Google (GOOG)

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Disclaimers

• I am not a registered investment advisor and I do not offer any investment advise
• No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments
Google - business
Google - business (cont’d)
Google - Misc thoughts

• What can go wrong?
  • Mobile advertising lower PPC
  • Motorola integration issues - Android fragmentation etc.
  • Anti monopoly regulation
  • 3 tier share structure - founder totalitarian rule
Google - Misc thoughts

• Opportunities:
  • Still rules search
  • Google docs
  • Chromebooks
  • Android tablets
  • Android phones (but where is the profit?)
Strategic considerations

- **Moat** (*switching costs, habit, low cost*):
  - What are the moats? Brand, ad platform, mobile OS
  - What does it take to sustain the moats? Sustain the above
  - Bargaining power of suppliers/customers? None

- Is it a low risk business? Somewhat.

- Is there high uncertainty? No.

- How capital intensive is the business? Not.

- Future growth - Unknown

- Are the revenues and cash flows of the business sustainable or overstated / understated due to boom or bust conditions? Probably not
Management

- I don’t usually do management analysis. Included for template completeness
- No dilution
- Can I trust management?
- Management shareholding (> 10%)
- Management incentives?
- Are the salaries too high?
- Is there heavy insider buying?
- Is there heavy insider selling?
- Do I like the management? (Operators, capital allocators, integrity)
- Profitable reinvestment
- What has management done with the cash?
- Where is Free Cash Flow invested? Share buybacks, dividends, reinvested, ROE & ROCE, incremental BV
Piotroski Score

Only applicable to Graham Cos - N/A to GOOG

1. Net Income: Bottom line. Score 1 if last year net income is positive.
2. Operating Cash Flow: Better earnings gauge. Score 1 if last year cash flow is positive.
3. Return On Assets: Measures Profitability. Score 1 if last year ROA exceeds prior-year ROA.
4. Quality of Earnings: Warns of Accounting Tricks. Score 1 if last year operating cash flow exceeds net income.
5. Long-Term Debt vs. Assets: Is Debt decreasing? Score 1 if the ratio of long-term debt to assets is down from the year-ago value. (If LTD is zero but assets are increasing, score 1 anyway.)
6. Current Ratio: Measures increasing working capital. Score 1 if CR has increased from the prior year.
7. Shares Outstanding: A Measure of potential dilution. Score 1 if the number of shares outstanding is no greater than the year-ago figure.
8. Gross Margin: A measure of improving competitive position. Score 1 if full-year GM exceeds the prior-year GM.
9. Asset Turnover: Measures productivity. Score 1 if the percentage increase in sales exceeds the percentage increase in total assets.

• Total: / 9
Is it a good business?

- 10 year history of profits
- ROE:
- Margins
- 3 year sales growth 25%, earnings growth 20%
- Minor dilution (employee stock programs?)
- Strong balance sheet
  - Debt << cash/short term investments
- ROIC = Earnings / (Equity + Debt - Cash) = Earnings / (Assets - non-debt liabilities - Cash)
  - ~= ROE
Is it a good business? Cash flow

• **Negative 2012 cash flow on acquisitions:**
  - 2012 h1 5675M earnings, 7946M operating cash flow, 6600FCF without acquisitions (FCF = OCF - capital expenditures), **negative on acquisitions**
  - Free Cash Flow/Share higher than dividends paid
Is business cheap? - Buffettology calculations

- ROE 15%
- Earnings in 10 years = ROE*Equity*(1+ROE)^9 = $34B
- Equity in 10 years = Equity*(1+ROE)^9 = $227B
- Market cap = 34B x P/E (15) = $500B
- Rate of return = 8% after tax (calculations omitted)

Is business cheap? DCF

• Discounted cash flow
  • Current earnings of 11B
  • 10% growth for 5 years, leveling after that
    • 15% discount -> $107B current valuation
  • 5% growth for 10 years, leveling after that
    • 15% discount -> $98B current valuation
  • 10% growth for 10 years, leveling after that
    • 15% discount -> $134B current valuation
  • Owner’s yield = earnings / (market cap + debt - cash) = earnings/EV
    • 11B / (210B+18B-43B) = 6%

• What makes up the margin of safety? Brand/moat
• Is there a sufficient margin of safety? No.
Is business cheap? - Graham investment considerations

• N/A for GOOG - included for completeness
• 3 P/Book - not a net net
• Altman Z score ( http://en.wikipedia.org/wiki/Altman_Z-score )