rating

**Increasingly High Capital Expenditures:** Q2 2024 saw CapEx increase by \$1.2bn QoQ to an enormous \$13.2bn largely due to servers and data centers. Management has indicated that these

CapEx figures will continue through 2025 as they look to invest in their AI and cloud businesses. While the model accounts for increased CapEx and higher depreciation, continued or ill-informed spending without positive revenue or earnings growth may lead to major corrections within the valuation. However, GOOG has been historically prudent with their spending, and there is no evidence to support cash issues soon.

**LLMs Threaten Search:** Growing concerns about LLMs such as ChatGPT taking search revenues away from Google may affect our PT. As LLMs begin to develop, people may instead rely on AI for their daily questions and advice. Google's 90%+ Search Market Share and 40% digital advertising market share may be threatened. Despite this, we don't believe this is a cause for

Our Price Target: **\$200**

Our PT is based on Google's continued strength within Cloud Computing and AI integration. With the Cloud industry poised to grow at a CAGR of 16.40%, we foresee Cloud Services Revenue growing at a similar rate. In addition, Gemini integration within Search will also boost overall Search and Advertising Revenues. With both being high-margin segments, we foresee positive EBIT growth that improves FCF, ultimately allowing GOOG to trade more in line with its peer hyperscalers.

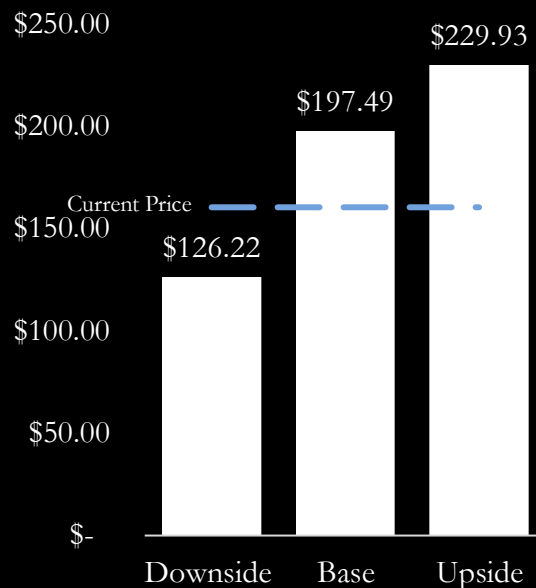
Our Upside Case: **\$229.93**

Our upside case is based on GOOG achieving significant EBIT margin growth as they expand into Cloud Services. GOOG cloud margins are at ~10% versus AWS's margins of ~25%. In addition, Gemini enterprise integration as well as sustained dominance with Search and Advertising lead to our upside price target.

Our Downside Case: **\$126.22**

Our downside case is based on unfavorable litigation against Google regarding Search.

## DCF Case Values



concern as Alphabet has remained prudent with Gemini integration into Google Search as well as their recent data licensing agreement with Reddit to enhance the Search experience.

## Projections

<b>Income Statement (\$mm)</b>	<b>2023A</b>	<b>2024E</b>	<b>2025E</b>	<b>2026E</b>	<b>2027E</b>	<b>CAGR%</b>
Revenue	307,158	345,411	390,848	443,748	505,495	4.5%
EBITDA	109,723	124,067	152,431	177,499	207,253	6.7%
EBIT	96,999	107,245	125,071	146,437	171,868	5.6%
EBIAT	34,748	65,896	55,288	68,575	77,348	11.0%
<b>Margin &amp; Growth Data</b>	<b>2023A</b>	<b>2024E</b>	<b>2025E</b>	<b>2026E</b>	<b>2027E</b>	<b>AVG%</b>
EBITDA Margin	35.7%	35.9%	39.0%	40.0%	41.0%	38.3%
EBIT Margin	31.6%	31.0%	32.0%	33.0%	34.0%	32.3%
Revenue Growth	9.4%	12.5%	13.2%	13.5%	13.9%	12.5%
EBIT Growth	9.9%	10.6%	16.6%	17.1%	17.4%	14.3%
<b>Valuation Metrics</b>	<b>2023A</b>	<b>2024E</b>	<b>2025E</b>	<b>2026E</b>	<b>2027E</b>	<b>AVG%</b>
P/FCF	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x
EV/Sales	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x
EV/EBITDA	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x
FCF Yield	6.6%	3.5%	4.1%	4.8%	5.8%	6.9%

## About \$GOOG

Google is a global leader in internet services and products, specializing in search engine technology, online advertising, cloud computing, software, and hardware. The company's primary revenue driver is digital advertising through its Google Ads platform. Google also offers a range of other products and services, including the Android operating system, YouTube, Google Cloud, and hardware devices such as the Pixel smartphone series and Google Home smart speakers.

## Disclosures & Ratings

Consortium Equity Research does not hold any professional relationships with any reported equities.

**Overweight** means the analyst team believes the stock price will outperform the coverage industry (TMT, Healthcare, Industrial, Consumer) in the next 6-12 months. **Equal Weight** means the team expects performance in line with the industry. **Underweight** means the team expects underperformance relative to the industry.