Alphabet Q3 Earnings Preview: Back To Basics

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Summary

- Recent deals announced by key AI players signal continued AI demand and a long runway ahead.
- Current consensus forecasts, even after recent bullish revisions, underestimate Alphabet Inc.'s growth CAPEX and also EPS growth potential.
- I see strong ROCE and cash flow to support better-than-expected growth in key areas like AI, cloud, cybersecurity expansion, and autonomous vehicles.
- A discounted cash flow model suggests GOOG's fair value to be $327, well above its current price, offering a significant margin of safety.
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GOOG stock: FQ3 earnings report scheduled on Oct 29

I last covered Alphabet Inc. aka Google (GOOG, GOOGL) on Sept 5 in an article titled "Alphabet's Path To $4 Trillion Market Cap In 2027 (Rating Upgrade)." The article was triggered by the outcome of the antitrust ruling, which removed a key concern I had about the stock and led to my Buy rating.

Since then, a few new developments have evolved around this AI frontrunner. In the remainder of this article, I will focus on the top 2 in my view: the large-scale deals key AI players have announced lately and also GOOG's upcoming earnings report (ER). Unless you've been living in a cave, you must have heard the recent deals announced by key AI players involving OpenAI (OPENAI), Nvidia (NVDA), Advanced Micro Devices (AMD), and also Broadcom (AVGO). These deals announced the build-out of AI infrastructure at a massive scale for the next few years.

Under this context, the thesis of this article is to argue A) why I believe current consensus forecasts underestimate GOOG's growth CAPEX potential and, in tandem, its profit growth too, and B) why the shares are trading at a sizable discount shown by a simple discounted free cash flow (FCF) model. To wit, investors are keenly anticipating Alphabet's upcoming ER, scheduled on October 29, 2025, for its FQ3. Analysts set a consensus revenue estimate of $99.96 billion and an EPS estimate of $2.240 per share, as you can see from the following screenshot. The EPS revisions since my last writing have been dominated by upward revisions (27 vs. 13 downward revisions). But as to be detailed next, I believe this bullish sentiment still does not fully capture the company's growth potential.

Latest Quarter's Earnings	
Announce Date	7/23/2025
EPS Normalized Actual	$2.31 (Beat by $0.11)
EPS GAAP Actual	$2.31 (Beat by $0.12)
Revenue Actual	$96.43B
Revenue Surprise	Beat by $2.39B

Upcoming Quarter's Earnings	
Announce Date	10/29/2025 (Post-Market)
EPS Normalized Estimate	$2.29
EPS GAAP Estimate	$2.29
Revenue Estimate	$99.96B
EPS Revisions (Last 90 Days)*	▲27 ▼13

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GOOG growth outlook

With the above EPS growth projection for its fiscal Q3, the forecast for the full year 2025 stands around $9.92 per share, translating into an annual growth rate of 23.43%. Looking further out, the long-term forecast suggests some fluctuations in its growth trajectory in the next few years, with the 7-year EPS compound annual growth rate (CAGR) projected at 13.8%, as seen.

Fiscal Period Ending	EPS Estimate	YoY Growth	Forward PE	Low	High
Dec 2025	9.92	23.43%	25.90	9.17	10.27
Dec 2026	10.67	7.55%	24.08	9.60	12.09
Dec 2027	12.08	13.20%	21.27	10.80	13.16
Dec 2028	13.71	13.48%	18.75	11.88	15.96
Dec 2029	16.84	22.86%	15.26	14.23	19.27
Dec 2030	21.72	28.97%	11.83	19.82	23.16
Dec 2031	24.59	13.20%	10.45	22.63	26.55

13.8% CAGR

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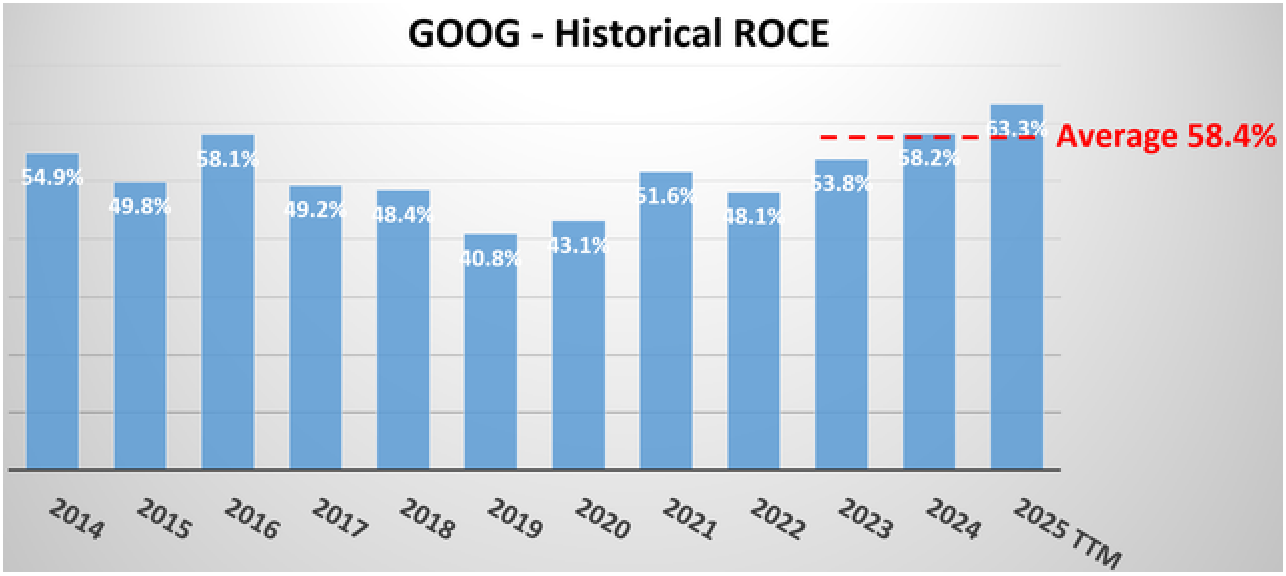
I believe these projections represent an underestimate of GOOG's growth potential. My method for estimating a company's organic growth rates is detailed in my other articles. So here I will directly quote the end results for GOOG:

> *The method involves the return on capital employed ("ROCE") and the reinvestment rate ("RR"). The ROCE for GOOG has been around 58.4% in recent years as seen in the chart below. My estimate for its growth RR is about 27% for the next few years given the AI deals mentioned earlier and assuming GOOG invests to keep pace. With these inputs, GOOG's growth rate would be ~15.8% (27% RR x 58.4% ROCE= 15.8%).*

I do see plenty of cash flow and growth opportunities for GOOG to maintain such an aggressive RR for the foreseeable future. The top growth area on my list is in the cloud space, where its Vertex AI platform and Gemini models have been making significant progress to help businesses integrate AI into their operations, from my observation. What's more, the recent acquisition of Wiz further strengthens its cybersecurity offerings, creating opportunities to support multi-cloud computing, which should enjoy a secular increase in demand in my view. Looking at more futuristic opportunities, Waymo, Alphabet's autonomous vehicle division, is scaling rapidly, also judging by the growth of paid passenger trips. This division, admittedly a relatively small earning contributor currently, has nonlinear growth potential to expand into new cities and fundamentally disrupt urban transportation and logistics. In particular, I believe partnerships with companies like Uber and other fleet operators could accelerate the pace of adoption.



Author

GOOG valuation via discounted cash flow

The combination of robust growth and a relatively low valuation multiple has resulted in a sizable discount in my model. In relative terms, the stock is the cheapest among the Mag 7 group in terms of FWD P/E ratio (currently trading at 25.9x). In absolute terms, the stock's current price is also substantially discounted from its fair value as estimated by a simple discounted FCF (DFCF) model as summarized below.

GOOG - Stage 1 of a 2-stage discounted FCF model												
Current FCF	$6.20		Growth rate		15.8%				Discount rate		9.23%	
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10		
FCF in next 10 years	$7.18	$8.31	$9.62	$11.14	$12.89	$14.93	$17.28	$20.00	$23.16	$26.81		Sum
Present value of Value	$6.57	$6.96	$7.38	$7.82	$8.29	$8.79	$9.31	$9.87	$10.46	$11.09		$86.55

GOOG - Stage 2 of a 2-stage discounted FCF model												
	Terminal growth rate			5.84%					Stage 2 worth			$327
											Total	**$327**

Author

Here, I used a two-stage DFCF model, with a higher growth rate in the first stage to capture the anticipated AI build-out as aforementioned and a second stage to capture the terminal growth rate. As detailed in my earlier article:

> *There are a total of 3 key parameters in the 2-stage DFCF model: the discount rate, the growth rate in stage 1, and the terminal growth rate. For the discount rate, I relied on the so-called WACC, the weighted average cost of the capital model. The discount rate for GOOG is about 9.23% on average in recent years following this model.*

For the growth rate in the 1st stage, I plugged in 15.8% based on the arguments presented in the foregoing section. For its terminal growth rates, I assumed a growth RR of 10% (the average of large tech companies), thus leading to a growth rate of ~5.84% (10% RR x 58.4% ROCE = 5.84% terminal growth rate). Finally, as for its FCF for the current year, my estimate is $6.2 per share based on my assumption of its CAPEX as aforementioned.

Under these parameters, my estimate of the fair price for GOOG is around $327. In comparison, the stock's current market price is around $253 only, leaving a considerable margin of safety.

Other risks and final thoughts

In terms of downside risks, near-term results (such as the FQ3 ER) could face temporary margin pressure due to higher CAPEX and R&D expenses. But for the long term, I am optimistic and expect core margin upside due to a variety of factors (such as AI-driven efficiency gains and also synergistic advantages of its various offerings). Deceleration in paid click growth and slower ad growth could also occur as competition dynamics evolve. Leading factors in my mind on this front include A) the competing products that Meta is rolling out to integrate its social media platforms with AI, and also B) the potential of market share gain from ChatGPT in the search market.

My overall conclusion is that the positive catalysts afoot outweigh the above negatives. To recap, I expect GOOG to generate plenty of cash flow to support maintaining aggressive growth CAPEX for the foreseeable future. I believe the current consensus forecasts underestimate Alphabet's growth CAPEX and also EPS growth potential, especially given the recent deals announced by key AI players, which signal continued demand and a long runway ahead. Such an underestimate eventually translates into a large valuation discount and an asymmetric return/risk, leading to a reiteration of my Buy rating.

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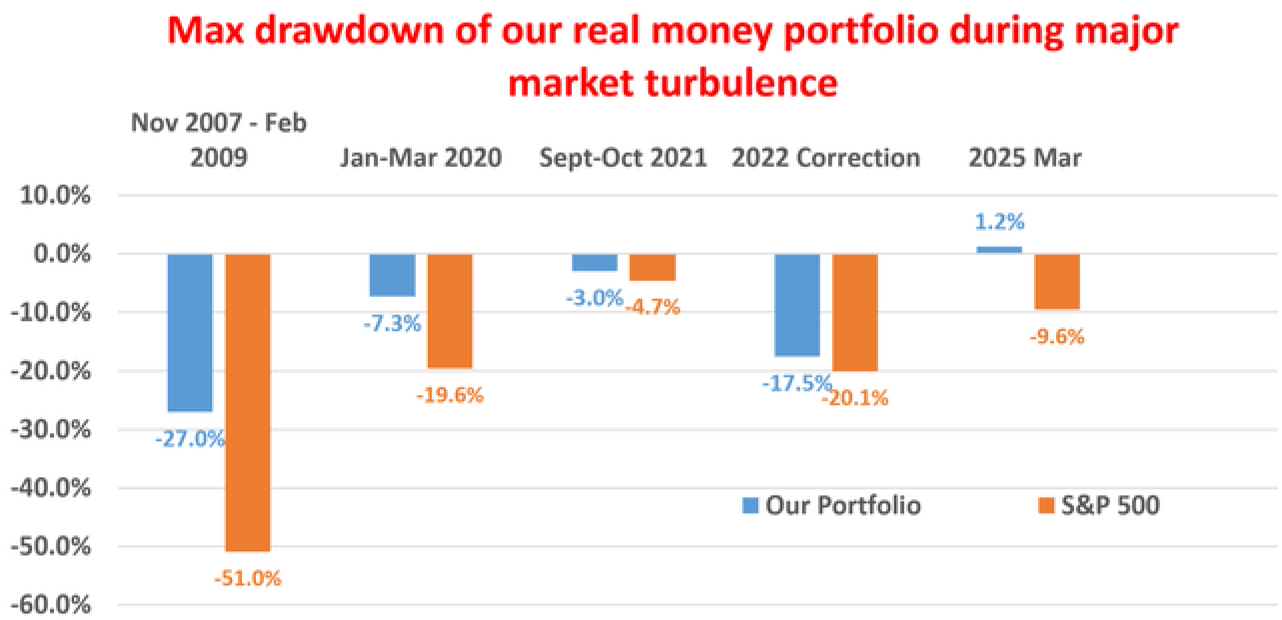

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