

Alphabet, formerly called Google, maintains the largest online index of websites accessible through automated search technology. It generates revenue through online advertising, cloud services, and hardware. Google is now an operating segment of Alphabet. The company was founded in 1998 by Sergey Brin and Larry Page and went public in 2004.

Analyst's Notes

Analysis by Joseph Bonner, CFA, October 31, 2024

ARGUS RATING: BUY

- Google Cloud drives 3Q as Waymo scales
- Alphabet EPS rose 37% on 16% revenue growth in 3Q24.
- Alphabet continues to see generative AI as a key technology shift, warranting massive investment as it pushes its Gemini advanced AI model forward through a variety of enhancements and across its tech and product stacks.
- The company continues to face extreme regulatory pressure and risk from antitrust investigations, lawsuits, including a verdict in a U.S. case, a new U.S. trial, and new legislation in Europe.
- We are raising our 2024 GAAP EPS estimate to \$8.02 from \$7.61 and our 2025 forecast to \$8.73 from \$8.24.

INVESTMENT THESIS

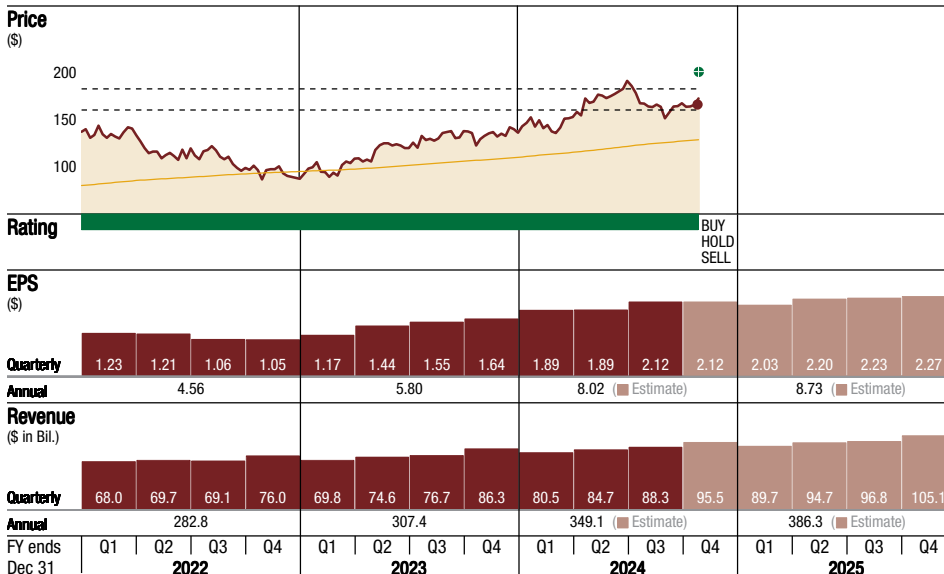
We are maintaining our BUY rating on Alphabet Inc. (NGS: GOOGL) to a target price of \$200. It is perhaps ironic that Alphabet's spectacular success in internet search with often over 90% of search queries in many countries has led to a raft of antitrust allegations, investigations, and litigation. Although the outcomes of various litigation remain unknown, we think Alphabet is likely to operate in a more restrictive regulatory environment over time.

Alphabet remains an advertising juggernaut despite possible serious threats from competing generative AI platforms to its Search business and the antitrust litigation/regulatory pressure. YouTube and Google Cloud are also doing just fine as the company spikes investment in its own competitive AI applications as well as compute infrastructure as it races against Microsoft/Open AI and Meta to ensure its future relevance. Cost optimization remains a key priority for Alphabet in 2024 with the benefit observable in continued margin expansion.

We see Alphabet as one of the Tech industry's leaders, along with Meta Platforms, Apple, Amazon and Microsoft. These companies have come to dominate new developments in mobile, public cloud, and big data analytics, as well as emerging areas such as artificial intelligence, virtual/augmented reality, and even quantum computing.

Market Data Pricing reflects previous trading week's closing price.

—200-Day Moving Average Target Price: \$200.00 52 Week High: \$182.02 52 Week Low: \$159.74 Closed at \$165.27 on 10/25



Argus Recommendations

Twelve Month Rating	SELL	HOLD	BUY
Five Year Rating	SELL	HOLD	BUY
Sector Rating	Under Weight	Market Weight	Over Weight

Argus assigns a 12-month BUY, HOLD, or SELL rating to each stock under coverage.

- BUY-rated stocks are expected to outperform the market (the benchmark S&P 500 Index) on a risk-adjusted basis over the next year.
- HOLD-rated stocks are expected to perform in line with the market.
- SELL-rated stocks are expected to underperform the market on a risk-adjusted basis.

The distribution of ratings across Argus' entire company universe is: 72% Buy, 28% Hold, 0% Sell.

Key Statistics

Key Statistics pricing data reflects previous trading day's closing price. Other applicable data are trailing 12-months unless otherwise specified

Market Overview

Price	\$174.46
Target Price	\$200.00
52 Week Price Range	\$122.69 to \$191.75
Shares Outstanding	5.84 Billion
Dividend	\$0.80

Sector Overview

Sector	Communication Services
Sector Rating	OVER WEIGHT
Total % of S&P 500 Market Cap.	8.90%

Financial Strength

Financial Strength Rating	HIGH
Debt/Capital Ratio	9.2%
Return on Equity	29.7%
Net Margin	27.7%
Payout Ratio	0.07
Current Ratio	2.10
Revenue	\$339.86 Billion
After-Tax Income	\$94.27 Billion

Valuation

Current FY P/E	21.75
Prior FY P/E	30.08
Price/Sales	3.00
Price/Book	6.81
Book Value/Share	\$25.61
Market Capitalization	\$1.02 Trillion

Forecasted Growth

1 Year EPS Growth Forecast	38.28%
5 Year EPS Growth Forecast	17.00%
1 Year Dividend Growth Forecast	N/A

Risk

Beta	1.19
Institutional Ownership	77.36%

Analyst's Notes ...Continued

While Alphabet has often been criticized as a Johnny-one-note for its dependence on digital advertising, the rapid growth of Google Cloud has begun to diversify the company's revenue. Even the much maligned Waymo autonomous vehicle business has begun to expand commercial services, well ahead of competitors. Alphabet remains at a minimum competitive, if not a leader, in the development of generative AI, perhaps the new computing paradigm.

We remain positive on Alphabet's underlying businesses and believe that GOOGL shares are attractively valued.

RECENT DEVELOPMENTS

Alphabet reported 3Q24 results on October 29 after the market close. Alphabet beat the 3Q consensus estimates by \$46 million on revenue and \$0.27 on EPS. Alphabet provides no guidance, so large variances from consensus are typical. GOOGL shares rose about 3% on October 30.

Consolidated net revenue rose 16.4% from the prior year to \$74.55 billion (less traffic acquisition costs). Google's 3Q24 advertising revenue, its primary revenue stream, rose 10.4% to \$65.85 billion, reflecting 12% growth in both Search advertising and YouTube ads. This increase in advertising revenue was led by financial and the retail sectors. Google Cloud reported strong 35% revenue growth, accelerating from 29% in 2Q23 and 22.5% growth in 1Q24.

Google Subscriptions Platforms & Devices (renamed from

'Google Other' and including YouTube subscriptions, Google Play, hardware, and other nonadvertising businesses) posted 28% revenue growth, driven by the launch of a new set of Pixel devices in September. In the small Other Bets segment, revenue rose 31% to \$388 million.

Traffic acquisition costs (TAC) rose 8.5% from the prior year to \$13.7 billion. The TAC margin as a percentage of revenue narrowed by 40 basis points to 21%.

The total cost of revenue rose 5% from the prior year. Other cost of revenue, excluding TAC, rose 10.5%, primarily driven by YouTube content and hardware costs. Third-quarter operating income rose 34% to \$28.5 billion, and the operating margin expanded by 450 basis points to 32.3% as the company's cost optimization efforts continued to fuel robust margin expansion in the quarter. GAAP diluted EPS rose 37% from the prior year to \$2.12. Share repurchases over the past year boosted EPS growth by three percentage points.

The much-maligned Other Bets segment, i.e., Google Fiber, Waymo and Verily Life Science (along with other smaller start-ups), reported a 3Q operating loss of \$1.1 billion compared to losses of \$2.3 billion in 2Q24 and \$1.2 billion in 3Q23. The Google Cloud segment turned in an operating profit of \$1.95 billion, accelerating from \$1.2 billion in 2Q24 and just \$266 million in 3Q23.

Waymo, Alphabet's autonomous driving business and the largest component of the Other Bets segment, continues to scale its

Growth & Valuation Analysis

GROWTH ANALYSIS

(\$ in Millions, except per share data)

	2019	2020	2021	2022	2023
Revenue	161,857	182,527	257,637	282,836	307,394
COGS	71,896	84,732	110,939	126,203	133,332
Gross Profit	89,961	97,795	146,698	156,633	174,062
SG&A	28,015	28,998	36,422	42,291	44,342
R&D	26,018	27,573	31,562	39,500	45,427
Operating Income	35,928	41,224	78,714	74,842	84,293
Interest Expense	-2,327	-1,730	-1,153	-1,817	-3,557
Pretax Income	39,625	48,082	90,734	71,328	85,717
Income Taxes	5,282	7,813	14,701	11,356	11,922
Tax Rate (%)	13	16	16	16	14
Net Income	34,343	40,269	76,033	59,972	73,795
Diluted Shares Outstanding	13,971	13,741	13,553	13,159	12,722
EPS	2.46	2.93	5.61	4.56	5.80
Dividend	—	—	—	—	—

GROWTH RATES (%)

Revenue	18.3	12.8	41.2	9.8	8.7
Operating Income	10.2	14.7	90.9	-4.9	12.6
Net Income	11.7	17.3	88.8	-21.1	23.0
EPS	12.5	19.2	91.4	-18.7	27.2
Dividend	—	—	—	—	—
Sustainable Growth Rate	17.9	17.5	30.9	26.9	25.3

VALUATION ANALYSIS

Price: High	\$68.35	\$92.19	\$150.97	\$151.55	\$142.68
Price: Low	\$51.12	\$50.44	\$84.81	\$83.34	\$84.86
Price/Sales: High-Low	5.9 - 4.4	6.9 - 3.8	7.9 - 4.5	7.1 - 3.9	5.9 - 3.5
P/E: High-Low	27.8 - 20.8	31.5 - 17.2	26.9 - 15.1	33.2 - 18.3	24.6 - 14.6
Price/Cash Flow: High-Low	18.0 - 13.5	22.4 - 12.2	23.0 - 12.9	21.7 - 11.9	17.2 - 10.2

Financial & Risk Analysis

FINANCIAL STRENGTH

	2021	2022	2023
Cash (\$ in Millions)	20,945	21,879	24,048
Working Capital (\$ in Millions)	123,889	95,495	89,716
Current Ratio	2.93	2.38	2.10
LT Debt/Equity Ratio (%)	10.4	10.6	9.1
Total Debt/Equity Ratio (%)	11.3	11.6	10.1

RATIOS (%)

Gross Profit Margin	56.9	55.4	56.6
Operating Margin	30.6	26.5	27.4
Net Margin	29.5	21.2	24.0
Return On Assets	22.4	16.6	19.2
Return On Equity	32.1	23.6	27.4

RISK ANALYSIS

Cash Cycle (days)	33.7	40.7	—
Cash Flow/Cap Ex	3.7	2.9	3.2
Oper. Income/Int. Exp. (ratio)	263.2	200.8	279.3
Payout Ratio			

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Analyst's Notes ...Continued

commercial service, no doubt, also driving the continued segment losses. In September, Waymo expanded its partnership with ride-hailing service Uber Technologies to bring commercial autonomous ride-hailing to Austin, Texas and Atlanta, Georgia in 2025 whereby Uber will manage a Waymo fleet of vehicles. Waymo already operates its own autonomous vehicles in Phoenix, San Francisco, Los Angeles, and Austin, racking up one million fully autonomous miles per week and over 150,000 paid rides. While investors have regularly criticized Waymo as an expensive boondoggle over the last decade and a half, Waymo is far ahead of any AV competitor, namely Tesla. The company is also looking to apply its deep GenAI knowledge to improve on Waymo's reliability and lower costs as the business continues to scale.

Alphabet/Google remains beset by antitrust charges from all sides. The most important of these cases were filed by the U.S. Department of Justice. On August 5, a federal judge branded Google a monopolist in a ruling on the first antitrust case brought by the DOJ and joined by 37 U.S. states. The decision held that Google has monopoly power in the market for general search services and general search text advertising, that Google's distribution agreements are exclusive and have anticompetitive effects, and that Google exercised its monopoly power by charging above market prices for general search text ads allowing it to earn monopoly profits. The ruling really turned on the judge's view of the anticompetitive effect of Google's 'exclusive' distribution agreements. According to the ruling, Google paid \$26.3 billion in

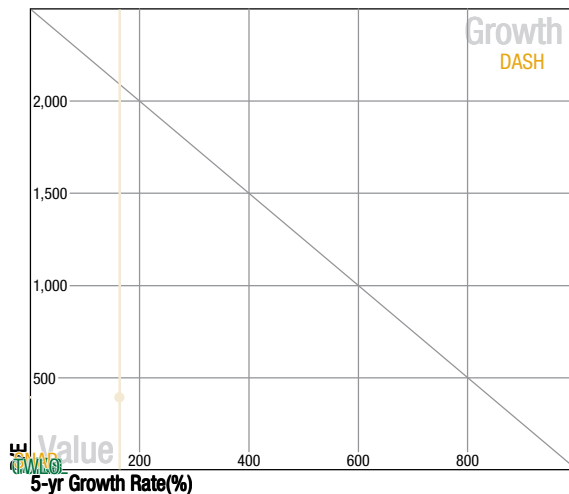
2021 to secure its position as the preloaded default search engine on Apple's Safari browser, Mozilla's Firefox browser, all major Android device OEM's, Samsung, Motorola, and Sony, and the major U.S. wireless carriers, AT&T, Verizon, and T-Mobile. It was the exclusivity of the arrangements and the power gained from being the default search engine on almost all mobile devices sold in the U.S. that enabled Google to harness massive amounts of data to improve its search engine that gave Google its monopoly position even if other search engines could be installed on the devices. The judge did find for Google on a few issues including that Google lacks monopoly power in the market for search advertising, that there is no product market for general search advertising and that Google is not liable for actions involving its advertising platform. The judge also declined to sanction Google for its failure to preserve employees chat messages.

While Alphabet/Google will undoubtedly appeal the judge's ruling, the next steps in the case will be the judge's determination of sanctions and remedies for Google's behavior. While one of the sanctions sought by the DOJ is break up, most third party observers do not expect this but rather some type of decree prohibiting Google's monopolistic behavior, for example, prohibiting Google from entering into exclusive agreements with distributors. One unintended consequence of such a ruling is that Apple might need to forego a large part of the annual \$20 billion that Google pays it in very high margin revenue for its distribution agreement with Google if the agreement is no longer exclusive.

Peer & Industry Analysis

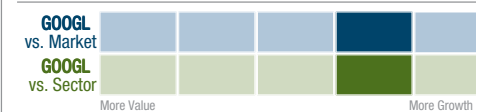
The graphics in this section are designed to allow investors to compare GOOGL versus its industry peers, the broader sector, and the market as a whole, as defined by the Argus Universe of Coverage.

- The scatterplot shows how GOOGL stacks up versus its peers on two key characteristics: long-term growth and value. In general, companies in the lower left-hand corner are more value-oriented, while those in the upper right-hand corner are more growth-oriented.
- The table builds on the scatterplot by displaying more financial information.
- The bar charts on the right take the analysis two steps further, by broadening the comparison groups into the sector level and the market as a whole. This tool is designed to help investors understand how GOOGL might fit into or modify a diversified portfolio.

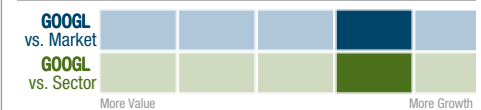


Ticker	Company	Market Cap (\$ in Millions)	5-yr Growth Rate (%)	Current FY P/E	Net Margin (%)	1-yr EPS Growth (%)	Argus Rating
META	Meta Platforms Inc	1,292,923	16.0	28.3	35.6	10.1	BUY
GOOGL	Alphabet Inc	1,019,370	17.0	21.8	27.7	8.9	BUY
DASH	DoorDash Inc	59,713	900.0	2,217.9	-1.7	1,328.6	HOLD
PINS	Pinterest Inc	19,670	25.0	21.2	5.8	16.9	BUY
SNAP	Snap Inc	17,959	10.0	52.6	-18.5	50.0	HOLD
TWLO	Twilio Inc	11,334	12.0	20.9	-10.7	14.5	BUY
Peer Average		403,495	163.3	393.8	6.4	238.2	

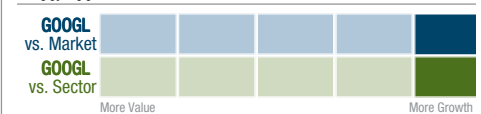
P/E



Price/Sales



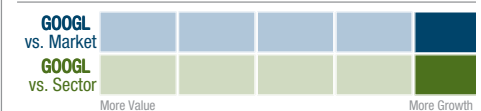
Price/Book



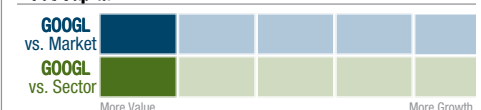
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5 Year Growth



Debt/Capital



Analyst's Notes ...Continued

A second federal antitrust trial brought by the DOJ and 17 states commenced in September. The government is alleging that Google has a monopoly in the market for software used to buy and sell ads placed on web pages also known as ad-tech. As is often the case, the wheels of justice turn excruciatingly slow, and Google has made the argument that it is already losing market share in ad-tech to competitors like TikTok and Amazon. This second trial is expected to be completed on November 25.

Meanwhile, Google continues to face regulatory issues in Europe. In September, the company lost an appeal of a 2017 decision that charged Google with giving preferential treatment to its own price-comparison shopping service versus competitors, which included a 2.4 billion euro fine. In a separate case, Google scored a partial win when the General Court of the European Union, the EU's second highest court, reversed a 1.49 billion euro fine, though upheld the European Commission's findings around Google's anticompetitive behavior in restrictive contracts related to advertising on third party websites. In an echo of the U.S. ad-tech case against Google, the U.K. Competition and Markets Authority made a provisional finding that Google has engaged in anti-competitive conduct around favoring its own ad-tech.

Google also continues to be sued for anti-competitive behavior in the private litigation space. In August, local business and social network website Yelp sued Google in federal court for preferencing its own local services over Yelp. In September, videogame maker Epic Games sued Google and Samsung, alleging that the two companies colluded to impose restrictions on third-party app stores, making it virtually impossible for users to load them and making the Google Play store the only real choice on Samsung mobile devices. Epic Games lost a similar suit against Apple but won an earlier case against Google. In something of a turnabout, Google filed a complaint against Microsoft in September with the European Commission alleging anti-competitive behavior in the enterprise software market by Microsoft's Azure cloud service.

EARNINGS & GROWTH ANALYSIS

We are raising our 2024 GAAP EPS estimate to \$8.02 from \$7.61 and our 2025 forecast to \$8.73 from \$8.24. Alphabet does not issue guidance. Our estimates imply 24% EPS growth on average over the next two years, above our long-term earnings growth rate forecast of 17%.

Search advertising, whether on Google sites or through its third-party Google Network (on desktop or mobile), remains the company's crucial revenue driver, even as its other businesses, such as YouTube, Google Play and Google Cloud have become multibillion-dollar businesses in their own right and in the case of Cloud has become a significant revenue growth driver. Management often notes that it manages for the long term and that quarterly results can be lumpy. Alphabet has been famously stingy with information on its business outside of advertising.

One of the key investor questions Alphabet has had to address is the perception that though the company did much of the basic research that led to generative AI that it has fallen behind Open AI's ChatGPT. Further, investors have been concerned about whether GenAI powered applications from ChatGPT/Microsoft, a well-funded giant along with a host of smaller GenAI start-ups, could pose an existential threat to Google's digital advertising business. Google's share of this business has been slowly eroding for years due to increased competition first from Amazon then TikTok and could drop below 50% in 2025 according to industry

tracker eMarketer. Alphabet has responded to the threat by rolling out AI Overviews in Search first in the U.S. earlier this year and now into over 100 countries, reaching 1 billion users on a monthly basis. Google has also begun putting advertising around AI Overviews. Indeed, management has been laser-focused on infusing GenAI across its tech stack and product stack. GenAI applications to the Google Cloud Platform (GCP) are obvious though also will continue to entail significant capital expenditure. CFO Anat Ashkenazi noted that capex will increase in 2025. Capex was already up 80% in the first nine months of 2024 to \$38.26 billion, again much of the increase due to GenAI infrastructure buildout. Even more to the point, GenAI is improving Google Search advertising and YouTube's content discovery engine. GenAI has also been incorporated into Android and the new Pixel hardware line.

With GCP, Google has provided a steady stream of improvements, as it does with most of its products, and is working to differentiate its services through AI. It has also moved to provide discounts, competing on price against Amazon, and has made investments and formed partnerships to secure long-term cloud computing deals with major clients. GCP has also tripled its sales force since 2019, essentially putting more feet on the street to compete with industry leaders Amazon and Microsoft. In addition, it has made strategic acquisitions in the space. CEO Sundar Pichai believes that GCP provides a number of differentiators relative to competitors, including AI-based real-time data and analytics, an open infrastructure that runs client workloads anywhere, and a superior level of cybersecurity.

Industry tracker Gartner places Google Cloud Platform a distant third in the market. Google is also partnering with multinational giants, as in its deals with SAP, Salesforce and Cisco, to integrate business software systems into GCP. Management clearly views GCP as critical to the company's future. Former Oracle executive Thomas Kurian heads GCP.

Google's YouTube is all about short-form video and as Netflix recently admitted, the most popular streaming-video service in the world. YouTube launched its Shorts service to compete with TikTok, and is currently working to monetize the new service. Management has introduced revenue-sharing with content creators, and YouTube content creation as well as advertising campaigns provide more prime opportunities for generative AI applications. YouTube also has a growing streaming television channel service, called 'YouTubeTV.' The service, technically a virtual multichannel video program distribution service (vMVPD), has become another formidable competitor in the over-the-top (OTT) streaming video market. This market already includes Hulu Live TV, Dish's Sling, as well as a host of other OTT services such as Netflix, Amazon Prime Video, and Disney+. We say 'formidable' because YouTube users already spend over a billion hours a day watching its short-form content; it thus has a huge potential customer base. YouTube TV is available on both the Roku and Apple TV streaming devices. Google has also partnered with Verizon, the largest wireless provider in the U.S. and a growing player in the 5G-connected home market.

On April 24, President Biden signed into law a bill that would essentially force ByteDance, the Chinese owner of the popular social media site TikTok, to either sell TikTok or TikTok would be banned from distribution in the U.S. by January 19, 2025, subject to an additional three-month extension. TikTok has pledged to

Analyst's Notes ...Continued

fight the new law in court. The passage of the law is an obvious positive for TikTok's competitor YouTube, Alphabet's Google division short form video business. An actual ban would be an even bigger positive for YouTube. We think the court case may turn on how the court views fundamental freedom of speech rights for TikTok and its users, versus the national security and user privacy concerns of the government. The simplest solution would be a sale to an American company or U.S. investor group, though it is unclear whether ByteDance could obtain Chinese government clearance for a sale. The Chinese government has already come out against a sale so it would have to reverse its position to now approve one. The situation is even muddier since many of the investors in ByteDance/TikTok are a who's who of Silicon Valley venture capital firms who may exert considerable political influence in the U.S. The outcome of the November U.S. presidential election could affect the outcome of the TikTok situation as former president Trump has expressed pro-TikTok sentiments after being anti-TikTok when he was previously in office.

With the start of the 2023 American football season, under an agreement with the NFL, YouTube began exclusively distributing NFL Sunday Ticket as an add-on to YouTube TV subscriptions, or on a standalone basis on YouTube Primetime Channels. Sunday Ticket broadcasts Sunday afternoon out-of-market regular season NFL football games produced by CBS and Fox. Direct broadcast satellite service DirecTV had previously held the rights to Sunday Ticket. According to the Wall Street Journal Google pays about \$2 billion a year for the residential rights to Sunday Ticket for a seven-year term, well above the \$1.5 billion per year that DirecTV paid for both residential and commercial rights. While the return on investment for Sunday Ticket is unclear, given the high cost and Alphabet's usual stinginess with actual data, logic assumes it should be a subscriber draw at least during the NFL season.

Sources including a Wall Street Journal article on October 27, 2023, have reported that Google has agreed to invest \$2 billion in generative AI startup Anthropic on top of a \$300 million investment and partnership agreed in February 2023. Amazon made a \$4 billion commitment to Anthropic in September. The WSJ also reported that Anthropic had signed a \$3 billion multiyear deal with Google Cloud, which we expect is for cloud services to be used in training and exploiting generative AI models. The Google/Anthropic partnership illustrates how the Tech industry is starting to draw up sides in the competition for generative AI models after the much-heralded partnership of generative AI leader OpenAI and Microsoft. Google is also in partnership with key generative AI chip maker Nvidia.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on Alphabet is High, our highest rating. The company's credit ratings are in the high As - high-quality investment grade - with stable outlooks.

Alphabet repurchased \$45.3 billion of its stock in the first nine months of 2024, after buying back \$61.5 billion of its stock in all of 2023. It repurchased \$59 billion in 2022, \$50 billion in 2021, \$18.4 billion in 2020, and \$31.1 billion in 2019. The share count has fallen 2% in the last 12 months.

Alphabet paid the first quarterly cash dividend in its history on June 17. The quarterly dividend is \$0.20 or \$0.80 on an annual basis with a forward yield of 0.5%. Our dividend estimates are \$0.60 for 2024 (i.e. comprising the last three quarters of 2024) and \$0.84 for 2025.

Management intends to provide both the new dividend and ongoing share repurchases as parts of its shareholder return program. With \$111 billion in cash on the balance sheet and \$56 billion in trailing 12-month free cash flow, Alphabet has the resources to cover the new dividend which we estimate to be about \$10 billion a year and continue making large share repurchases.

MANAGEMENT & RISKS

Generative AI, exemplified by the success of OpenAI's ChatGPT model among a host of other competitors poses an existential threat to Alphabet's core revenue engine, internet search. In July, OpenAI launched its SearchGPT search engine in beta (test) mode. Google has begun to provide an AI overview in its search results which may be the beginning of useful commercial applications. The GenAI competitive threat to Google's internet search business bears close monitoring.

Like Microsoft and Intel before it, Alphabet has run into serious antitrust issues. The European Commission has issued adverse rulings and levied record-breaking fines, with perhaps more to come. The U.S. Department of Justice and many U.S. states have filed complaints against Alphabet's Google division. Much of this antitrust litigation targets Google's dominance in the search advertising and digital advertising markets. Google continues to face antitrust litigation from all sides.

In December 2023, Google lost an antitrust jury trial in a suit brought by videogame publisher Epic Games, the distributor of the iconic 'Fortnite' videogame. Epic Games' lawsuit revolved around the Google Play app store, the 30% fee charged to app developers for customer purchases, and the rights of app developers to use their own distribution and billing methods while remaining on Google Play. Google is appealing the verdict. We note that Epic Games lost a similar antitrust suit against Apple and as Tech reporter Casey Newton points out, third-party app stores and billing systems will become a legal requirement in Europe in 2024.

In late 2022, the European Union passed new legislation, the Digital Services Act (DSA) and the Digital Markets Act (DMA), both aimed at strictly regulating large online businesses, i.e., Google and other large American tech companies. On April 25, 2023, Google Search, Google Play, Google Maps, and Google Shopping were designated as a 'very large online platform' or a 'very large online search engine' by the European Commission, making them subject to the DSA. The DSA is aimed at regulating Google's practices around content moderation/disinformation and user privacy, among other issues, and the company will be required to undergo outside audits of its practices and share algorithmic data with EU regulators.

The DSA took effect on August 25, 2023, and penalties for noncompliance are severe. The obvious risk to Alphabet is the imposition of a severe financial penalty for alleged noncompliance, though regulations could also have the perverse effect of locking in the existing competitive structure of an industry. Some critics claim that this occurred when the EU enacted its General Data Protection Regulation in 2018, as large companies with more resources are better able to comply with these laws than smaller competitors. EU regulators have tried to skirt this issue by making the new laws applicable only to services that aggregate very large numbers of users. While regulatory litigation and actions in the U.S. and Europe may take years to play out, we see them as a material risk to Alphabet which could one day be subject to onerous regulation and perhaps even to a forced breakup, as well as to additional large

Analyst's Notes ...Continued

fines.

Alphabet's internet advertising-based businesses are highly competitive and subject to rapid and disruptive technological change. The rapid development of generative AI is a new and material risk to Google's dominance in internet search and to Alphabet as a whole. To remain relevant, Alphabet must keep up with, if not lead, such technological changes. Management recognizes that cultural norms around user privacy are evolving. Such norms could develop in a direction that limits Google's use of user data to make advertising more targeted, more relevant to the user, and thus more valuable to advertisers. The rapid adoption of mobile connectivity is a strong secular trend, and Google competitor Facebook has developed a mobile advertising platform to challenge Google's hegemony in digital advertising. Another deep-pocketed tech competitor, Amazon, has also moved into the advertising business, which threatens Alphabet/Google's industry position. Mobile search, particularly important to Alphabet/Google, remains a vibrant business, though it typically carries a lower rate. Alphabet must find ways to capitalize profitably on emerging platforms in order to sustain its growth.

Management does not provide forecasts and instead discusses the business only in general terms. This leads to large variances - positive or negative - between consensus estimates and actual results. In addition, while the first and fourth quarters are seasonally strong, the second and third quarters are seasonally slower, and the investment community may underestimate or overestimate these seasonal effects. Large negative variances to consensus may hurt GOOGL shares.

Finally, management may not be able to guide the company's rapid growth efficiently. Competitive pressures are also likely to increase as Alphabet's rivals - Apple, Facebook, Amazon, Yahoo and Microsoft - continue their attempts to capture market share in the online advertising space, enterprise cloud computing, streaming internet video, generative artificial intelligence and other competitive markets. While Alphabet's search engine, its core business, has essentially outpaced all its peers and its Android mobile operating system is the dominant global system, Alphabet competes at subscale in both cloud computing, well behind Amazon Web Services and Microsoft Azure, and in hardware, with a small fraction of competitor Apple's business. Alphabet has invested heavily to catch up in cloud computing and hardware, but although Alphabet's cloud computing business is obviously growing rapidly, it has yet to demonstrate that it can actually take market share while also expanding profitability.

Anat Ashkenazi became CFO on July 31, replacing Ruth Porat who was promoted to President and Chief Investment Officer. Ms. Ashkenazi had been CFO of pharma company Eli Lilly since 2021 and worked for Lilly in various financial executive positions since joining that company in 2001.

COMPANY DESCRIPTION

Alphabet, formerly called Google, maintains the largest online index of websites accessible through automated search technology. It generates revenue through online advertising, cloud services, and hardware. Google is now an operating segment of Alphabet. The company was founded in 1998 by Sergey Brin and Larry Page and went public in 2004.

Google's AdWords is an auction-based program that lets businesses display ads along with particular search results. Google's AdSense program enables websites in the company's network to

serve targeted ads, based on search terms or web content, from AdWords advertisers. Most of the revenue generated through AdSense is shared with network partners. In addition, Alphabet owns YouTube.com, the web-based video site. It has also expanded into mobile telephony with its Android smartphone operating system and into public cloud services. About 52% of Alphabet's revenue is generated outside the U.S.

On April 3, 2014, Alphabet's new nonvoting class C shares began trading under the ticker GOOG. Alphabet's publicly held class A shares switched to the ticker GOOGL. The effect of the new class C share issuance was a non-economic 2-for-1 stock split.

On July 15, 2022, Alphabet executed a 20-for-1 stock split on its Class A, Class B and Class C stock. The stock split had no impact on the economic value of GOOGL shares.

VALUATION

Alphabet shares are up 22% year-to-date on a total return basis, compared to a 24% advance for the S&P 500, a 36% gain for the S&P 500 Information Technology Sector GICS Level 1 Index, and a 38% gain for the NYSE FANG+ Index according to Bloomberg. Alphabet's trailing EV/EBITDA of 17 is a below the peer median of 17.5 and near the five-year average. The forward EV/EBITDA of 13.3 is 2% below the peer average, compared to an historical discount of 5%. We are maintaining our BUY rating on GOOGL to a 12-month target price of \$200.

On October 31 at midday, BUY-rated GOOGL traded at \$174.13, down \$0.33.

About Argus

Argus Research, founded by Economist Harold Dorsey in 1934, has built a top-down, fundamental system that is used by Argus analysts. This six-point system includes Industry Analysis, Growth Analysis, Financial Strength Analysis, Management Assessment, Risk Analysis and Valuation Analysis.

Utilizing forecasts from Argus' Economist, the Industry Analysis identifies industries expected to perform well over the next one-to-two years.

The Growth Analysis generates proprietary estimates for companies under coverage.

In the Financial Strength Analysis, analysts study ratios to understand profitability, liquidity and capital structure.

During the Management Assessment, analysts meet with and familiarize themselves with the processes of corporate management teams.

Quantitative trends and qualitative threats are assessed under the Risk Analysis.

And finally, Argus' Valuation Analysis model integrates a historical ratio matrix, discounted cash flow modeling, and peer comparison.

THE ARGUS RESEARCH RATING SYSTEM

Argus uses three ratings for stocks: BUY, HOLD, and SELL. Stocks are rated relative to a benchmark, the S&P 500.

- A BUY-rated stock is expected to outperform the S&P 500 on a risk-adjusted basis over a 12-month period. To make this determination, Argus Analysts set target prices, use beta as the measure of risk, and compare expected risk-adjusted stock returns to the S&P 500 forecasts set by the Argus Market Strategist.
- A HOLD-rated stock is expected to perform in line with the S&P 500.
- A SELL-rated stock is expected to underperform the S&P 500.

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