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:
  - 2009: 18.11 2010:18.39 2011: 16.75 2012 h1: 17.54
- Margins
  - 2009: 28 2010:29 2011: 26 2012h1:25
- 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)

- 9 year earnings growth: 48%. Not sustainable. Assuming 20% earnings growth: 16% share price growth.

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)