Alphabet Inc

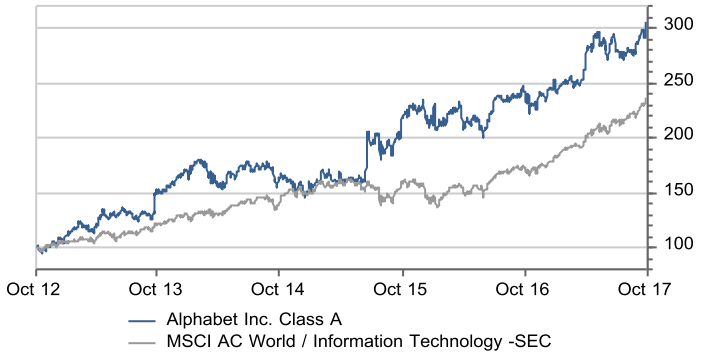
Global & US Conviction Lists Member

Isin / FactSet Code	**US02079K3059 / GOOGL-US**	Market cap (in EUR mn)	**617 628**	52-week high	**1 063.62**	Rating	**BUY**
Sector	**Information Technology**	Market cap (in local curr. mn)	**715 368**	52-week low	**743.59**	12-month target price	**1 160.00**
Industry	**Internet Software & Services**	Local currency	**USD**	YTD return%	**30.44**	Last price (27/10/17)	**1 033.67**
Benchmark	**MSCI AC World / Information Technology -SEC**	Free-float	**100%**	12-month return%	**26.47**	Potential upside	**12%**

Investment Case:

- In our view, Alphabet's new operating structure will provide more clarity. While the investment case is dependent on its core business Google's performance, details of the company's initiatives and focus on developing new technologies (such as Nest, driverless cars and life sciences) acts positively.
- In our view, Google benefits from the shift towards digital advertising (internet, smartphones, etc.) from advertising through traditional media (radio and newspapers). We believe that this shift should last over the long term, as the content published on the internet increases and takes over traditional media. The company is able to monetise its platform and is witnessing increasing traction in services such as YouTube. We believe given the strong user base, the monetisation should improve further.
- We value the stock at 28x its FY18E (from 26.5x) to arrive at a target price of USD 1 160.00 (from USD 1 060.00). The higher multiple is to account for the higher margin and better than expected growth.

Five-year Performance vs. Benchmark (rebased to 100)



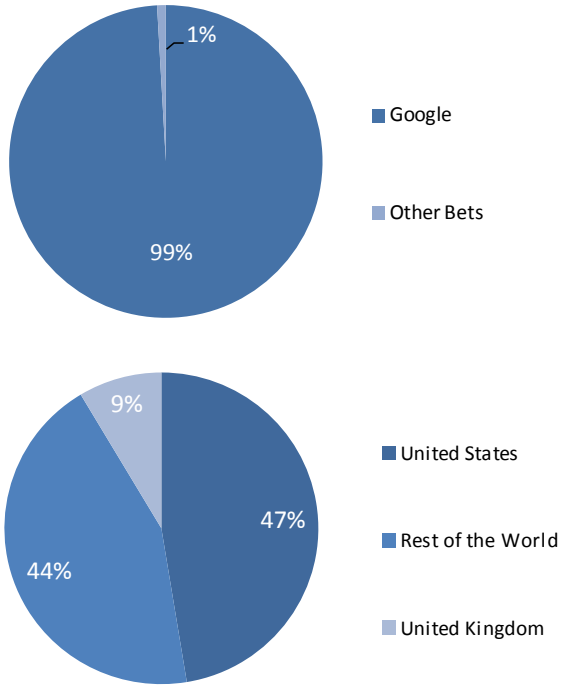
Sources: SGPB, FactSet

Company Description:

Alphabet is the parent company of Google, the leader in the web-based search segment. Alphabet has two segments: (1) Google, which includes internet products such as Search, Ads, Commerce, Maps, YouTube, Google Cloud, Android, Chrome, Google Play and hardware initiatives (2) the upcoming/non-search related technologies.

Revenue by Key Segments & Geographies: FY16

(FY ending December)



Sources: SGPB, FactSet

Recent Developments Analysis:

- 3Q17 net revenues (excluding traffic acquisition cost, TAC) rose 21.9% YoY to USD 22.3 bn, slightly ahead of consensus at USD 21.9 bn.
- Overall advertising revenues grew 21.4% to USD 24 bn on the back of a 22.6% increase in core site revenues. Paid click (volumes) grew 47%, while cost-per-click (pricing) fell 18%. The company reported revenues from Other Bets (non-Google businesses) at USD 302 mn, up 53.3%.
- GAAP operating income rose 34.9% to USD 7.8 bn and was 10.0% above consensus. Operating margin of 34.9% was up 338 bps YoY and 268 bps above consensus.
- Google is witnessing an increasing cost of acquiring business (TAC, up 31.6%), as more advertising shifts towards mobiles, where the costs are higher. However, the company is focussed on growing the overall revenues, which it believes would offset the increase in costs.
- On the call, the management re-emphasised its focus on innovation as the long-term growth driver for its business, including advertising, which makes us confident of the long-term growth prospects.

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DESCRIPTION			VALUATION					GROWTH				PROFITABILITY			BALANCE SHEET		
FactSet Code	Company	Cap (mn€)	EV/EBITDA (e)		P/E (e)		Div. Yield	Sales Growth		EPS Growth		EBITDA Margin	Net Margin	ROE	Net Debt/ EBITDA		Net Debt/ Equity
			FY1x	FY2x	FY1x	FY2x	FY1%	FY1%	FY2%	FY1%	FY2%	FY1%	FY1%	FY1%	FY0x	FY1x	FY0x
FB-US	**Facebook, Inc. Class A**	446 016	19.0	14.4	33.4	27.3	0.0	41.7	29.8	25.5	23.9	63.9	40.5	20.7	-2.0	-1.7	-0.50
BIDU-US	**Baidu, Inc. Sponsored ADR Class**	56 678	23.2	18.0	30.0	25.5	0.0	24.0	23.4	43.5	15.4	25.0	18.6	16.5	-1.5	-2.8	-0.42
IAC-US	**IAC/InterActiveCorp.**	8 683	16.5	11.6	41.2	27.1	0.0	0.6	14.0	1.7	57.7	18.8	6.9	11.4	1.0	-0.4	0.10
	Average:		**19.6**	**14.7**	**34.9**	**26.6**	**0.0**	**22.1**	**22.4**	**23.6**	**32.3**	**35.9**	**22.0**	**16.2**	**-0.8**	**-1.6**	**-0.27**
GOOGL-US	**Alphabet Inc. Class A**	617 628	14.4	11.6	32.3	25.0	0.0	20.7	18.2	-7.2	27.2	49.6	25.6	14.4	-2.7	-1.7	-0.59

na=Not available, nm=Not meaningful

Financial terms detailed in glossary

Sources: SGPB, FactSet

Risks To Our Investment Case:

- Google might not be able to maintain its market share in online advertising (~66% in the US), given the rise of players such as Facebook and Microsoft's Bing. Google's margin may fall in the long run, due to the ongoing expansion of the mobile internet and lower advertising prices on mobile devices, as compared to desktops. Also, like other cyclical companies, Google may see some weakness in the overall advertising spends.
- Alphabet is acquiring companies to expand its product and service offerings. While this might be revenue-accretive in the future, it will lead to increased costs because of which margins may be pressured in the near term.
- The company's non-search business is a high-cost segment with a high failure risk that might impact the overall profitability.

Business Quality Review:

- Google's revenues have grown 137% from 2011-16. While the pace of growth is expected to moderate due to base effect, we expect the growth trajectory to remain intact.
- The company witnessed a slowdown in its volumes but is back on the growth track with changes to its platform.
- Operating margins and ROE are expected to be stable at ~34% and ~14%, respectively, till 2019.

Dividend Policy:

- Alphabet does not pay a dividend currently, and given its high-growth profile, we do not expect it to initiate dividend payment in the near future.
- The company has a strong cash balance of ~USD 100 bn (as of 3Q17) and is expected to generate FCF of ~USD 25 bn in 2017. Alphabet uses its cash for internal growth opportunities and acquisitions in emerging technology.

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Financial Terms And Acronyms

BV (Book Value): is the total value of net assets of a company.

BV/S (Book Value Per Share): is the total value of the net assets of a company divided by the total number of outstanding shares.

C/I (Cost Income Ratio): is used for valuing banks. It shows a company's costs in relation to its income.

CAGR (Compound Annual Growth Rate): is a term used for the geometric progression ratio that provides a constant rate of return over a specific time period.

CAPEX (Capital Expenditure): is the fund used by the company to acquire or upgrade the physical assets such as property, industrial buildings or equipment. The most capital intensive industries include oil, telecom and utilities.

CAR (Capital Adequacy Ratio): is a measure of a bank's capital. It is expressed as a percentage of a bank's risk-weighted credit exposures.

CET I (Common Equity Tier I Ratio) : is a measure of the bank's common equity capital as a percentage of risk-weighted assets. It is generally compared to a defined benchmark stipulated by the regulatory authority to determine whether a bank is sufficiently capitalised.

COMBINED RATIO: It represents the total of acquisition and administrative expenses, and claims and insurance benefits incurred, divided by net premiums earned.

DIVIDEND PER SHARE (DPS): Dividend per share or DPS (total dividend paid out divided by the total number of shares) expressed as a percentage of current stock price.

EBIT (Earnings Before Interest and Taxes): profit before taking into account interest payments and income taxes.

EBIT Margin: Ratio that expresses EBIT as a percentage of total sales (EBIT/Sales*100)

EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortisation): profit before taking into account interest payments, income taxes and non-cash operating expenses (depreciation and amortisation).

EPS (Earnings Per Share): is the division of total net profit by the number of shares.

EQUITY is the difference between the value of the assets and the cost of the liabilities.

EV (Enterprise Value) is a measure of a company's value, often used as an alternative to straightforward market capitalisation. It is calculated as (market cap + debt + minority interest + preferred shares) − total cash − cash equivalents.

FCF (Free Cash Flow): represents the difference between operating cash flow and capital expenditures.

FFO (Funds from Operations): measures a REIT's operating performance. It is net income plus gains (minus losses) from property sale and purchase. FFO per share is often used in place of earnings per share when analysing REITs.

FY0: Realised year, **FY1**: Current unrealised year, **FY2**: next year, **FY17E:** Fiscal year 2017 estimation

GOODWILL: is an intangible asset that arises as a result of the acquisition of one company by another company for a premium value.

GROSS INCOME: gross profit calculated as a company's total sales minus its cost of goods sold (COGS) that corresponds to labour and production costs.

GROSS MARGIN: expresses gross income as a percentage of total sales.

LIKE FOR LIKE (LFL) GROWTH: is a measure of growth in sales, adjusted for new or divested businesses.

Loan-to-deposit (L/D) ratio: Loans/Deposits. This helps in assessing a bank's liquidity, lending capacity and balance sheet quality.

LTV (Loan-To-Value Ratio): is a financial term used to express the ratio of a loan to the value of an asset purchased.

NAV (Net Asset Value): is similar to book value and is also called per investment unit. NAV is the marked-to-market value of the company's property investments less liabilities.

ND (Net Debt): is calculated as a company's total debt minus cash and other similar liquid assets.

NET MARGIN: is a financial ratio which measures the profitability of the net income of a company.

NI (Net Income or Bottom Line): represents a company's total earnings (or profit) which is calculated by adjusting revenues for the costs, depreciation, interest, taxes and other expenses.

NIM: Net Interest Margin

NON-PERFORMING LOANS (NPL) RATIO: NPLs/Loans. This indicates the percentage of the loans that are non-performing or are in stressed segments.

OPERATING MARGIN: See definition of EBIT Margin.

ORGANIC GROWTH: is the growth rate that a company can achieve by increasing its output and enhancing sales, excluding any profits or growth from takeovers or M&A activities.

P/E or PER (Price Earnings Ratio): reflects the trading price of a share in relation to the expected earnings.

P/BV (Price To Book Value): expresses the share price with regard to the accounting value of the company.

PAYOUT RATIO: is the proportion of earnings paid out as dividends to shareholders and typically expressed as a percentage.

PROFIT WARNING: is the announcement made by the company before its earnings release indicating the investors that its earnings would not meet the analysts' expectations.

RWA (Risk Weighted Assets): is a measure of the bank's assets, weighted according to their risk. It involves the risk weighting of both on and off-balance-sheet exposures.

REVENUE GROWTH: Illustrates the growth of sales over a given period.

ROA (Return on assets): a financial ratio that is calculated as net income divided by total assets and shows how profitable a company is relative to its total assets.

ROC (Return on invested capital): a profitability ratio which is calculated as net income minus dividends divided by total invested capital.

ROE (Return On Equity): The amount of net income returned as a percentage of shareholders' equity. Return on equity measures a corporation's profitability by disclosing how much profit a company generates with the money shareholders have invested.

TBV (Tangible Book Value): is the book value excluding intangible assets.

TBV/S (Tangible Book Value Per Share): allows to estimate the accounting value of a company by measuring its stockholders' equity per share. Formula: Re-valued Net Assets/Total Shares of Company.

WACC (Weighted Average Cost of Capital): also referred to as the firm's cost of capital, it is the rate that a company is expected to pay on an average to all its security holders to finance its assets.

WORKING CAPITAL: is the difference between a company's current assets and current liabilities and shows whether the company has sufficient short-term assets to cover its short-term debts.

Appendix

Investment Rating Definitions:

Buy	Stock that is expected to outperform its MSCI sector index over a 12-month investment horizon.
Neutral	Stock that is expected to perform in line with its MSCI sector index over a 12-month investment horizon.
Sell	Stock that is expected to underperform its MSCI sector index over a 12-month investment horizon.
Restricted	Covered stock that is not rated or assigned a target price as the Societe Generale group has a capital market transaction with that company.
Termination	Stock is subject to be deleted from the SGPB recommended universe and will no longer be followed. In this case, a coverage termination alert is issued.

Recommended Universe Principle:

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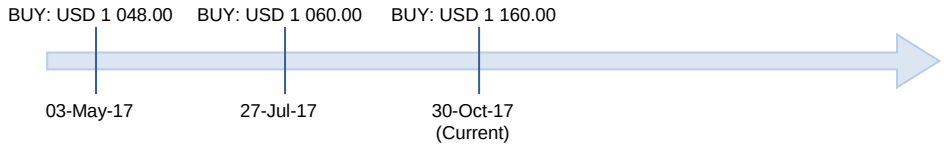
Product Risk Rating:

The product category of single equity, stock, share is rated at '4'.

In order to draw the attention of potential investors to the risk linked to each investment solution, Societe Generale Private Banking has ranked each product according to its own specific risk scale from the lowest risk (class 0) to the highest risk (class 4). The risk classification in 5 levels, is a Societe Generale Private Banking internal risk indicator. These internal indicators are based on the Value at Risk 95% 1 year (VaR). The VaR corresponds to the maximum amount that the portfolio being considered could lose in normal market conditions over a given period with a given probability (past performances and simulations of performance shall not be considered as a reliable indicator of future performance). If the VaR 95% 1 year is y%, this means that there is a 95% probability that the portfolio will not lose more than y% of its value in one year.

Risk Levels	Losses
0 - Lowest Risk	There is a 95% probability that the product will not depreciate in value in one year.
1 - Low Risk	There is a 95% probability that the product will not lose more than 5% of its value in one year.
2 - Medium Risk	There is a 95% probability that the product will not lose more than 15% of its value in one year.
3 - High Risk	There is a 95% probability that the product will not lose more than 30% of its value in one year.
4 - Highest Risk	There is a minimum of 5% probability that the product will lose more than 30% of its value in one year.

1Y Target Price:



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R1: Low Risk
R2: Medium Risk
R3: High Risk
R4: Highest Risk

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