Calgary Portfolio Management Trust

Alphabet

Communication Services
NASDAQ: GOOGL
Market Outperform | Hold

Alphabet

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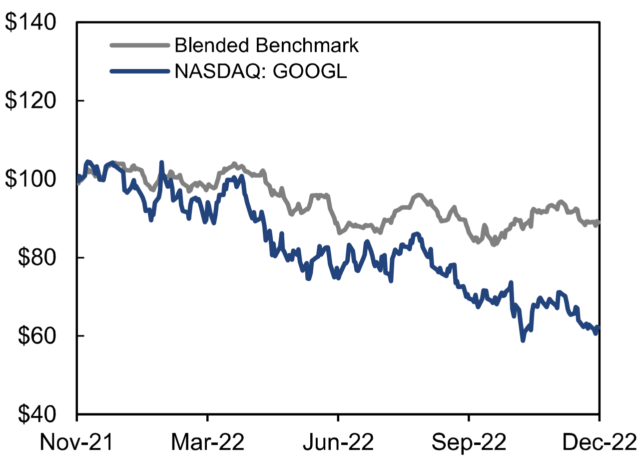
Emily Chen, Portfolio Manager
Joel Homersham, Investment Analyst
Ryan Crisalli, Investment Analyst

Return on Investment	
Current Share Price	$88.23
Intrinsic Value	$111.00
Dividend Yield	N/A
Implied Discount	26%
Conviction Rating	2

Market Profile	
52-Week Range	$83.34 - $151.55
Market Capitalization (US$B)	$1,142
Net Debt (US$B)	($87)
Enterprise Value (US$B)	$1,055
Beta (5-Year Monthly)	1.07

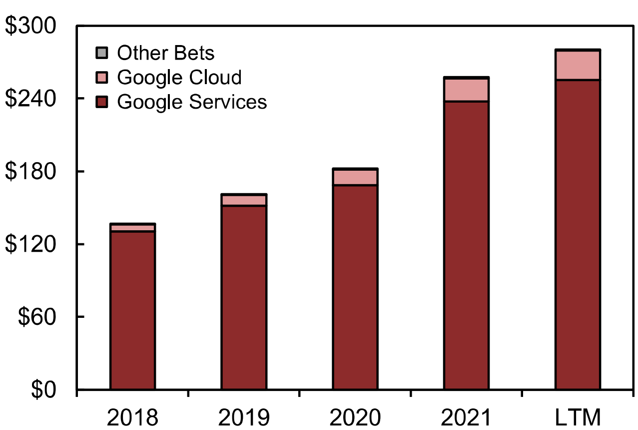
Metrics	2022E	2023E	2024E
Revenue (US$B)	$278.2	$299.8	$332.6
EBITDA (US$B)	$99.5	$110.1	$125.3
EV/EBITDA	10.6x	9.6x	8.4x

Holding Period Trading Performance (Indexed to $100)



Source: S&P Capital IQ

Figure 1: Segmented Revenue (US$B)



Source: S&P Capital IQ

Business Description

Alphabet (NASDAQ: GOOGL) was established in 2015 by the co-founders of Google (Sergey Brin and Larry Page) to expand outside of the Company's core internet and search advertising business. As a well-known multinational conglomerate, GOOGL continues to revolutionize how the world shares, creates, and accesses information. The Company reports in three segments: (1) Google Services, (2) Google Cloud, and (3) Other Bets.

Google Services: GOOGL's main products and services (ads, Android, Chrome, hardware, Google Maps, Google Photos, Google Play, Search, and YouTube) comprise this segment. To generate revenue, the Company primarily relies on its advertising model, which can be further segmented into performance-based advertising (clickable ads that are relevant to the target user) and brand-based advertising (ads that are designed to enhance brand awareness in marketing campaigns). Further product monetization is achieved through app sales, device sales, and YouTube Premium. In Q3 2022, Google Services generated 89.7% of total revenues.

Google Cloud: GOOGL's significant investment in cloud infrastructure, cybersecurity, data management, analytics, and artificial intelligence (AI) is captured by this segment. The Company has developed two main offerings: Google Cloud Platform (which allows developers to test and deploy applications using its infrastructure) and Google Workspace (suite of cloud-based collaboration tools for enterprises including Docs, Drive, Calendar, and Meet). In Q3 2022, this segment generated 10.0% of revenues.

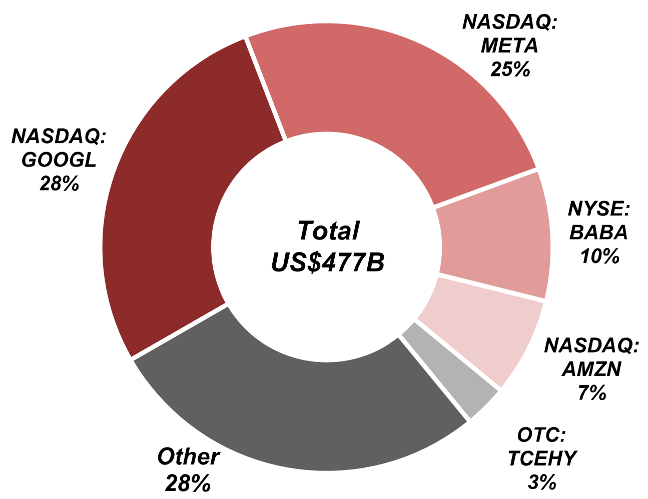
Other Bets: Apart from its core business, GOOGL also possesses an investment portfolio focused on supporting technology start-ups. Other Bets operates as independent companies in varying stages of development ranging from R&D to commercialization. Examples of portfolio holdings include GV, Nest, and Waymo. As these ventures are early-stage, the Other Bets segment generates minimal revenue for GOOGL, comprising only 0.3% in Q3 2022.

Industry Overview and Outlook

The U.S. web-services industry is dominated by entrenched major players, requiring continuous investment to develop new and unique offerings. An additional level of complexity is present in advertising business models, which must balance the interests of platform users with the Company's efforts to attract advertisers. In 2023, competitive pressures within the industry are expected to intensify as a result of reduced marketing budgets and the increasing popularity of alternative platforms (i.e., TikTok and ChatGPT). On the other hand, cloud services are forecasted to experience resilient demand due to the critical functions that it serves for clients. While GOOGL captured ~13% of the global cloud market in 2022, Amazon Web Services and Microsoft Azure continued to protect their market share positions, retaining 38% and 24%, respectively.

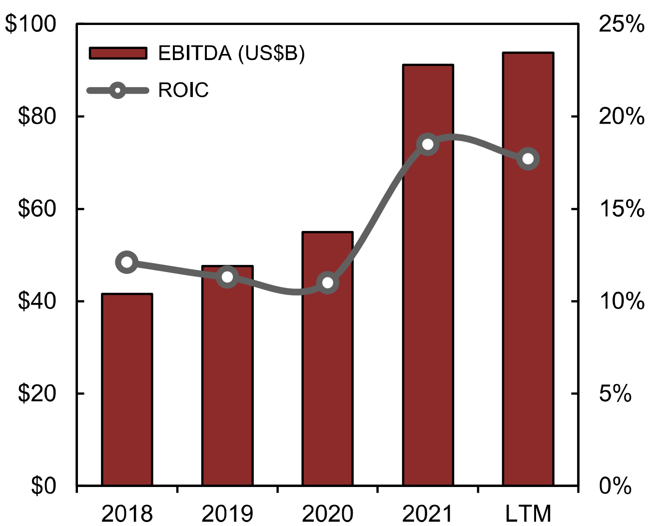
Over the past decade, rapid technological advancement in AI and machine learning has enabled companies to drastically improve the quality of products offered (i.e., better content recommendations for search engines). However, regulatory risks may pose unforeseen barriers to fully implementing and monetizing these developments.

Figure 2: 2022E Digital Advertising Market Share



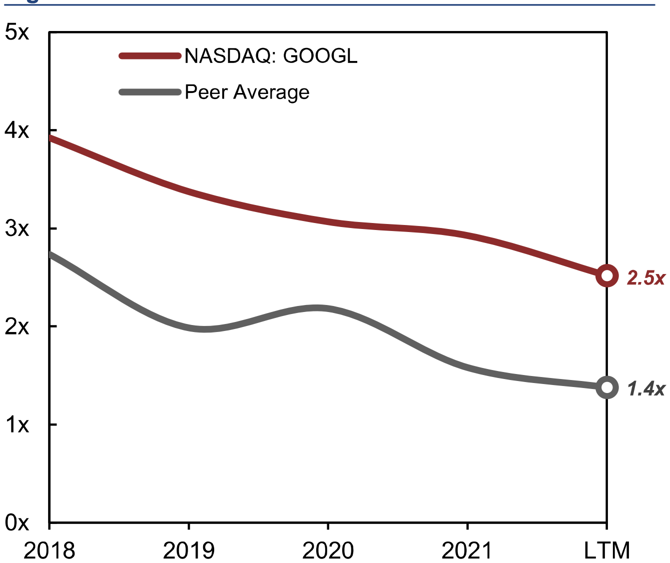
Source: Bloomberg, Research and Markets

Figure 3: LHS EBITDA vs RHS ROIC



Source: S&P Capital IQ

Figure 4: Current Ratio vs Peers



Source: S&P Capital IQ

Mandate Fit

Quality Management: Sundar Pichai is the CEO of Alphabet and CEO of Google, serving in each role since 2019 and 2015, respectively. With nearly 20 years of experience working at GOOGL, Pichai has acquired extensive knowledge while supporting the Company's development of many key offerings, such as Search, Chrome, Google Maps, Android, and Gmail. Under Pichai's leadership, GOOGL's corporate strategy has shifted towards advancing AI technology, which has enabled the Company to protect its competitive edge. In 2019, upon assuming the Alphabet CEO role, Pichai was issued US$280mm in PSUs/GSUs as one-time compensation, with a US$2mm base salary paid annually thereafter. The first tranche of Pichai's PSUs successfully vested in January 2022 due to GOOGL's superior performance relative to the S&P 100. NEO compensation in 2021 consisted primarily of stock awards (>95% of total pay).

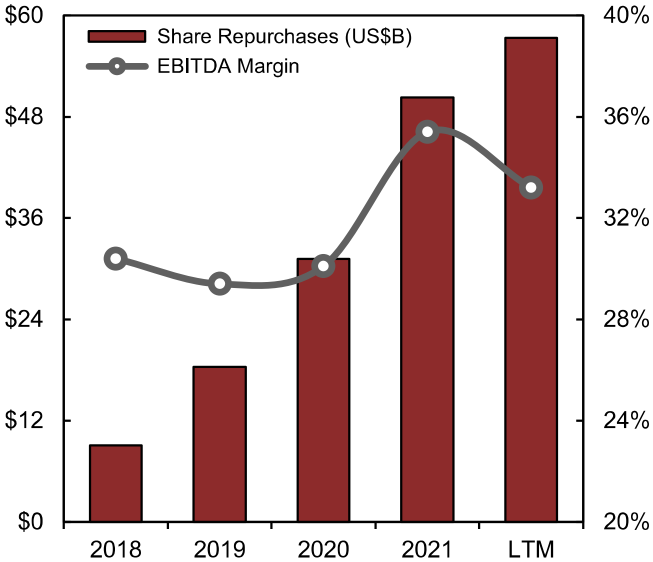
Competitive Advantage: The key to GOOGL's success is its sizable yet streamlined technology development pipeline. In the last five years, GOOGL has invested US$100B in R&D, resulting in best-in-class product offerings that provide superior functionality and user experience. Examples of recent and/or developing initiatives include the monetization of YouTube Shorts, Google Maps, and the Discover tab. Additionally, GOOGL has maintained a strong focus on AI integration through experimentation with its Multitask Unified Model.

GOOGL's balanced approach to achieving sustainable growth is extremely effective within the rapidly evolving competitive landscape. The Company leverages its high-margin core advertising business to fund 'non-Search' investments that diversify revenue streams and provide significant upside potential in the long-term (i.e., YouTube, Google Cloud, and Google Play). In Q3 2022, GOOGL achieved a 32.2% operating margin in its Google Services segment, offsetting losses in Cloud and Other Bets. As ongoing monetization improvements (such as Performance Max) are launched, GOOGL can further enhance profitability and generate shareholder value. Additionally, the Company's success is highly difficult to replicate due to the breadth of its offerings, requiring extensive R&D efforts to become a true rival. Even if new entrants and industry disrupters gain initial traction, the strength of GOOGL's base business allows it to acquire competitors before they pose a significant threat. The Company can also make strategic M&A deals to address gaps in its existing operations, as seen with its acquisition of Mandiant (a leader in providing cybersecurity solutions) for US$5.4B in Q1 2022.

Furthermore, GOOGL's Other Bets portfolio is carefully curated to provide exposure to high-risk high-reward opportunities (moonshots). Notably, the Company has exposure to the autonomous vehicle market through Waymo, which was founded in 2009 as the Company's self-driving car project. Waymo is positioned to generate significant returns once the technology matures due to its in-house development system and emphasis on rigorous data testing. Currently, the majority of revenues generated in the Other Bets segment is from health technology and internet services sales.

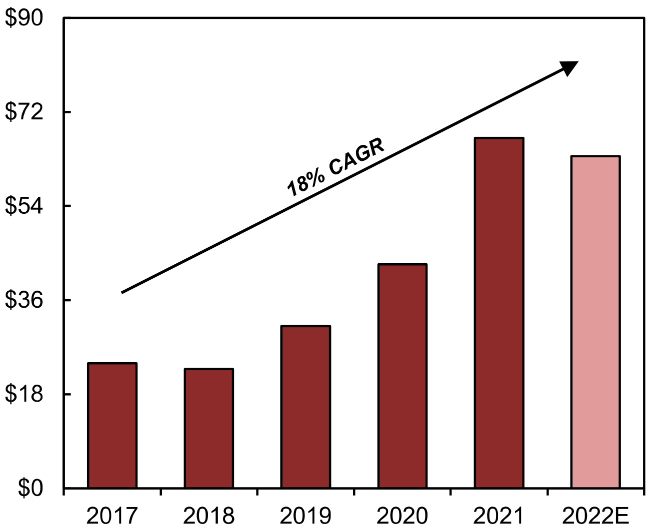
Strong Balance Sheet: As of Q3 2022, GOOGL has current liabilities of US$64B, long-term debt of US$15B, and lease liabilities of US$11B. However, the Company possesses US$140B of cash on hand, which is more than sufficient to fund GOOGL's debt obligations and planned R&D investments. Short-term liquidity remains a strength for the Company, as the LTM current ratio is 2.5x (higher than the peer average of 1.4x). Furthermore, due to the Company's capital discipline and high-margin business (cont.)

Figure 5: LHS Repurchases vs RHS EBITDA Margin



Source: S&P Capital IQ

Figure 6: Free Cash Flow (US$B)



Source: S&P Capital IQ

model, the Total Debt/EBITDA ratio remains low at 0.3x. GOOGL's financial strength is reflected by its investment grade credit ratings of AA+ and Aa2 from S&P Global and Moody's, respectively.

Growing Free Cash Flow: GOOGL has maintained strong FCF growth over the trailing five- and ten-year periods but faces significant headwinds surrounding its digital advertising business. The Company has seen material pullback in search advertising from areas including insurance, mortgage, and cryptocurrency – all of which were major contributors to record FCF in 2021. GOOGL has announced layoffs and postponed projects such as its next generation Pixelbook laptop to focus on core business priorities and insulate margins. Despite the challenging macroeconomic backdrop, GOOGL continues to return value to shareholders via share buybacks, having repurchased US$50.3B in FY2021.

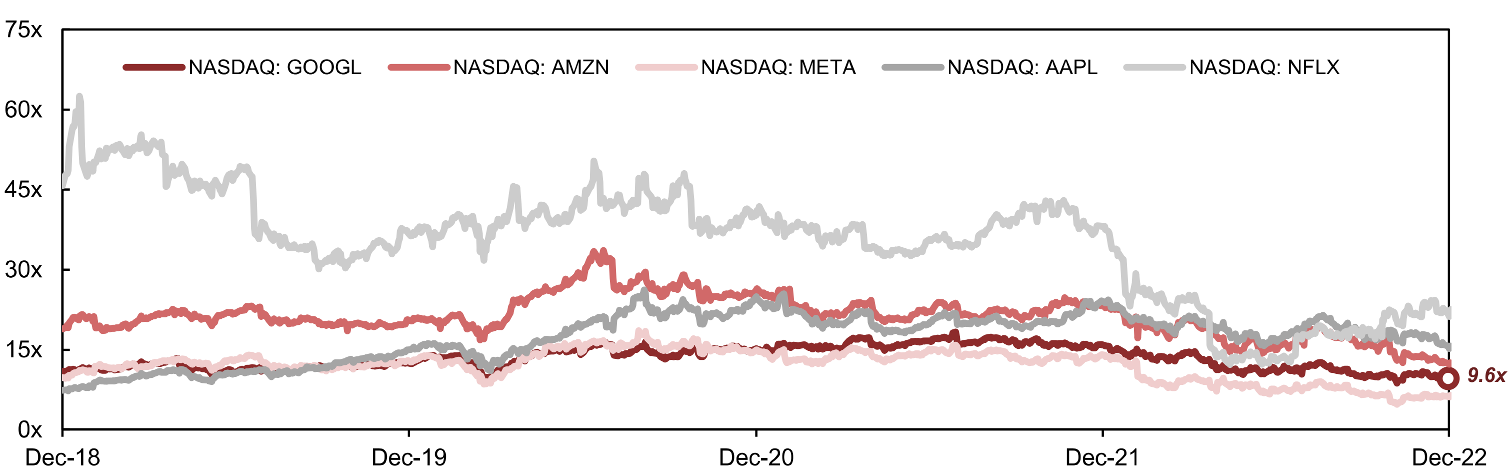
Business Risks

In the current inflationary environment, GOOGL may experience a decrease in advertisement revenues due to clients reducing their marketing budgets. Even in periods of macroeconomic headwinds, the Company must still innovate to maintain a technological edge relative to peers, requiring careful human capital management and significant financial investment. Furthermore, consumers are becoming increasingly sensitive to data privacy and security issues, which may prompt the development of stringent legislation that can hinder GOOGL's ability to monetize its offerings. Other risks include slow adoption of the Company's new ad products, enforcement of antitrust legislation, and loss of intellectual property rights.

Revised Valuation and Investment Thesis

The intrinsic value of $111 was derived by applying a 2024E EV/EBITDA exit multiple of 13x, resulting in a 26% implied discount. Upon review, the CPMT believes that the original investment thesis for GOOGL remains intact. GOOGL has continued to demonstrate excellence in allocating FCF to value-add opportunities, evidenced through the development of Google Cloud, Maps, and the Discover tab. The CPMT believes that GOOGL will continue to win market share relative to peers and maintain its leading position in the digital advertising space. Furthermore, the upside optionality of the Other Bets segment can generate additional shareholder value in the long-term. Although current macroeconomic conditions pose challenges to the Company's growth, the Fund remains convicted in GOOGL's ability to efficiently allocate resources into highly accretive projects.

Figure 7: NTM EV/EBITDA vs Peers



Source: S&P Capital IQ