

Price and Performance (Values in USD)	
Price	1385.40
52 Week High	1530.74
52 Week Low	1008.87
YTD	3.4%
Average Daily Volume (mn)	2,141,661
Market Cap (mn)	947,035
Beta	0.89
EPS	49.59

Source: BiG Research; US

Alphabet Inc	
Ticker MyBolsa/website BiG	GOOGL
Ticker BiGlobal Trade	GOOGL
Ticker BiGTrader24	GOOGL
Ticker BiG Power Trade	GOOGL
P/E Ratio 2020E	27.47
P/BV Ratio	4.65
EV/Sales	4.17

Source: BiG Research;

Consensus (last 5 m)	
Buy	41
Hold	3
Sell	0

Source: BiG Research;

Financial Information	
Sales (USD mn)	161,857
EBITDA (USD mn)	47,832
Nº of Employees	118,899
ROA	13.3%
ROE	17.8%
Dividend Yield	0.0%

Source: BiG Research;

Credit Ratings		
Agency	Rating	Outlook
S&P	AA+	STABLE
Moody's	Aa2	STABLE

Source: BiG Research;

## Notes:

All quotes were updated in Bloomberg at 15h20 of May 11th, 2020.

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## Analyst:

**João Calado, CFA**

With the contribution of:

**Francisco Fonseca**

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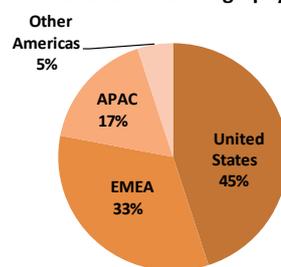
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## Alphabet (Ticker: GOOGL US)

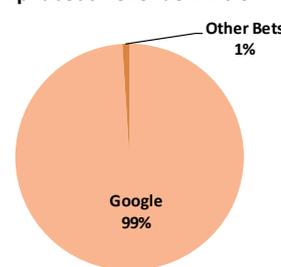
### ▲ Description

Alphabet is the conglomerate that resulted from the 2015 restructuring of the company formerly known as Google. Alphabet is now divided into Google – which manages the Google search engine that has expanded to a whole ecosystem which includes e-mail (Gmail), cloud, video (YouTube), a mobile operating system (Android), etc.; and other bets – includes subsidiaries such as Verily, Calico, Waymo, and Google<sup>[x]</sup>, among others (12 in total). Google is the money maker of Alphabet (99% of revenues), operating on a revenue generation system sustained by **advertising** revenues and subscription (**cloud**) revenues. Alphabet has a three-tier stock structure, composed of: class A (ticker GOOGL), which trade in the NASDAQ stock exchange and have one voting right per share; class B which are held by insiders and do not trade in public markets and have ten voting rights per share; and class C (ticker GOOG) shares who also trade in the NASDAQ stock exchange but have zero voting rights. Class A and C shares were created through a stock split in 2014.

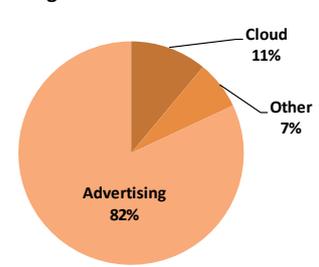
Revenue Per Geography



Alphabet's Revenue Division



Google's Revenue Division



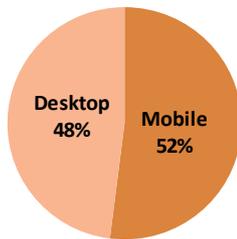
Source: BiG Research

### ▲ Coronavirus Impact

- In **March 2020** Alphabet experienced a **decline in advertising revenues** due to the impact of COVID-19 and the related reductions in global economic activity. There were two main reason for this decline: 1) users' search activity increased, yet their interests shifted to less commercial topics; 2) reduced spending by advertisers in response to the macroeconomic impact.
- The company also assessed the realized and potential **credit deterioration of their customers** due to changes in the macroeconomic environment, which has been reflected in an increase in allowance for credit losses for accounts receivable.
- Looking ahead, the **full impact of COVID-19 on the business is unknown** and highly unpredictable, and historical trends in revenues, operating income, etc., may differ materially.
- In addition, **many expenses are less variable** in nature and may **not correlate to changes in revenues**. The extent of the impact will depend on the duration and severity of the pandemic as well as the macroeconomic impact of government measures to contain the spread of the virus.
- To address the potential impact on the business, over the near-term, the company is **revaluing** the pace of **investment plans** (ex. hiring, investments in data centers, servers, network equipment, and marketing and travel spending. Alphabet did not disclose specific costs and investment reductions, norther how the impact of COVID-19 will affect the stock repurchase program

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## Search Ad Spending Share %

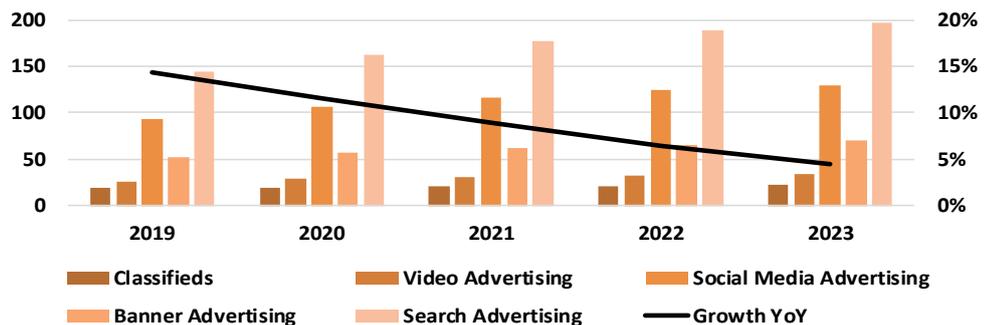


Source: BiG Research; Statista

## Investment Thesis

**Exposure to online advertising:** Google’s search engine and its portfolio of apps are one of the most popular mediums of online advertising, with the company having around 82% of total revenues (1Q20) coming from advertising. Nowadays, Ad Mobile already surpassed Desktop, and the new gap is expected to increase over the next years. Further, Search Media Advertising and Social Media advertising will continue to be the growth drivers of this industry. It is a certainty that the COVID-19 will affect the Ad Spending on a short-term horizon, nevertheless, the recovery, as well as the long-term impact, is still unclear. Since these costs are flexible, the market is expecting a fast recovery, rather than a gradually extended one.

### Forecast for Ad Spending before COVID-19 (USD bn)



Source: BiG Research; Statista

**Cloud Services:** Google has the 3<sup>rd</sup> highest (but still low in absolute terms) market share of public cloud, followed by Microsoft and Amazon, which is currently the undisputed leader. Yet, since the market is expecting strong growth in the next years, Google will be able to benefit from this upward trend of the industry, even if the market share remains stable at medium single digits. The cloud revenues already account for 11% of total revenues (1Q20).

Cloud service provider	FY2019		FY2018		Annual Growth YoY
	USD bn	Market Share	USD bn	Market Share	
AWS	34.6	32.3%	25.4	32.7%	36%
Microsoft Azure	18.1	16.9%	11.0	14.2%	64%
Google Cloud Platform	6.2	5.8%	3.3	4.2%	88%

Source: BiG Research; Canalys

**Hardware:** Alphabet has expanded its portfolio by including hardware products, as the Pixel Phone, the Pixelbooks and the Google Nest home. While Pixel phones are still quite small in the smartphone market, in 2019 the Google Nest home had the 2<sup>nd</sup> largest market share (30.9% vs 23.9 in 2018) of the US smart speaker market.

**Other Bets** This segment, while still being a money losing unit, can create several potential revenue sources in the long-term future. One of the ‘main bets’ is Waymo (formerly known as Google Self-Driving Car Project), has introduced the latest fifth-generation “Driver” suite of hardware and software that basically allows a car to be driven without human input. The first test vehicle to have Waymo’s new ‘Driver’ suite of sensors and software is the electric Jaguar I-Pace. Further, Verily, the “bet” that generates more revenue within the segment, has been developing a web site, alongside with the White House and public companies, that lets consumers identify the symptoms and risks associated with coronavirus, and the nearest locations where testing is available.

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## Income Statement

Income Statement (USD mn)	2017	2018	2019
Revenues	110,855	136,819	161,857
Cost of revenues	45,583	59,549	71,896
R&D	16,625	21,419	26,018
Sales and marketing	12,893	16,333	18,464
G&A	6,840	6,923	9,551
European Commission Fines	2,736	5,071	1,687
Total costs and expenses	84,677	109,295	127,616
Operating Income	26,178	27,524	34,241
Other income (expense), net	1,015	7,389	5,394
EBIT	27,193	34,913	39,635
Provision for income taxes	14,531	4,177	5,282
Net income	12,662	30,736	34,353
EPS (basic)	18.27	44.22	49.59

Source: Company's data

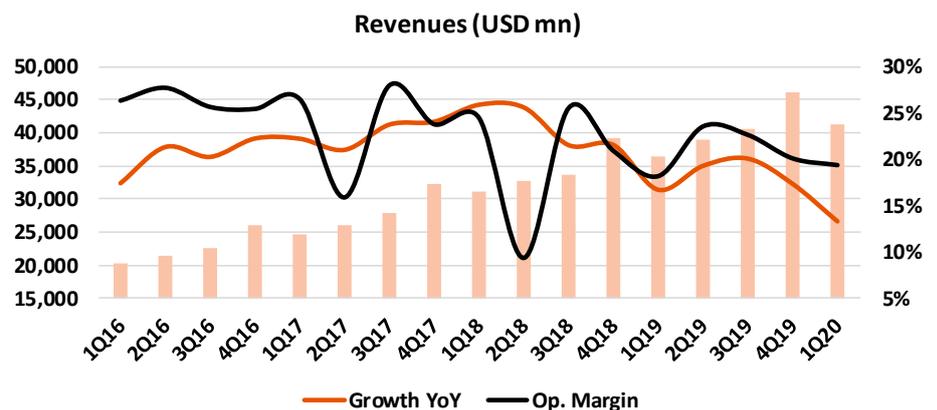
- Alphabet divides **cost of revenues** in two segments:

- **TAC:** paid to Google Network Members primarily for ads displayed on their properties and amounts paid to Google's distribution partners (browser providers, mobile carriers, software developers, etc.) who make available the company's search access points and services. TAC rate corresponds to TAC's costs as a percentage of advertising revenues since these costs are mainly related to this revenue source.
- **other cost of revenues:** Content acquisition costs (payments to content providers on YouTube and Google Play); expenses associated with data centers and other operations; and inventory related costs, etc.

Cost of revenues increased +21% y/y in 2019 to USD 71.9 bn (44.4% of total revenues vs 43.5% in 2018). TAC increased +12.6% y/y to USD 30 bn and other costs of revenues +27% y/y to USD 41.8 bn (caused by an increase in data center and content acquisition costs for YouTube).

- **Operating income** was USD 34.2 bn (+24% y/y) and operating margin was 30.8% (vs 21.2% 2018)

- **Other Income** includes interest income, realized gain/loss on equity and debt securities, and the subsequent Performance Fees (compensation arrangements with payouts based on realized investment returns). The rise in this measure in 2018 and 2019, relatively to 2017, was caused by an increase of the two topics firstly mentioned.



Source: BiG Research; Company's data

Free Cash Flow (USD mn)	2017	2018	2019
Operational Cash Flow	37,091	47,971	54,520
Net Income	12,662	30,736	34,343
D&A	6,915	9,035	10,856
Changes in WC	9,246	4,908	810
Others	8,268	3,292	8,511
Investment Cash Flow	- 31,401	- 28,504	- 29,491
Change in Fixed & Int. Assets	- 13,085	- 25,041	- 23,548
Change from Acq. & Div.	- 287	- 1,491	- 2,515
Other	- 18,029	- 1,972	- 3,428
Financial Cash Flow	- 8,298	- 13,179	- 23,209
Debt change	- 86	- 61	- 268
Share buyback	- 4,846	- 9,075	- 18,396
Other Financing Activities	- 3,366	- 4,043	- 4,545
Effect of FX	405	- 302	- 23
Change in free cash flow	- 2,203	5,986	1,797
Cash and cash eq.	10,715	16,701	18,498

Source: Company's data

## Free Cash Flow

Last year, the company was able to generate an operational cash flow of USD 54.5 bn, which represents a +14% growth y/y. It is also important to note that the operating cash flows generated are always enough to cover both capex and share buyback – signals a strong capacity of generating operational cash flows that sustain both investing and financial activities.

- **Capital expenditures** have been increasing over the years, and this trend will continue in the long term, due to the company's commitment to heavily invest in land and buildings for data centers and offices, and information technology infrastructure, which includes servers and network equipment.

- Alphabet pays **no dividend**.

- In 2019, Alphabet **bought back** USD 18 bn worth of shares and further USD 8.5 bn in the first semester of 2020. As of March 31, 2020, USD 12.8 bn remains available for repurchase – no maturity. So far there no modifications due to the COVID-19 pandemic.

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Balance Sheet (USD mn)	2018	2019	1Q20
Cash & Equivalents	16,701	18,498	19,644
Marketable securities	92,439	101,177	97,585
Accounts Receivables	20,838	25,326	21,825
Non-marketable investments	13,859	13,078	12,367
Property and equipment, net	59,719	73,646	76,747
Intangible assets, net	2,220	1,979	1,840
Operating Lease assets	-	10,941	11,219
Goodwill	17,888	20,624	20,734
Other Assets	9,138	10,640	11,442
<b>Total Assets</b>	<b>232,792</b>	<b>275,909</b>	<b>273,403</b>
Accounts payable	4,378	5,561	4,099
Accrued comp. and benefits	6,839	8,495	5,656
Accrued exp. and other liab.	16,958	23,067	22,601
Long-term debt	4,012	4,554	5,016
Operating Lease liabilities	-	10,214	10,476
Income taxes payable	11,327	9,885	9,207
Other long-term liabilities	11,650	12,691	12,689
<b>Total Liabilities</b>	<b>55,164</b>	<b>74,467</b>	<b>69,744</b>
<b>Total Equity</b>	<b>177,628</b>	<b>201,442</b>	<b>203,659</b>
<b>Equity + Liabilities</b>	<b>232,792</b>	<b>275,909</b>	<b>273,403</b>

Source: Company's data

## Balance Sheet

- Since 2018, total assets increased by around +18%, due to IFRS16 accounting implementation (operational leases included in the Balance Sheet), property and equipment gains (data centers and offices, and information technology infrastructure), and cash pile extension.
- As of the last filling (March 31<sup>st</sup>), Alphabet had **USD 117 bn available in cash and cash equivalents**, and only **USD 5 bn of debt**, which represents a **net cash position of USD 112 bn**.

## Last Earnings (1Q20):

- **Revenue:** +13% y/y to USD 41.2 bn; Google Advertising increased +10.4% y/y to USD 33.7 bn; Google Cloud increased 52% y/y to USD 2.8 bn; Google Other increased 23% y/y to USD 4.4 bn. Advertising accounted for 82.4 %, down from 84.9%.
- **TAC (cost of sales):** +18.5% y/y to USD 19 bn (TAC rate was 22.1% vs 22.4% 1Q19)
- **Operating Income:** +1% y/y to USD 8 bn (Operating Margin 19.5%); Google operating income was USD 9.3 bn (Operating Margin: 22.6%) and Other Bets reported a loss of USD -1.1 bn.
- **Net Income:** +3% y/y to USD 6.8 bn; EPS came as USD 10 (+4% y/y).
- **Capex:** +29% y/y to USD 6 bn (allocation stated above)
- **Operational Free Cash Flow:** -4.6% y/y to USD 11.5 bn, due an increase of USD 3.5 bn in accrued expenses and other liabilities

## Management Team

- **Sundar Pichai** is currently **Google's CEO** - since Alphabet creation in 2015 -, and in December 2019 he also was named **CEO of Alphabet**, replacing Larry Page (co-founder), who stepped down (Sergey Brin, the other co-founder, also stepped down).
- In 1995, Pichai enrolled at Stanford University where he took a master's degree in engineering and materials science. After, he briefly worked for **Applied Materials** (semiconductors), and in 2002 earned an MBA from the Wharton School of the University of Pennsylvania.
- Following a short period in **McKinsey & Co.**, Pichai joined Google in 2004 as the head of product management and development. He initially worked on the **Google Toolbar**, which enabled those using the Microsoft Internet Explorer and Mozilla Firefox Web browsers to easily access the Google search engine. Over the next few years, he was directly involved in the development of Google's own browser – **Chrome** - which was released to the public in 2008. That same year Pichai was named VP of product development, and he began to take a more active public role. By 2012 he was a senior VP, and two years later he was made **product chief over both Google and the Android** smartphone operating system.
- In 2011, Pichai was aggressively pursued by Twitter to join the company, and in 2014 he was touted as a possible CEO for Microsoft, but, in both cases, he was granted large financial packages to remain with Google.
- In December 2019, **Larry Page** and **Sergey Brin (co-founders)** decide to step down from their roles as CEO and President of Alphabet, respectively. Nevertheless, both remained active as co-founders, shareholders and board members of Alphabet. Page and Brin each own 25.9% and 25.1% of Alphabet's voting power, respectively, accounting for **over half of the company's controlling shares**, due to Alphabet's super-voting structure, which gives 10 votes per share of its Class B stock.



Sundar Pichai



Larry Page and Sergey Br

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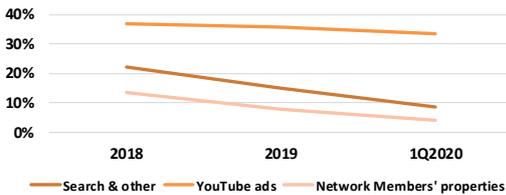
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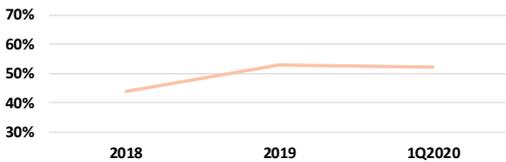
## ▲ Main Segments

Google Advertising Growth YoY



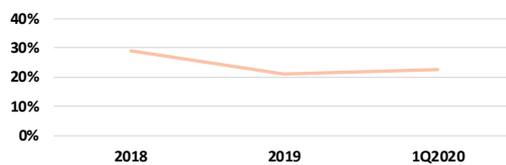
- **Google Advertising** (82% of total revenues)
  - o **Google Search & other** (60% of total revenues): revenues from traffic generated by search distribution partners who use Google.com as their default search in browsers, toolbars, and Gmail, Google Maps, and Google Play.
  - o **YouTube ads** (10% of total revenues)
  - o **Google Network Members' properties** (12% of total revenues): AdMob, AdSense, and Google Ad Manager.

Google Cloud Growth YoY



- **Google Cloud** (7% of total revenues)
  - o **Google Cloud Platform** ("GCP"), which includes infrastructure, data and analytics, and other services.
  - o **G Suite** productivity tool.

Google other Growth YoY

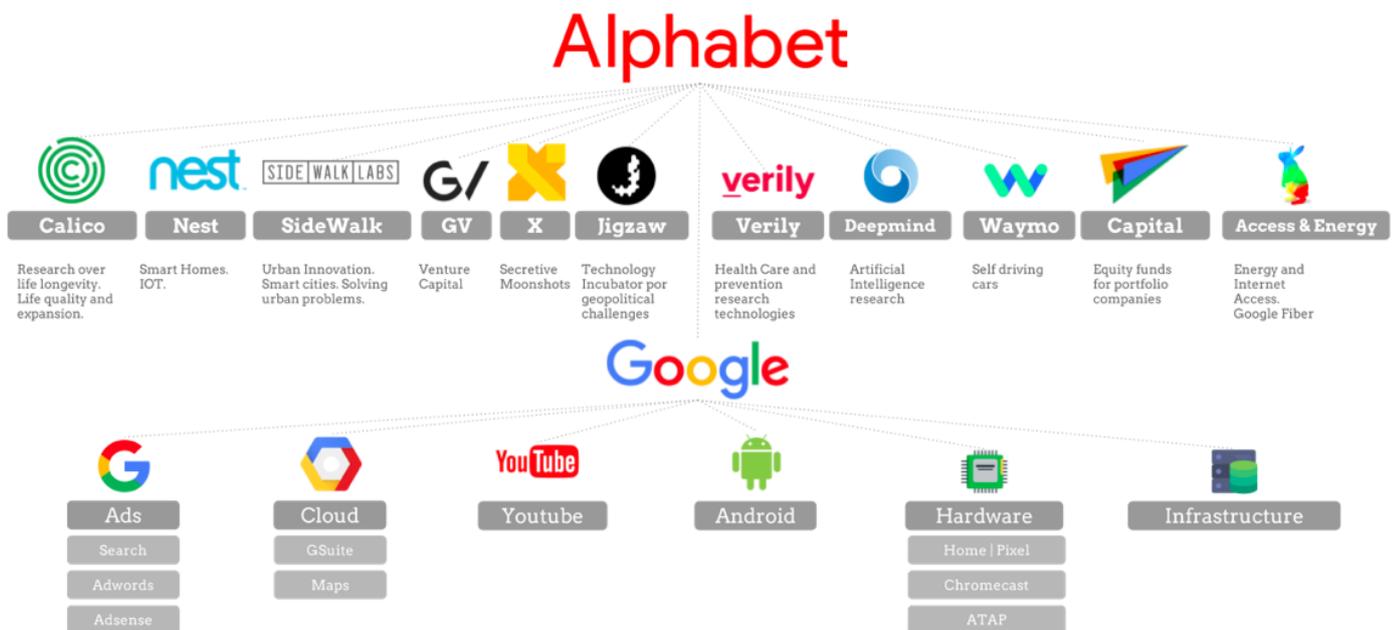


- **Google other** (11% of total revenues)
  - o **Google Play**: sales of apps and in-app purchases as well as and digital content sold in the Google Play store.
  - o **Hardware**: Google Nest home products, Pixelbooks, Pixel phones and other devices.
  - o **YouTube non-advertising**: YouTube Premium and YouTube TV subscriptions.

Source: Company's data

- **Other Bets** (0.3% of total revenues)
  - o Sale of Access internet services and Verily licensing and R&D services.

Other Bets portfolio includes emerging businesses at various stages of development, ranging from those in the R&D phase to those that are in the beginning stages of commercialization, and Alphabet's goal is for them to become thriving, successful businesses in the medium to long term. Revenues are primarily generated from internet and TV services, as well as licensing and R&D services. Other Bets operate as independent companies and some of them have their own boards with independent members and outside investors.



Source: BiG Research; InspectCompany

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## Relative Valuation

Name	P/E 2020E	P/E 2021E	P/BV	YTD	ROE	ROA	Net Debt/ EBITDA	EBIT Margin
Yahoo! Japan	24.2	19.2	2.7	-5%	10%	3%	-	14.5
Baidu	16.4	11.8	1.5	-21%	1%	1%	-5.7	5.9
Facebook	25.5	19.6	5.7	3%	22%	17%	-1.5	36.2
Alphabet	27.5	21.4	4.7	3%	18%	13%	-2.0	21.4
Average exc. Alphabet	22.1	16.9	3.3	-8%	11%	7%	-3.6	18.8

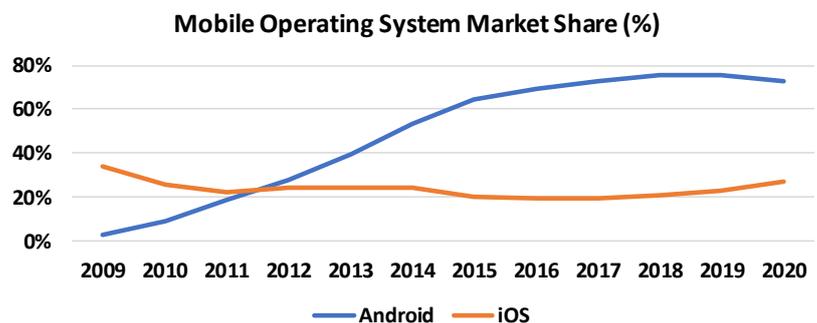
Source: Bloomberg; BiG Research

Alphabet trades at a premium vs. the market peers, in part due to the market leadership position that its search engine occupies in most markets (Google is currently not present in China and some authoritarian regimes). The company has a strong net cash position, common in the tech sector. Considering EBIT and both ratios of return on assets and return on equity, Alphabet is above peers.

## Risks

**Regulation:** In 2017, Google was mandated to pay a fine of USD 2.7 bn for favoring its shopping service by the European Union. Google also was mandated, in July 2018, by the European Union anti-competition regulator to pay USD 5 bn for abuse of dominance of its Android mobile operating system. Google was ordered to end all illegal conduct within 90 days or pay a fine of 5% of average daily worldwide revenue – hence the decision of Google to stop bundling its apps on android phones, allowing phone makers to use ‘fork’ versions of the Android operating system. The increasing regulation of tech companies is a trend that will remain in the near future, with the E.U. currently discussing a tax on digital revenues of tech companies such as Google and Facebook. In 2019, the E.U. filled an antitrust fine for Google of USD 1.5 bn, accusing the company of abusing its dominant position by forcing customers of AdSense to sign contracts stating they would not accept advertising from rival search engines.

**Android Forks:** Forks are alternative versions of Android that phone manufacturers can develop and include as the operating system for their devices. Android has the largest market share in the mobile operating system market (70.7% of worldwide market share as of April 2020) and alternative solutions may erode the market share of the operating system. However, Alphabet may define a system to ensure that the forks are compatible with the suite of apps of the company, guaranteeing some control over them. Moreover, the company will begin to charge a licensing fee for phone makers that want to pre-install apps like Gmail, Maps, YouTube in the E.U.



Source: BiG Research; statcounter

**Margin Concerns:** Google had a strong increase (above advertising revenues growth) in traffic acquisition costs – the amount that Google pays to its advertising partners (for example Google pays Apple a fee for making Google the default search engine on Safari’s browser). This has a negative effect on margins and thus on profits.

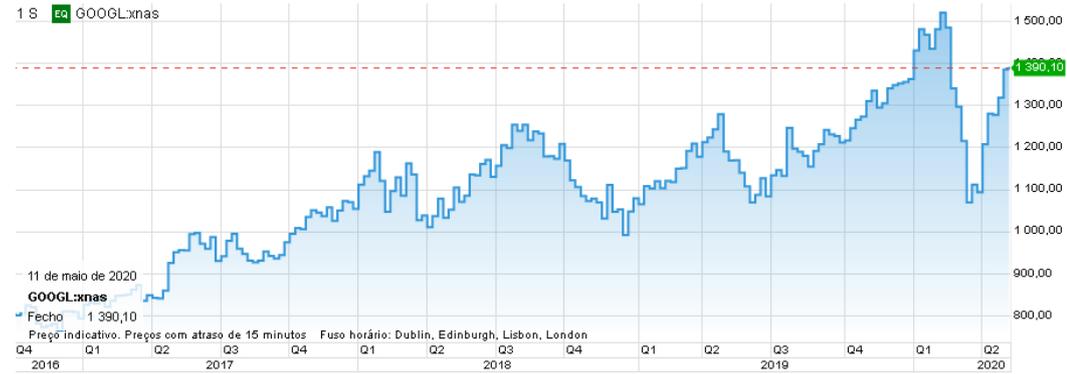
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## Graph



Source: BiGGlobalTrade; BiG Research

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