

PORTFOLIO HOLDING UPDATE: ALPHABET (add analysts' expectations)

There was an internal discussion in the club whether or not to keep Alphabet, after its CEO announced that the company will invest \$75 billion in CapEx in 2025. Particularly, we were afraid that a significant investment like this could hurt the company's margins and revenues, causing Alphabet's stock price to realistically decrease. While this could still be true, with the following analysis we will see that the impact of these heavy investments is not particularly heavier on revenues than the previous years, if the estimates will be accurate.

Q4 2024 Financial Highlights

Alphabet posted its Q4 and FY 2024 results on February 4, 2025. Their **Q4 revenues increased 12% YoY to \$96.5 billion**, thanks to its strong business momentum driven by Google Search, YouTube ads and AI. The **operating income** also increased by **more than 30%** and the **operating margin expanded by 5%**, reaching **32%**.

In the **last quarter, EPS grew 31%**, while **YoY** had an impressive **growth from \$5.8 to \$8.04**, with **almost a 40% increase**.

The following table summarizes the consolidated financial results for the quarter and fiscal year ended December 31, 2023 and 2024 (in millions, except for per share information and percentages).

	Quarter Ended December 31,		Year Ended December 31,	
	2023	2024	2023	2024
	(unaudited)		(unaudited)	
Revenues	\$ 86,310	\$ 96,469	\$ 307,394	\$ 350,018
Change in revenues year over year	13 %	12 %	9 %	14 %
Change in constant currency revenues year over year ⁽¹⁾	13 %	12 %	10 %	15 %
Operating income	\$ 23,697	\$ 30,972	\$ 84,293	\$ 112,390
Operating margin	27 %	32 %	27 %	32 %
Other income (expense), net	\$ 715	\$ 1,271	\$ 1,424	\$ 7,425
Net income	\$ 20,687	\$ 26,536	\$ 73,795	\$ 100,118
Diluted EPS	\$ 1.64	\$ 2.15	\$ 5.80	\$ 8.04

⁽¹⁾ Non-GAAP measure. See the section captioned "Reconciliation from GAAP Revenues to Non-GAAP Constant Currency Revenues and GAAP Percentage Change in Revenues to Non-GAAP Percentage Change in Constant Currency Revenues" for more details.

Q4 2024 Supplemental Information (In millions, except for number of employees; unaudited)

Revenues, Traffic Acquisition Costs (TAC), and Number of Employees

	Quarter Ended December 31,	
	2023	2024
Google Search & other	\$ 48,020	\$ 54,034
YouTube ads	9,200	10,473
Google Network	8,297	7,954
Google advertising	65,517	72,461
Google subscriptions, platforms, and devices	10,794	11,633
Google Services total	76,311	84,094
Google Cloud	9,192	11,955
Other Bets	657	400
Hedging gains (losses)	150	20
Total revenues	\$ 86,310	\$ 96,469
Total TAC	\$ 13,986	\$ 14,848
Number of employees	182,502	183,323

Source: Alphabet Q4 Earnings Report

Google Services is still the **main source of revenue** for the company, and **it increased 10% YoY**. It includes products and devices such as ads, Android, Chrome, devices, Google Maps, Google Play, Search, and YouTube. Google Services generates revenues primarily from advertising; fees received for consumer subscription-based products such as YouTube TV, YouTube Music and Premium, and NFL Sunday Ticket, as well as Google One; the sale of apps and in-app purchases; and devices¹.

This segment is relying mostly on **Google Search**, that could be targeted in the next future by **anti-trust regulations**, and also AI's advancements. The threat seems to be coming especially from Microsoft and OpenAI, that could both expand their share in the search engine business. Though, I do not see these factors as a potential danger to the stability of Google and its leadership in the sector. Particularly, Microsoft "products" Copilot and Bing are not a huge threat for Alphabet, since Copilot is not as used as ChatGPT and Bing is far behind Google Search in terms of market share, despite being in the market since 2009. Though, Microsoft's AI **Copilot** has a **larger market share** in Generative AI than Google **Gemini (14.4% Copilot and 13.5% Gemini)**, positioning them 2nd and 3rd in this ranking only behind ChatGPT². However, this did not seem to have affected the capacity of the Mountain View company to generate revenue, seeing its strong 2024 financial results.

About OpenAI, its famous chatbot ChatGPT doesn't rely on a single search engine, but rather a system that performs targeted queries and filters results based on quality and relevance. This means that to get its results, it uses also Google Search. For this reason, even if ChatGPT will

¹ 2024 Q4 Alphabet earnings report

² <https://firstpagesage.com/reports/top-generative-ai-chatbots/>

have an exponentially greater market share in the search engine market, Alphabet's one wouldn't decline by much from its current 90%³.

Another obstacle that is worth mentioning is the Chinese startup DeepSeek, that made all the Silicon Valley tremble after creating a very competitive chatbot with a very limited budget. Alphabet CEO Sundar Pichai, when asked in the Q4 earnings call about DeepSeek's impact, didn't sound worried at all, since he announced that Google Gemini 2.0 Flash and 2.0 Flash Thinking models are more efficient than DeepSeek's V3 and R1 in terms of cost performance and latency.

Between all Google Services, only Google Network saw its revenues declining, even if it was a marginal reduction.

Google Cloud has grown heavily compared to Google Services, with a **30% increase** compared to a 10% for Google Services, improving the business diversification. That said, this growth was **lower than the 35% of the previous quarter** and, according to Morningstar, this has to be attributed primarily to Google Cloud being **capacity-constrained** (similar to Microsoft Azure).⁴ This has been confirmed by Google CFO Anat Ashkenazi, who said that the company continues to have greater demand for cloud services than it has available capacity, driven by demand for its AI products. In other words, **Google Cloud could have generated more revenue in Q4 if it had more capacity**.⁵ This justifies Alphabet's higher than expected \$75 billion CapEx in 2025, that will allow the company to spend more on building out its technical infrastructure, especially servers, data centers, and networking. In other words, Google needs more capacity to satisfy AI demand, and more capacity means more revenue.

*Google Cloud includes infrastructure and platform services, applications, and other services for enterprise customers. Google Cloud generates revenues primarily from consumption-based fees and subscriptions received for Google Cloud Platform services, Google Workspace communication and collaboration tools, and other enterprise services.*⁶

In this paragraph Other Bets and Hedging gains (losses) will not be taken into consideration because they have a marginal impact on the company's revenue.

³ <https://gs.statcounter.com/search-engine-market-share>

⁴ <https://www.morningstar.com/stocks/after-earnings-is-alphabet-stock-buy-sell-or-fairly-valued-5>

⁵ <https://www.fool.com/investing/2025/02/06/google-alphabet-great-news-nvidia-deepseek/>

⁶ 2024 Q4 Alphabet earnings report

Segment Operating Results

As can be seen in the table below, the Google Services segment grew by more than 20%, and it is important to highlight that all the costs associated with the Gemini App continue to be reported on Google Services. The segment that registered an astonishing growth was Google Cloud, that more than doubled its operating income from Q4 2023.

Other Bets and Alphabet-level activities both saw an operating loss, that if summed up give more or less the same result of the prior year's final quarter (around 3800).

	Quarter Ended December 31,	
	2023	2024
Operating income (loss):		
Google Services	\$ 26,730	\$ 32,836
Google Cloud	864	\$ 2,093
Other Bets	(863)	\$ (1,174)
Alphabet-level activities ⁽¹⁾	(3,034)	\$ (2,783)
Total income from operations	<u>\$ 23,697</u>	<u>\$ 30,972</u>

⁽¹⁾ In addition to the costs included in Alphabet-level activities, hedging gains (losses) related to revenue were \$150 million and \$20 million for the three months ended December 31, 2023 and 2024, respectively. For the three months ended December 31, 2023 and 2024, Alphabet-level activities included substantially all of the charges related to employee severance and our office space charges.

Source: Alphabet Q4 Earnings Report

Dividends

As of this year, the company has started to pay a dividend of \$0.8 per share. Considering its strong cash position (\$95 billion of cash, cash equivalents, and marketable securities) and its capacity to generate cash flow, even with the heavy capital expenditures I believe that Alphabet can maintain this dividend policy also in 2025.

Balance Sheets Highlights

Alphabet Inc.
CONSOLIDATED BALANCE SHEETS
(In millions, except par value per share amounts)

	As of December 31,	
	2023	2024 (unaudited)
Assets		
Current assets:		
Cash and cash equivalents	\$ 24,048	\$ 23,466
Marketable securities	86,868	72,191
Total cash, cash equivalents, and marketable securities	<u>110,916</u>	<u>95,657</u>
Accounts receivable, net	47,964	52,340
Other current assets	12,650	15,714
Total current assets	171,530	163,711
Non-marketable securities	31,008	37,982
Deferred income taxes	12,169	17,180
Property and equipment, net	134,345	171,036
Operating lease assets	14,091	13,588
Goodwill	29,198	31,885
Other non-current assets	10,051	14,874
Total assets	<u>\$ 402,392</u>	<u>\$ 450,256</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 7,493	\$ 7,987
Accrued compensation and benefits	15,140	15,069
Accrued expenses and other current liabilities	46,168	51,228
Accrued revenue share	8,876	9,802
Deferred revenue	4,137	5,036
Total current liabilities	81,814	89,122
Long-term debt	<u>11,870</u>	<u>10,883</u>
Income taxes payable, non-current	8,474	8,782
Operating lease liabilities	12,460	11,691
Other long-term liabilities	4,395	4,694
Total liabilities	119,013	125,172
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value per share, 100 shares authorized; no shares issued and outstanding	0	0
Class A, Class B, and Class C stock and additional paid-in capital, \$0.001 par value per share: 300,000 shares authorized (Class A 180,000, Class B 60,000, Class C 60,000); 12,460 (Class A 5,899, Class B 870, Class C 5,691) and 12,211 (Class A 5,835, Class B 861, Class C 5,515) shares issued and outstanding	76,534	84,800
Accumulated other comprehensive income (loss)	(4,402)	(4,800)
Retained earnings	211,247	245,084
Total stockholders' equity	<u>283,379</u>	<u>325,084</u>
Total liabilities and stockholders' equity	<u>\$ 402,392</u>	<u>\$ 450,256</u>

Source: Alphabet Q4 Earnings Report

The total cash, cash equivalents, and marketable securities have declined from \$110 billion to \$95 billion, though \$14 billion are from marketable securities whilst cash decreased by around \$600 million. The cash reduction might be an effect of the \$1 billion repayment of long-term debt.

Impacts of the \$75 billion Capital Expenditures

In the table below, it is possible to see the impact of the CapEx announced by the company on FY 2025 and in the next FY according to the LSEG analysts' estimates. With revenue growth around 10%, as it happened for the company in the latest years, the **impact** of the **\$75 billion** investments is **not** significantly **greater than the impact** of CapEx **on previous years**, with a 4% increase compared to FY Dec-24. Obviously, greater investments mean greater Depreciation & Amortization, but again there will presumably be a 5% increase compared to 2024.

Finally, FCF in 2025 will be around the same value as 2024, while in the next years is expected to grow strongly.

	HISTORICAL (ACTUALS)			FORECAST (MEAN)		
	FY Dec-22	FY Dec-23	FY Dec-24	FY Dec-25	FY Dec-26	FY Dec-27
REVENUE	282836,00	307394,00	350018,00	389588,14	432128,96	479647,58
YoY Growth %	9,78%	8,68%	13,87%	11,31%	10,92%	11,00%
CAPITAL EXPENDITURES	31485,00	32251,00	52535,00	75000,00	74422,99	81522,30
YoY Growth %	27,78%	2,43%	62,89%	42,76%	-0,77%	9,54%
CAPEX ON REVENUE	11,13%	10,49%	15,01%	19,25%	17,22%	17,00%
DEPRECIATION & AMORTIZATION	15928,00	11946,00	15311,00	20501,30	26155,45	34036,93
YoY Growth %	28,14%	-25,00%	28,17%	33,90%	27,58%	30,13%
CAPEX + D&A ON REVENUE	16,76%	14,38%	19,38%	24,51%	23,28%	24,09%
FREE CASH FLOW	60010,00	69495,00	72764,00	73835,96	89384,79	116543,88
YoY Growth %	-10,45%	15,81%	4,70%	1,47%	21,06%	30,38%

Source: LSEG Workspace

Stock Performance & Conclusions

If we look at **Alphabet's stock price** in the last 12 months **compared to the Nasdaq 100** (its benchmark), we can see that Alphabet has **outperformed** it by just **7%**. Though, it can be noticed that just before posting its Q4 results Alphabet was having a 50% upside, but since its CapEx was higher than analysts' expectations and Google Cloud slowed its growth, the stock plummeted. This sudden drop was also caused by DeepSeek, but we already know that it doesn't pose a threat to Google in general and its chatbot Gemini. For these reasons, we can determine that this is not a justified drop, because it has not that big of an impact on total revenues and the slowdown in its Cloud segment is not something to worry about as it will grow in the future thanks to the company's capital expenditures. To wrap it up, now it might be a great time to **buy Alphabet's** stock, also because it is trading at lower multiples than its peers despite having the best Earnings Yield, the second best ROIC and solid margins.



Source: LSEG Workspace

Companies	ROIC (FY)	Earnings Yield	EBITDA Margin (FY)	EV/EBIT (FY)	P/E (TTM)	Forward P/E
Alphabet (NAS: GOOGL)	29,26%	4,27%	37,40%	21,19x	25,36x	20,80x
Meta Platforms (NAS: META)	29,88%	3,18%	51,28%	23,69x	27,91x	29,05x
Apple (NAS: AAPL)	54,25%	2,53%	34,51%	27,90x	41,60x	33,42x
Microsoft (NAS: MSFT)	28,01%	2,99%	52,04%	31,57x	35,13x	31,27x
Mean	35,35%	3,24%	43,81%	26,09	32,50	28,64

Source: PitchBook