



GOOGLE - ALPHABET IS GETTING KILLED. KEEP UP THE FOCUS ON BANKRUPTING THEM

Alphabet Inc Releases Q4 2017 Results; Traffic Acquisition Costs Increase 33%, Net Income Shows Loss Due To One-Time \$10 Billion Tax Charge



By Ramish Zafar

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Alphabet

Interesting times for Google. After being consolidated into a parent company, Mountain View is struggling to keep up with changing times. Part of this is Google's fault. Its recent Pixel 2 launches resulted in aggressive spending – a fact that shows on the company's latest earnings results. TAC (Traffic Acquisition Costs) also increased over the year, but not at levels to create significant investor concern. Net Income for the year 2017 also falls by 35% YoY. Take a look below for the details.

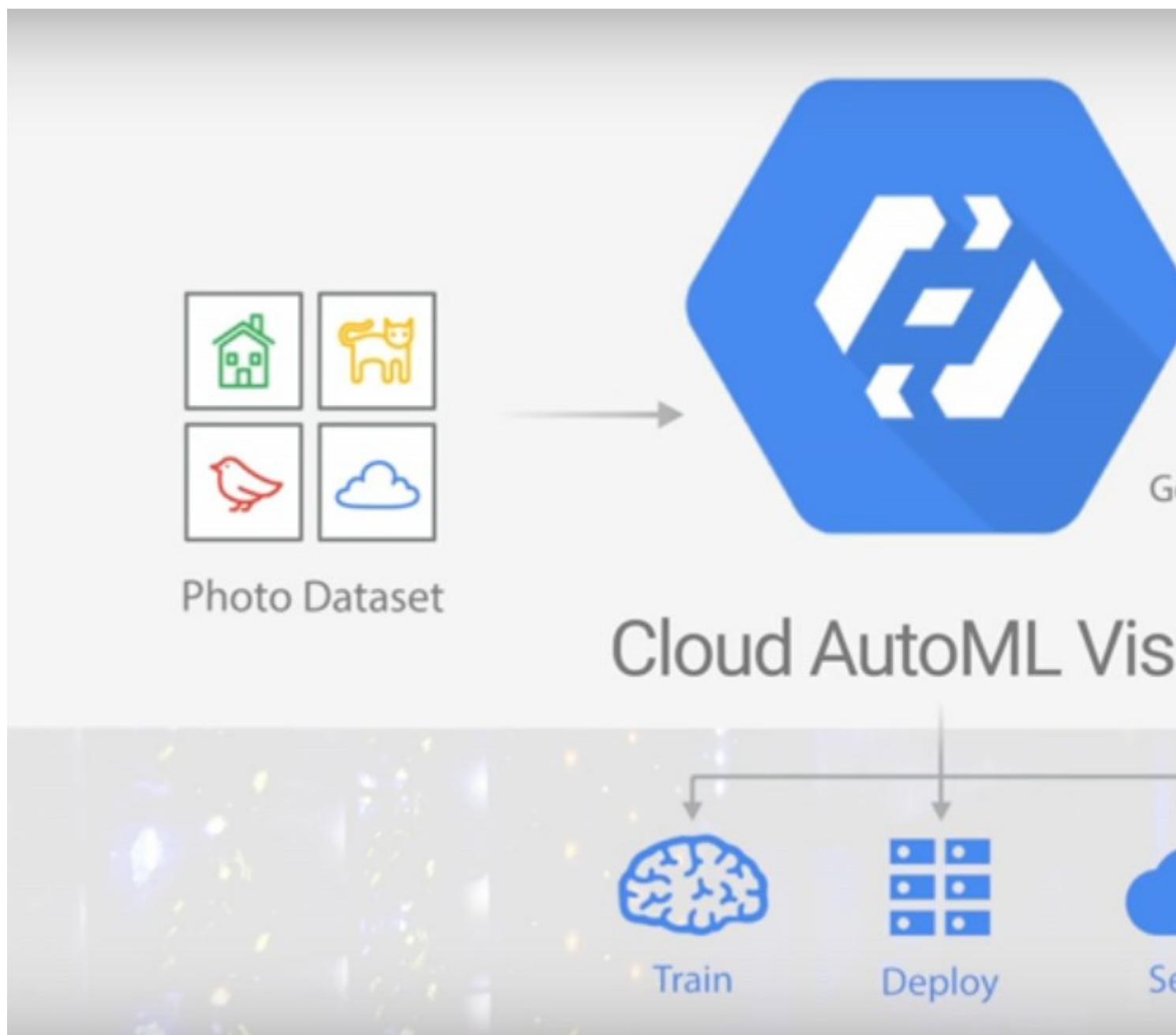
Alphabet ([NASDAQ:GOOGL 1,119.20 -5.28%](#)): TAC Increases By 33% YoY, Net Income Takes A Hit Due Tax Bill, Optimistic Growth In YouTube, Digital Advertisement Expected

It's a changing world and Alphabet is right at the front. Smartphone usage trumps PCs for access to the internet and this provides the company with new opportunities and problems. The switch to internet makes Google more dependent on manufacturers, such as Apple, for its Advertising revenues. Advertising revenues account for 86% of Alphabet's total revenues, so this is a factor for the bears.

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The amount Google pays to its partners to ensure that it's the default search option on browsers such as Safari or Firefox increased this quarter, reflecting the changing environment. TAC went up to \$6.45 Billion, up by 33% from Q4 2016. However, once we analyze the company's yearly and quarterly data for the past five years, these aren't significant enough to cause serious concern. The chunk of this increase comes from the shift to mobile - as Google is forced to pay more to companies for its search engine. Alphabet's CFO expects these to increase in the future as well. According to her, they represent Google seizing the growing smartphone search market early.

Users clicking on Google's ads from its sites that include Youtube and Search increased by 48% YoY, from Q4 in 2016. Digital advertisement spending in the future will use Google's services, offsetting any concerns due to increased TAC. YouTube use by younger generations is increasing, with many choosing the platform over standard televisions. TAC for both mobile search and programmatic ads is higher, and since Google used more of these platforms this year, the corresponding value for total TAC increased.



Alphabet ([NASDAQ:GOOGL 1,119.20 -5.28%](#)): Executives Break Down Cloud Revenue For The First Time, Hardware Moves First In ‘Other’ Segment, Followed By Cloud And Google Play

Another strong indicator for Alphabet heading into 2018 is its Cloud business. It's the future for Google, as it hopes to land a strong foothold in AI as well. Google Cloud finally reached meaningful scale this year, generating \$1 Billion in sales this quarter. Google also deepened its collaboration with Cisco, SalesForce and SAP. While this is an impressive achievement for Google, other players in the cloud

space are far ahead of Mountain View. Amazon reported a \$5.1 Billion revenue for its Web Services in Q4. Microsoft's intelligent cloud unit, the parent group of Redmond's cloud division, reported \$7.2 Billion in revenue.

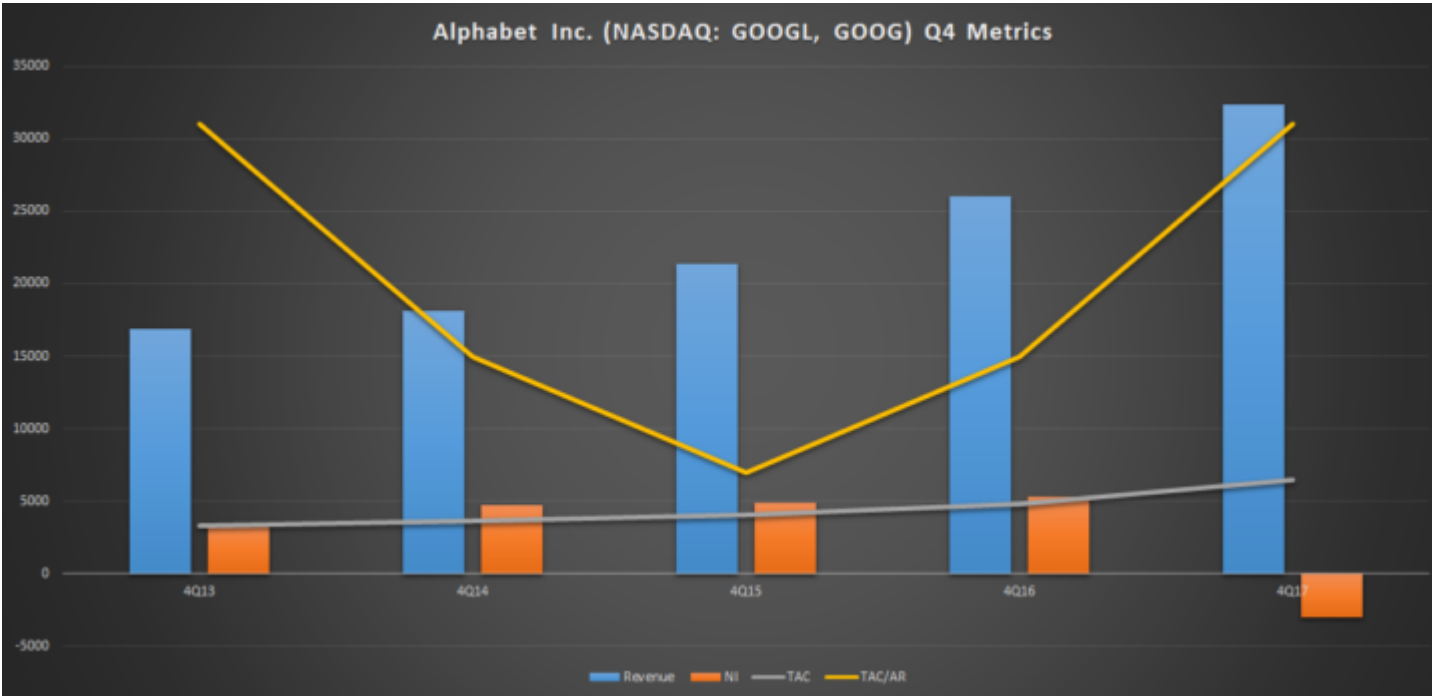
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Moving forward from Google's advertisement revenues, the company's 'Google Other' also changed in composition this quarter. Alphabet's Made by Google hardware division made impressive progress this quarter. Device shipments doubled YoY, indicating Google's strong success by integrating hardware and AI. The Pixel 2 smartphones feature both the Google Assistant and AI backed photography. This is proving very fruitful, as more than 3 Billion photos were uploaded on Google Photos on New Year's eve, according to Sundar Pichai.

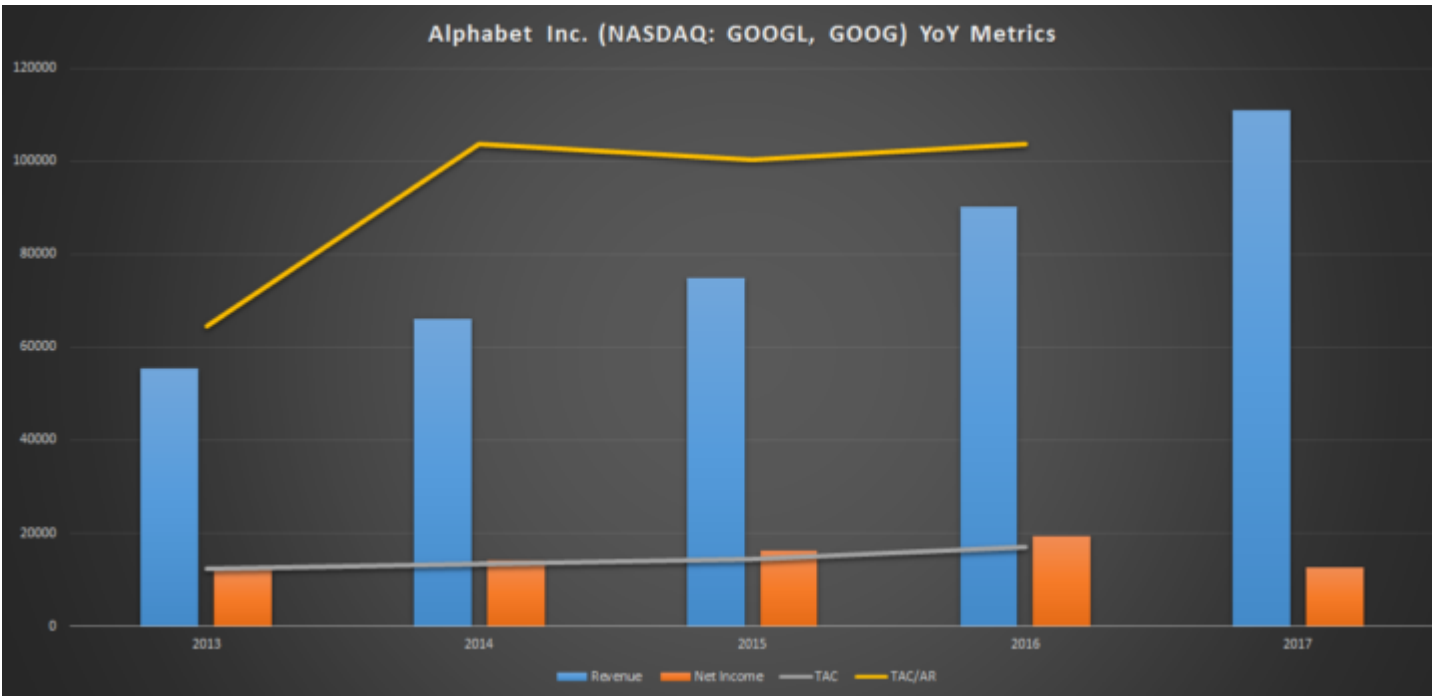
However, Alphabet is far from top when we talk about smartphones. While the Pixels exhibit strong performance, Google is still struggling to achieve hardware parity, particularly with Apple. As the smartphone industry acclimatizes to facial recognition and virtual fingerprint sensors, Google needs to speed up capital expenditure to ensure relevance. Artificial Intelligence is a top priority for the company, heading forward.

It's AI which will propel the company forward - and give its Cloud users a strong advantage. AutoML is at the forefront of Alphabet's efforts with it. AutoML allows small business to take advantage of Google's techniques such as learning2learn, to build their custom models. Fourth quarter US sales for Google's Chromebooks grew by 70% YoY.

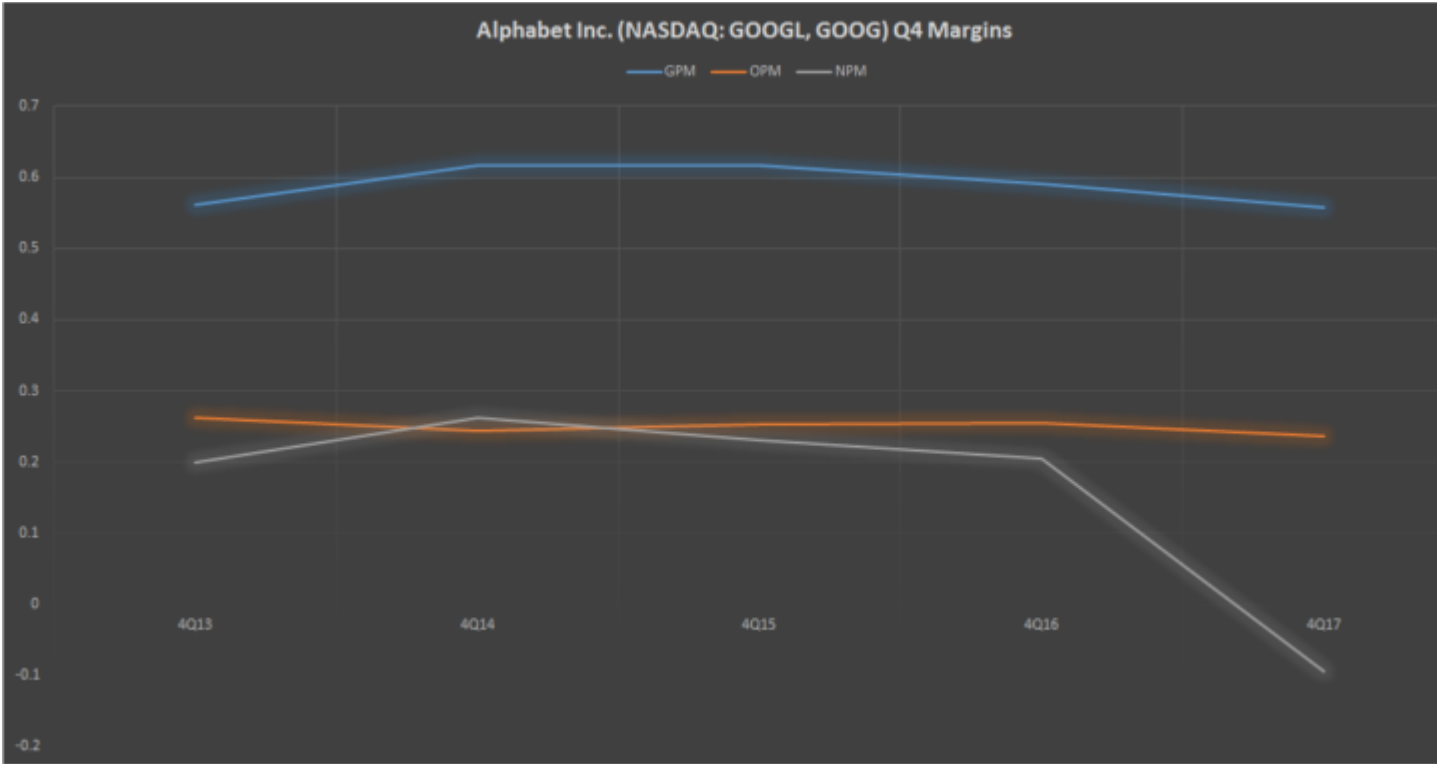
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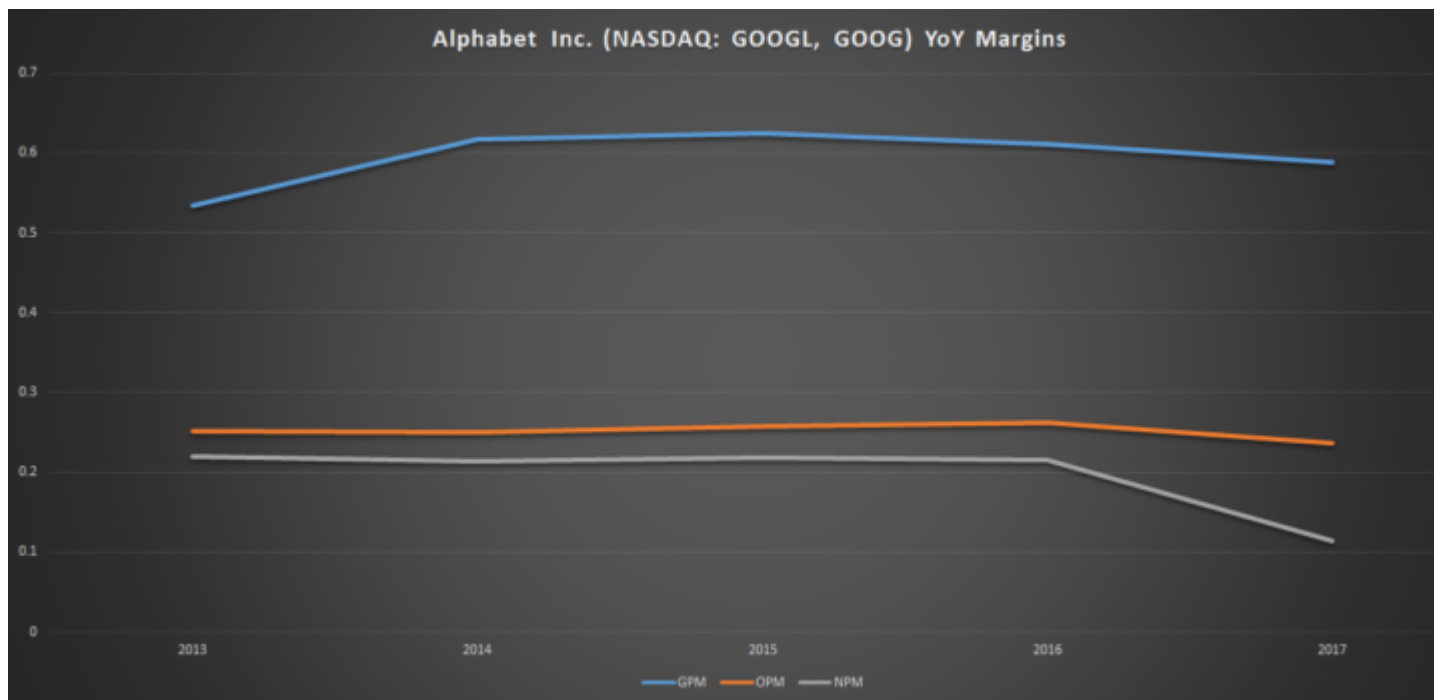


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Alphabet (**NASDAQ:GOOGL 1,119.20 -5.28%**) Highlights For Q4 2017:

- **Google Cloud Starts to Earn \$1 Billion Revenue Per Quarter:** A big win for Google this quarter is its Cloud service finally delivering results. Mountain View estimates that the group's \$1 Billion revenue per quarter makes it the fastest growing cloud platform in the world. Of course, there is a lot of competition in the market, especially with Amazon and Microsoft - both with strong footholds.
- **AutoML Makes Strong Gains Post Launch:** Google launched Cloud AutoML on January 17th, two weeks before its Q4 earnings call. Since then, the company reports that more than 10,000 customers have signed up for the service for trial purposes. All it needs is to deliver on a handful of these and we'll have Google as a major player taking on Amazon in no time. According to a report by Synergy Research, Microsoft's market share grew at 3%, with Google growing at 1%.
- **Alphabet Launches the Google Pixel 2 And Pixel 2 XL Under 'Made by Google':** Google upgrades its 2016 Pixel lineup of smartphones, with the Pixel 2 and Pixel 2 XL. They feature the Snapdragon 835, 4GB RAM and 64/128GB internal storage. The smartphones have the honor being rated by DxOmark for the best camera performance. Even though neither of them has

a dual camera setup, Google's intelligent software gives smartphones with this setup a good run for their money. The Pixel 2 pair use Google's Convolutional Neural Network (CNN) to map out pixels in the foreground (object of the picture) and the background. The CNN's results are then combined and refined using Dual Pixel Auto Focus. All this results in images with a shallow depth of field, typically produced by Single Lens Reflex (SLR) camera. The great thing about CNN and its images is that this allows Google to achieve results comparable with dual camera setups - making it one of the company's strongest competitive advantage in the market.

- **Alphabet generated \$32 billion revenue** in its Q4 for Fiscal Year 2017, marking a 24% increase over Q4 2016. Annual revenues for the group are \$110.9 billion, up 23% over last year. For the quarter, Alphabet's US revenues are \$15.4 billion. In Europe Middle-East and Africa (EMEA), revenues generated are \$10.3 billion. For Asia-Pacific (APAC) revenues are \$4.7 billion. Alphabet grew its revenues across all the territories, 21% for US, 24% for EMEA and 30% for APAC. Total cost of revenues was \$14.3 billion, up 34% YoY. Operating expenses are \$10.4 billion, growing by 19% YoY. Operating Income is \$7.7 billion, growing by 15%.
- **Alphabet reported a Net Loss of \$3 billion** as a direct result of the U.S. Tax Cuts and Jobs Act, 2017. This resulted in an effective tax rate of 138%, amounting to \$10 billion in Provision for Income Taxes. Excluding this impact, Alphabet's Net Profit is \$6.8 billion. For Q4, Google Sites revenues are \$22.2 billion, up by 24% YoY. This segment is led by YouTube and desktop search. For its second wave of growth, Google plans to expand on advertisement across desktop, hardware and YouTube. Network revenues stand at \$5 billion growing by 13%. Other revenues are \$4.5 billion, growing by 38% YoY.
- **Alphabet's \$9.9 billion of one time transition tax** allows it to bring back earnings stored abroad to the US. Estimates put the company's foreign cash holdings at around \$64 billion. The one time tax exemption allows US firms to bring back money stored abroad back at decreased tax charges. Alphabet also announced a \$8.6 billion buyback of Class C shares, which will be spread throughout the year. Subsequently, the company will invest its repatriated earnings in CapEx for Made By Google, AutoML and other areas, according to our estimates.

Alphabet (**NASDAQ:GOOGL 1,119.20 -5.28%**) Brief Snapshot Of Q4 2017 Results:

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Alphabet Inc.	Revenue	Net Income	TAC	TAC/AR
2013	55519	12214	12258	24%
2014	66001	14136	13497	39%
2015	74989	16348	14343	38%
2016	90272	19478	16973	39%
2017	110855	12662	N/A	N/A

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Alphabet Inc.	Gross Profit Margin	Operating Profit Margin	Net Profit Margin
2013	53%	25%	22%
2014	62%	25%	21%
2015	62%	26%	22%
2016	61%	26%	22%
2017	59%	24%	11%

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Alphabet Inc.	Revenue	Net Income	TAC	TAC/AR
4Q13	16858	3376	3310	24%
4Q14	18103	4747	3600	22%
4Q15	21329	4923	4055	21%
4Q16	26064	5333	4848	22%
4Q17	32323	-3020	6450	24%

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Alphabet Inc.	GP M	OP M	NPM
4Q13	56%	26%	20%
4Q14	62%	24%	26%
4Q15	62%	25%	23%
4Q16	59%	25%	20%
4Q17	56%	24%	-9%

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