

Not Much Alpha Left in This Bet

| *Google's growth dilemma*

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GQG Research

LET'S TALK STOCKS

Key Takeaways

- > Google redefined advertising with its innovative business model, but its dominance is now under siege from AI competitors and shifting market dynamics
- > Rising costs and capital-intensive projects are straining Alphabet's once agile operations, raising questions about sustainable growth
- > With slowing returns and increasing vulnerabilities, Alphabet's future may face estimate cuts and valuation pressures, presenting significant investment risks

Roger Federer changed the game of tennis, much like Alphabet's Google changed the game of advertising. Federer's fast, aggressive style on grass and his adaptable, versatile play on hard courts made him a legend, just as Google's seamless integration of ads into its search engine revolutionized relevance and efficiency in online advertising. Known for his class and elegant one-handed backhand, Federer dominated his era with 20 Grand Slam titles, leaving a legacy that transcended the sport. Similarly, Google, with its PageRank innovation and capital-light model, became a dominant force in its industry. Although tennis is an age-old sport, Federer transformed it, just as Google redefined advertising.

As Federer exited his prime playing years, he maintained flashes of greatness, but the natural limits of age and competition began to show. The clay courts did not help showcase Federer's speed and elegance and over time, they posed challenges that even his unparalleled skill could not fully overcome. In a similar vein, Alphabet now faces its own version of the clay court—shifting from nimbleness toward an infrastructure-heavy approach that slows down the very strengths that once defined its dominance. From here, Alphabet's future is likely to involve lower returns on new investments, higher spending on capital-intensive projects, and less opportunity for the effortless growth and compounding that investors have come to expect, in our opinion.

Below, we highlight three reasons we worry about the investment future of Google, Alphabet's largest subsidiary, and why we do not own the stock as of the date of this publication (23 March 2026). For full disclosure, Alphabet was among our top holdings in early 2024.

1. CHALLENGES FROM AI AND A SATURATING DIGITAL ADVERTISING MARKET

AI Could Cannibalize Google's Cash Cow

After dominating the search market for years with minimal competition, much like Federer's dominance during his peak years, Google's core search business is now under siege by a new generation of AI-powered competitors. Just as Federer faced a younger, faster field of rivals such as Rafael Nadal and Novak Djokovic, who challenged his supremacy, Google—despite owning its own AI-driven search tool, Gemini—now finds itself grappling with the rise of OpenAI's ChatGPT, xAI's Grok, and Anthropic's Claude. These competitors represent a major disruption to Google's traditional ad-driven model. Microsoft's CEO, Satya Nadella, once referred to internet search as the ultimate "no-fly zone" in Silicon Valley—a market so overwhelmingly dominated by Google that no competitor dared challenge it. That dominance began to unravel with ChatGPT's launch in 2022. By August 2025, McKinsey estimated that 44% of consumer purchasing journeys were driven by AI-powered search, surpassing traditional search, which accounted for *only* 31%. This trend is illustrated in the accompanying chart, which highlights the growing preference for AI tools in purchasing decisions.

Even if Google emerges as the leader in AI search with the integration of Gemini, its business model is likely to suffer, in our view. The traditional search model relied on users clicking through to publisher websites—commonly known as "10 blue links"—generating multiple ad impressions along the way. Since Google's incorporation of AI into its search results, which provides direct, synthesized answers, user click-through rates collapsed. Analysts estimate that over 50% of Google searches could now end without a single click to any website. This behavioral shift cannibalizes the primary revenue stream that built the business.¹

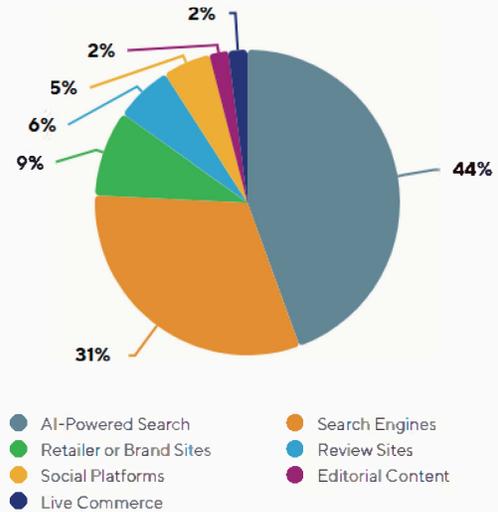
Moreover, AI-driven search not only undermines Google's core revenue but is also significantly more costly to operate. As detailed in our [Dotcom on Steroids: Part II](#) paper, traditional keyword search runs efficiently on precomputed indexes, making it relatively cheap to scale. In contrast, Large Language Model (LLM)-based search requires compute-heavy inference for every query. John Hennessy, chairman of Alphabet, noted that each AI-powered query consumes about 10x more energy than a traditional search—a gap that persists even as hardware efficiency improves.² This energy intensity translates directly into financial cost. Put simply, answering with a large AI model uses far more computing resources and energy than retrieving results from a precomputed index. For Google, this creates a double-edged sword: AI cannibalizes its core business while adding operational costs, raising questions about the long-term sustainability of this model.

The Overall Market Will Not Bail Google Out

Advertising bulls argue that AI will expand the total addressable market, suggesting that greater productivity will push advertising to occupy a larger share of GDP. However, historical data argues otherwise. Despite seismic shifts in media from print to radio to television to the internet to mobile, global advertising spend has consistently remained at 1% to 2% of GDP for over a century. We think the strong growth of the 2010s was a recovery from the post-dotcom "lost decade," not a fundamental shift in the market. Today, advertising spend as a percentage of GDP has returned to its 2000 highs, suggesting little room for further expansion.

Digital Information Sources Preferred by Consumers to Inform Their Purchasing Journeys

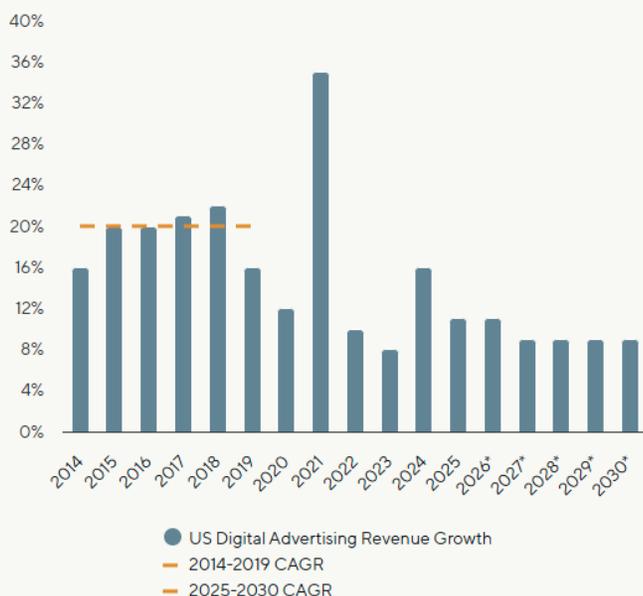
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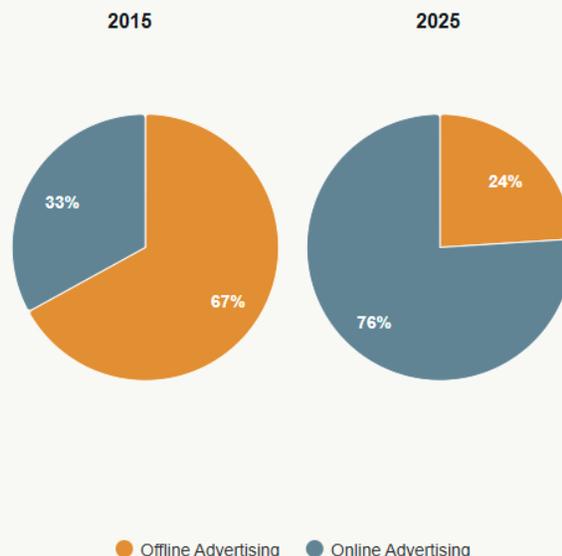
Source: GIG Partners LLC (chart). McKinsey's AI Discovery Survey (data). Data as of August 2025. Notes: Figures do not sum to 100% because of rounding. Purchasing journeys question: Rank the sources in order of most to least likely to use when researching or making decision related to a category, brand, product, or service. Respondent/users surveyed stated they use one of the following AI-powered search tools: ChatGPT, Claude, Copilot, Gemini, Google AI Overview, or Perplexity.

At the same time, digital advertising appears to be approaching saturation at roughly 75% of total ad spend. Before COVID, digital advertising grew 20% annually, driven by rapid share gains. However, industry participants now expect growth to slow to high-single-digits. This raises the question: can a legacy product, whose 90% share in search is steadily eroding, continue to achieve such significant market share gains?

US Digital Advertising Growth



US Advertising Breakdown



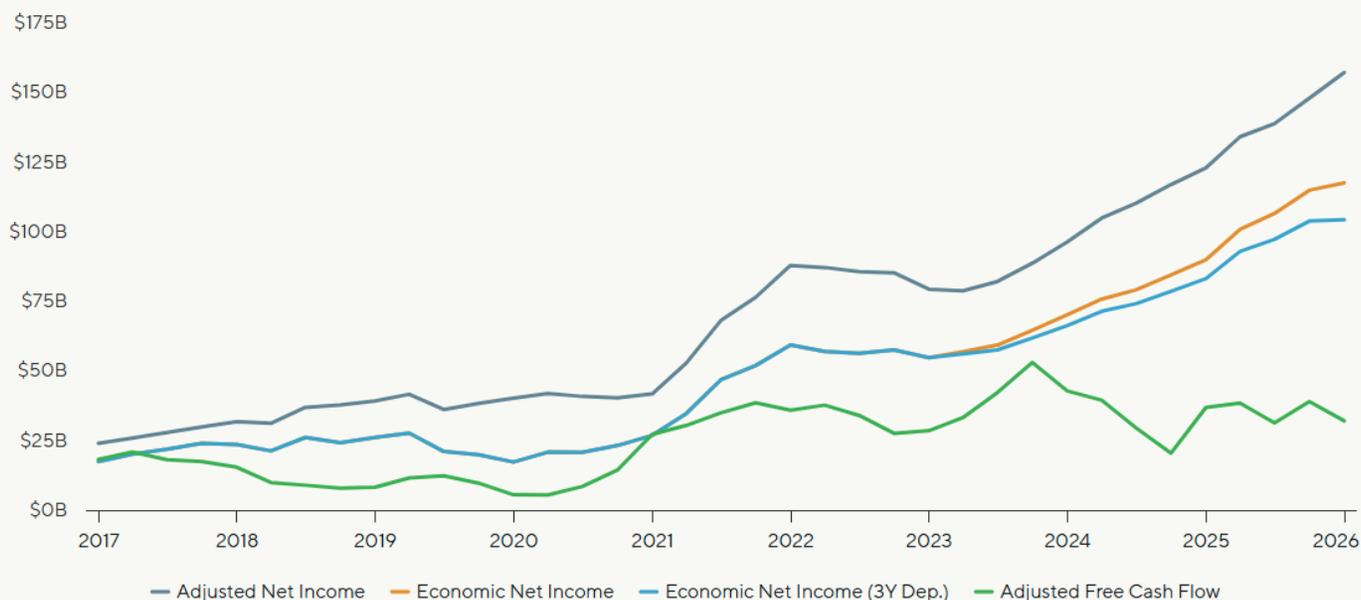
GQG Partners LLC (Chart). Morgan Stanley (Data). Data as of 11 February 2026. Actual results may differ from any projections illustrated above. *Data for years 2026 through 2030 are estimates.

Adding to Google’s existential threats is the heated competition in the digital advertising space. The traditional “Big 3” in the space, heavyweights Google, Meta, and Amazon, now face a growing list of formidable challengers including TikTok, Netflix, Walmart, OpenAI, Perplexity, Anthropic, xAI, AppLovin, The Trade Desk, and Alibaba, among others. Yet consensus forecasts still expect the “Big 3” to grow faster than the market for the next five years, a projection that only works if new entrants actually *lose* share. That outcome defies what we observe in the market today.²

2. ESCALATING COSTS WITHOUT CLEAR RETURNS

While Alphabet’s core business faces significant challenges, the company has diverted its focus to AI cloud infrastructure—a move akin to Federer doubling down on clay court tournaments in his later years, in our opinion. Bulls argue that Google Cloud will accelerate revenue growth and deliver operating leverage, just as Federer occasionally pulled off stunning wins late in his career. However, the mounting costs and high capital intensity resemble the wear and tear Federer endured in longer matches, with no guarantee of a triumphant outcome. This financial strain is already evident, as adjusted free cash flow (FCF) has stagnated since 2021 and is projected to decline in 2026. We think the gap between the optimistic narrative and the sobering reality can largely be attributed to two key factors: stock-based compensation (SBC) and the accounting treatment of capital expenditures.

Alphabet's Adjusted Free Cash Flow Generation Has Stalled



Source: GQG Partners LLC (chart), Bloomberg (data). Data for the time period 31 December 2016 through 31 December 2025. Trailing-Twelve Month Rolling Financials. Adjusted Net Income: Net Income excluding SBC Costs. Economic Net Income: Net Income including SBC Costs. Economic Net Income (3Y Dep.): Net Income including SBC Costs using 3-year Depreciation. Adjusted Free Cash Flow: Operating Cash Flow minus SBC Costs minus CapEx +/- mergers and acquisitions. Calculation of SBC Costs and 3-year Depreciation impact are GQG's estimations. SBC Costs: Estimated cost to offset equity dilution plus equity award taxes. 3-year Depreciation: Estimated impact from reclassifying useful life of server and networking equipment. Content does not constitute investment advice and no investment decision should be made based on it. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

Stock-Based Compensation

When a company issues stock as employee compensation, no cash changes hands, but the share count rises, diluting per-share earnings for shareholders. Further, there is a significant tax expense associated with settling this equity payment (\$14.1B for Alphabet last year alone). The cost of employee compensation is so large, that massive buyback programs are required to offset its negative impact on share prices. Since 2017, Alphabet has spent about \$350B on share buybacks and roughly \$200B to offset SBC dilution and related taxes, an enormous expense. Most adjusted EPS and FCF calculations ignore this cost entirely. Equity investors cannot afford to miss accounting for these costs because they are ultimately borne by the equity holder.

CapEx and the Accounting Surrounding It

According to our estimates, Google Cloud's trailing-twelve-month (TTM) CapEx-to-sales ratio increased from around 60% in Q1 2023 to over 100% in Q4 2025, indicating that capital spending on cloud infrastructure now outpaces the revenue generated on the investment—and the pace of spending shows no signs of slowing. In February 2025, management initially expected to spend \$75B in CapEx for 2025. By June, they had revised the expectation upward to \$85B, and by Q3 2025, management increased the figure again to \$91B before ultimately spending that amount by year-end. Following that record-breaking spending—which ran \$16B over the initial plan—the company now estimates that CapEx will approximately double, reaching \$175B to \$185B in 2026, roughly three times the \$59B in Google Cloud revenue generated in 2025. This is not a temporary buildout followed by a harvest of returns, but rather a structural shift toward permanently higher capital requirements.

Making matters worse, the accounting flatters results in a way that will not last, in our opinion. Cloud providers have been extending the depreciation timelines for GPUs—treating hardware that we expect will lose economic value within one to three years as if the equipment will remain useful for six to seven years. For example, in Q4 2025, Google Cloud reported operating margins of 30.1% based on a six-year depreciation schedule. However, if Google used a more realistic three-year schedule to account for the rapid obsolescence of AI-training-focused assets such as GPUs and TPUs, those margins would compress toward break-even. This approach of spreading costs over a longer time than is realistic creates serious risks for future earnings, as this practice artificially inflates short-term profitability by recognizing revenue upfront while deferring expenses into later years through unrealistic asset lifespans (as pointed out in our [Dotcom on Steroids: Part III](#)).

The spending pressure Alphabet is under has pushed the company toward a level of financial liability once foreign to its business model. By the end of 2025, uncommenced lease obligations spiked to over \$50B. These leases represent binding future commitments to data centers and other related projects. To put this growth in perspective, the company held only \$7.3B in such commitments as recently as 2024. These growing off-balance-sheet liabilities limit Alphabet’s flexibility, effectively locking the company into a high-stakes bet on the long-term profitability of AI, with little room for maneuvering, in our view.

Further, Alphabet is now quietly taking on a new role in the AI buildout: backstopping other companies’ balance sheets. In its recent filings, Alphabet has introduced new obligations tied to unconsolidated vehicles, including credit backstops for data center structures and financial guarantees for energy infrastructure partners.³ These contingent liabilities are creatures of the AI era, and their accounting involves a high degree of judgment.

This shift raises serious concerns about the direction of Alphabet’s business strategy. A company that once operated as a nimble, capital-light advertising broker is increasingly involved in construction financing and complex financial arrangements. Historically, we think companies with intricate accounting tend to experience price-to-earnings (P/E) multiple compression, as investors demand a higher risk premium.

3. CYCLICALITY AND OVERVALUATION AMID SLOWING GROWTH

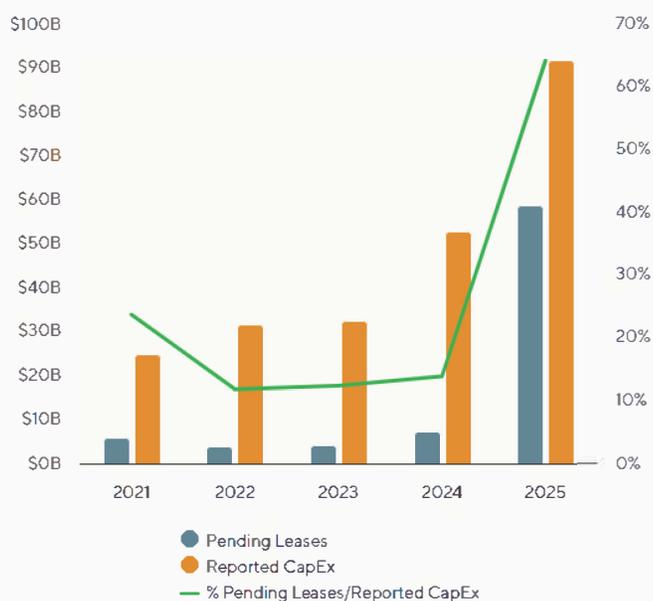
Advertising is one of the most economically sensitive line items in any budget. It tends to be the first thing companies cut when conditions tighten. As the world’s largest advertising platform, Google is a direct reflection of this cyclical nature. We believe that 2026 represents a similar set up to the 2022 cycle.

A Trip Down Memory Lane

During the COVID stimulus boom of 2020-2021, businesses aggressively expanded their digital advertising. Revenue growth for Google Services (search ads, YouTube ads, network ads, and subscriptions) climbed from \$152B in 2019 to \$169B in 2020 (11% year-over-year growth) to \$238B in 2021 (41% year-over-year growth).

After inflation began to ripple through the economy and the Federal Reserve responded by hiking rates aggressively in 2022, the business cycle turned. Alphabet’s financial performance responded in the same cyclical fashion: Google Services’ revenue growth slowed to 6.7% year-over-year and net income fell 21% leading the stock to plummet nearly 40% over the course of that year.

Alphabet’s Pending Leases Have Accelerated



GQG Partners LLC (chart). Alphabet Form 10-K (data). Figures are based on annual 10-K reporting. Data as of 31 December 2025. Content does not constitute investment advice and no investment decision should be made based on it.

2022 Alphabet Estimate Revisions vs. Stock Price



Source: GQG Partners LLC (chart). Bloomberg (data). Data for the time period 4 January 2021 through 31 January 2023. Content does not constitute investment advice and no investment decision should be made based on it. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

The painful irony is that management, investors, and Wall Street had been warned and still got caught. Google’s management team went on a spending spree leading into the downturn. In March 2021, CEO Sundar Pichai announced in a blog post: “We plan to invest over \$7 billion in offices and data centers across the US and create at least 10,000 new full-time Google jobs in the US this year.”⁴

As late as February 2022, CFO Ruth Porat was confidently describing “broad-based advertiser strength and strong consumer online activity.”⁵ When the downturn hit, Google was forced to reverse spending plans and enact job cuts. In a May 2024 post-mortem, departing Porat admitted: “A couple of years ago we actually got that upside down and expenses started growing faster than revenues. The problem with that is – it’s not sustainable.”⁶

Fast-Forward to Today

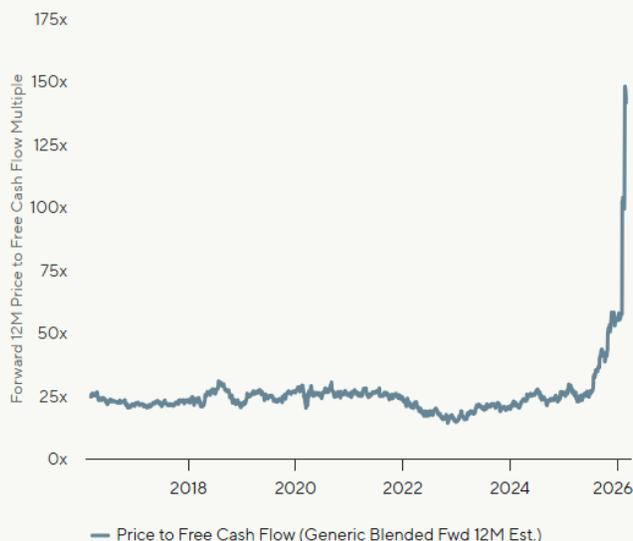
The lessons of 2022 have already been forgotten. Alphabet has embarked on a spending binge far larger than 2021—this time concentrated in physical infrastructure that cannot be offset by job cuts and must be depreciated over years. Compounding this, the consumer economy has weakened into a bifurcated “K-shaped” pattern, with clear stress in major cohorts. Yet, consensus still expects double-digit advertising growth into perpetuity.

Current Wall Street estimates have Google Services growing at low-double-digits in 2026, with mid-single-digit net income growth.² If Google Services simply grows in line with the overall digital advertising market, say 8%, we project earnings growth would turn negative, just as it did in 2022. The sensitivity analysis is stark. These are not tail risks; they are realistic scenarios the consensus is pricing as near impossibilities, in our view.

Alphabet is currently trading at roughly 27x its expected earnings for the next twelve months, which is near the top of its historical valuation range. We believe this high multiple leaves no room for the company to miss earnings expectations. The situation appears even more concerning on a cash-flow basis, as the stock trades at 133x its expected FCF for the next year—far higher than its pre-COVID multiple of approximately 20x. This is despite the fact that its FCF has stagnated since 2021.

Valuation vs. Fundamentals

Can Alphabet justify its lofty multiple?



Source: GQG Partners LLC (chart). Bloomberg (data). Data for the time period 7 March 2016 through 5 March 2026. Content does not constitute investment advice and no investment decision should be made based on it. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

THE BOTTOM LINE

We think Alphabet's investors face the same bittersweet realization as Federer fans once did. While Federer remained a phenomenal player well into his late 30s, the relentless pace of younger competitors and the physical demands of the game made his continued dominance impossible. Gracefully transitioning into retirement, Federer left behind a legacy of brilliance. Google, however, may face a far less graceful transition. Its pivot from an agile, capital-light business model to one of the world's heaviest infrastructure spenders resembles a player forced to switch from their natural surface to one that exposes their weaknesses. The path forward for Google suggests not effortless elegance, but the grinding challenges of maturity, where the returns on effort diminish. In our view, the next few years will likely be marked by estimate cuts and multiple contractions, signaling significant challenges for Google investors.

END NOTES

¹Chapekis, Athena and Lieb, Anna. "Google users are less likely to click on links when an AI summary appears in the results." Pew Research Center. 22 July 2025.

²Bloomberg consensus estimates. 10 March 2026.

³Parshall, Allison. "What Do Google's AI Answers Cost the Environment?" Scientific American. 11 June 2024.

⁴Alphabet Inc. Form 10-K. 31 December 2025.

⁵Pichai, Sundar. "Investing in America in 2021." The Keyword. 18 March 2021.

⁶Alphabet Inc. 4Q 2021 Earnings Call. February 2025.

⁷Bloomberg consensus estimates. 10 March 2026.

⁸Elias, Jennifer. "Google employees question execs over 'decline in morale' after blowout earnings." NBC Philadelphia. 10 May 2024.

DEFINITIONS

Gross Domestic Product (GDP) is the total monetary or market value of all final goods and services produced within a country's borders in a specific time period (usually a quarter or a year). It acts as a comprehensive scorecard of a given country's economic health.

Depreciation is the systematic allocation of a tangible asset's cost over its useful life, representing how much of an asset's value has been used. It accounts for wear and tear, deterioration, or obsolescence, allowing businesses to deduct the cost of assets like machinery, vehicles, and buildings from their taxes.

Capital expenditures (CapEx) are funds used by a company to acquire, upgrade, and maintain physical, long-term assets such as property, buildings, technology, or equipment to grow or maintain business operations. These investments, which provide benefits for more than one fiscal year, are recorded on the balance sheet and depreciated over time.

A **capital-intensive** business requires substantial, high-cost investment in fixed assets—machinery, equipment, and infrastructure—relative to labor to operate and generate revenue. These firms have high fixed costs, significant depreciation, and high barriers to entry. Common examples include oil, manufacturing, airlines, and telecommunications.

GPUs (Graphics Processing Units) are versatile, parallel-processing chips used for gaming, rendering, and AI training (e.g., NVIDIA H100). **TPUs (Tensor Processing Units)** are Google-developed ASICs specifically designed for high-speed matrix math in neural networks and LLMs (e.g., Gemini). GPUs are best for flexible, varied workloads, while TPUs offer superior, energy-efficient performance for large-scale AI.

Stock-based compensation (SBC) is a non-cash method of paying employees, executives, and directors with company equity (shares or options) rather than cash. It is heavily used in startups and tech to align employee interests with shareholders' and conserve cash.

Market capitalization (market cap) is the total dollar value of a company's outstanding shares, calculated by multiplying the current share price by the total number of shares outstanding. It represents the market's valuation of a company, commonly used to measure size, assess risk, and categorize.

Net income is the remaining profit after all expenses, taxes, and deductions are subtracted from total revenue or gross income.

EBITDA stands for Earnings Before Interest, Taxes, Depreciation, and Amortization. It is a non-GAAP financial metric used to measure a company's core operating profitability and cash flow, allowing for easier comparisons between companies by removing financing costs, tax regimes, and non-cash accounting items.

EPS (Earnings Per Share) is a key financial metric indicating a company's profitability by dividing net income by outstanding shares. It tells investors how much money a company makes for each share of stock, used to evaluate value and compare profitability within industries.

Operating Cash Flow (OCF) is the net amount of cash generated by a company's core, day-to-day business operations during a specific period. It represents real liquidity by focusing on cash revenue and expenses, excluding financing or investing activities. OCF is a key indicator of a business's ability to remain profitable, pay bills, and sustain operations without external funding.

Free cash flow (FCF) is the cash a company generates after covering its operating expenses and capital expenditures (CapEx). It represents the discretionary funds available for repaying debt, paying dividends, or reinvesting in growth. FCF is a key indicator of financial health, calculated as Operating Cash Flow minus CapEx.

The **CapEx-to-sales ratio** measures the percentage of revenue a company reinvests into fixed assets (property, plant, equipment) to drive growth or maintain operations. A higher ratio suggests aggressive expansion (e.g., >10-15%), while a lower ratio often indicates a mature, asset-light, or underinvested business (e.g., 2-5%).

The **Price-to-Earnings (P/E) ratio** is a valuation metric that measures a company's current share price relative to its earnings per share (EPS). It indicates how much investors are willing to pay for \$1 of a company's earnings, helping determine if a stock is overvalued, undervalued, or fairly priced.

The **Price to Free Cash Flow (P/FCF) ratio** is an equity valuation metric that compares a company's market price per share to its free cash flow (FCF) per share, indicating how much investors pay for \$1 of cash generated. It is used to identify potentially undervalued (low ratio) or overvalued (high ratio) stocks.

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