



THE RACE TO THE TOP: APPLE AND ALPHABET

February 2016
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Apple and Alphabet: The Market Cap Stakes

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On Feb 12, 2015

Apple's market cap: \$655 billion

Alphabet market cap: \$371 billion

On Feb 12, 2016

Apple's market cap: \$518 billion

Alphabet market cap: \$477 billion

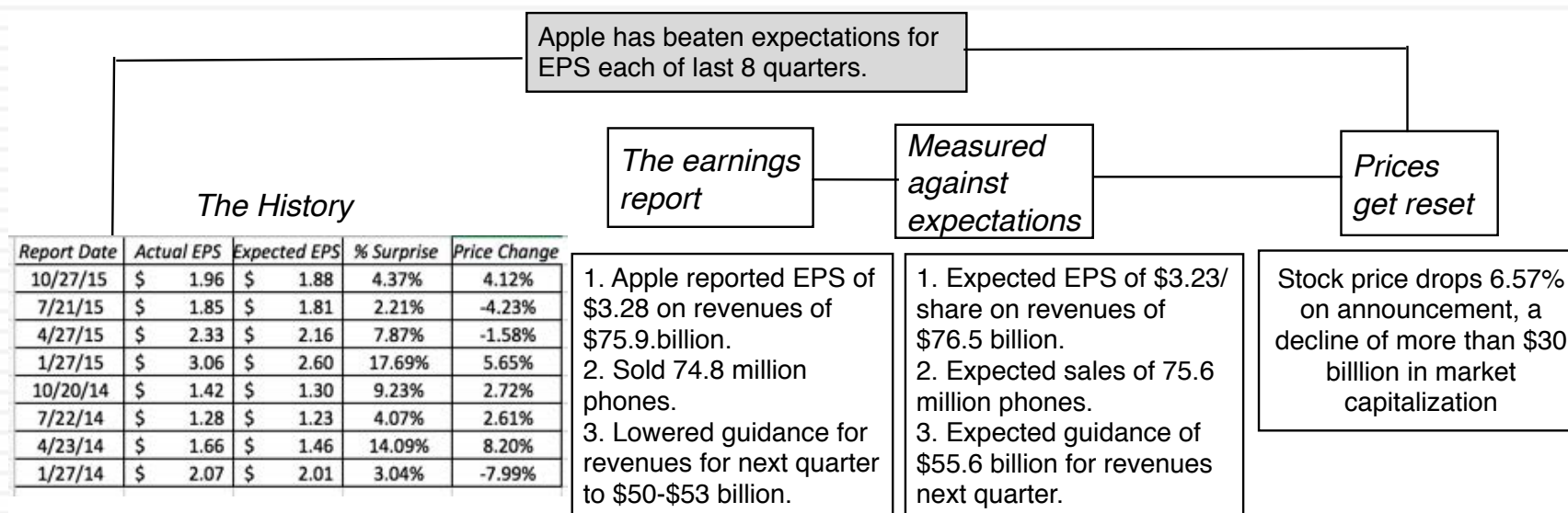


Apple reported earnings on January 26, 2016

Alphabet reported earnings on February 2, 2016

Apple's Earnings Report (1/26/16): The Pricing Effect

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Apple's Earnings Report (2/2/16): The Story Effect

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Pre-report Narrative

Apple is a low-growth, cash-rich company, with operating margins under stress from competition and little chance of introducing a game changing new product.

Apple's Earnings Report on January 26, 2016

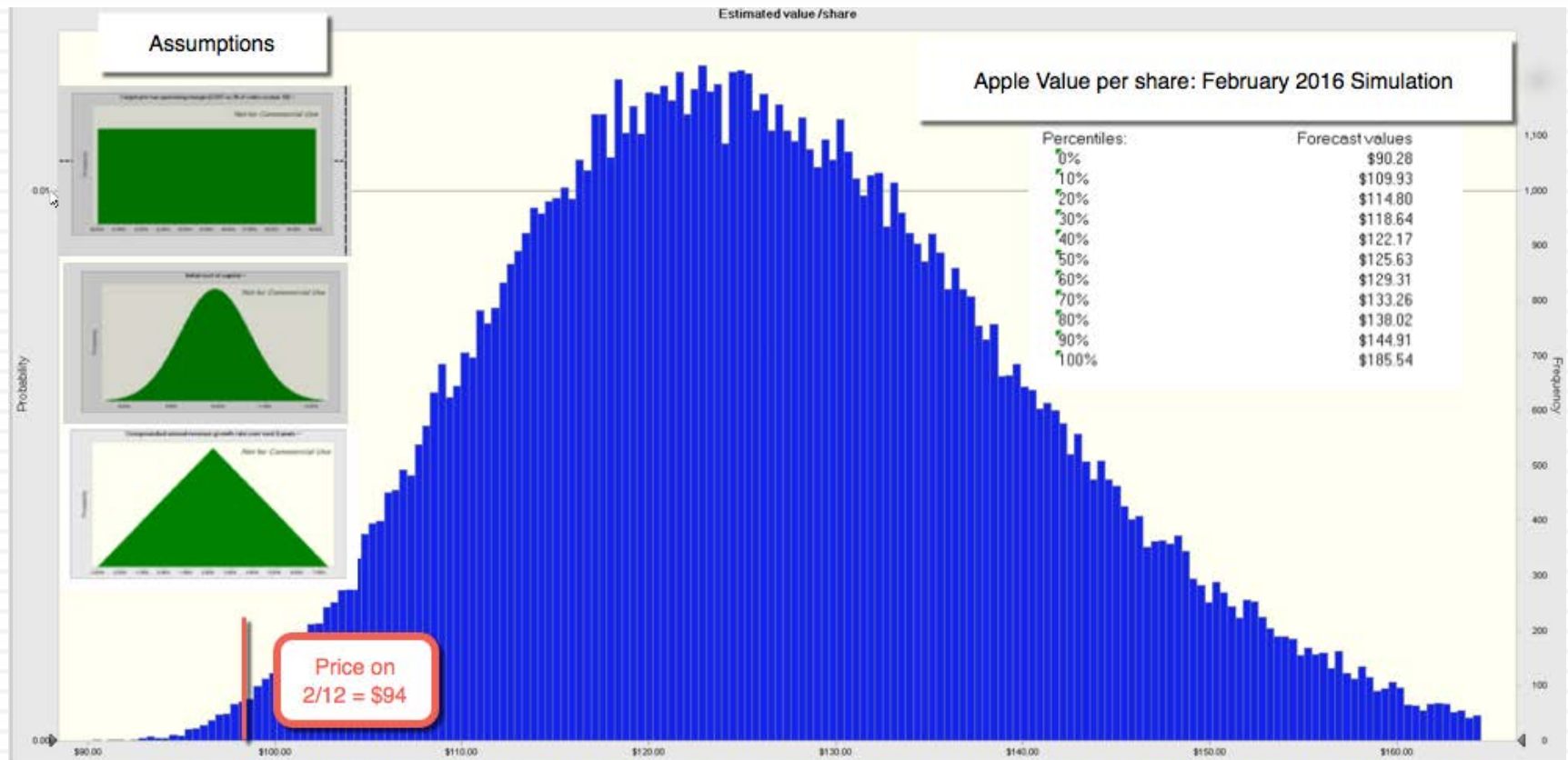
1. Revenue growth for most recent twelve months was 2.20%, following double-digit growth in the prior year, as slowing growth in China, a stronger dollar and no new iPhone model this year exacted their toll.
2. The pre-tax operating margin was 30.28% for the most recent 12 months, down from 32.03% in November 2015, reflecting the continued drop in operating margins.
3. The company's guidance suggests that growth will continue to be in the low single digits next year.
4. iPhone sales are slowing, as the iPhone 6 ages, and users hold out for the iPhone 7 and competitors (especially Samsung) take market share from Apple.

Post-report Narrative

Apple is still a low-growth, cash-rich company, with declining operating margin and no game changer in sight.

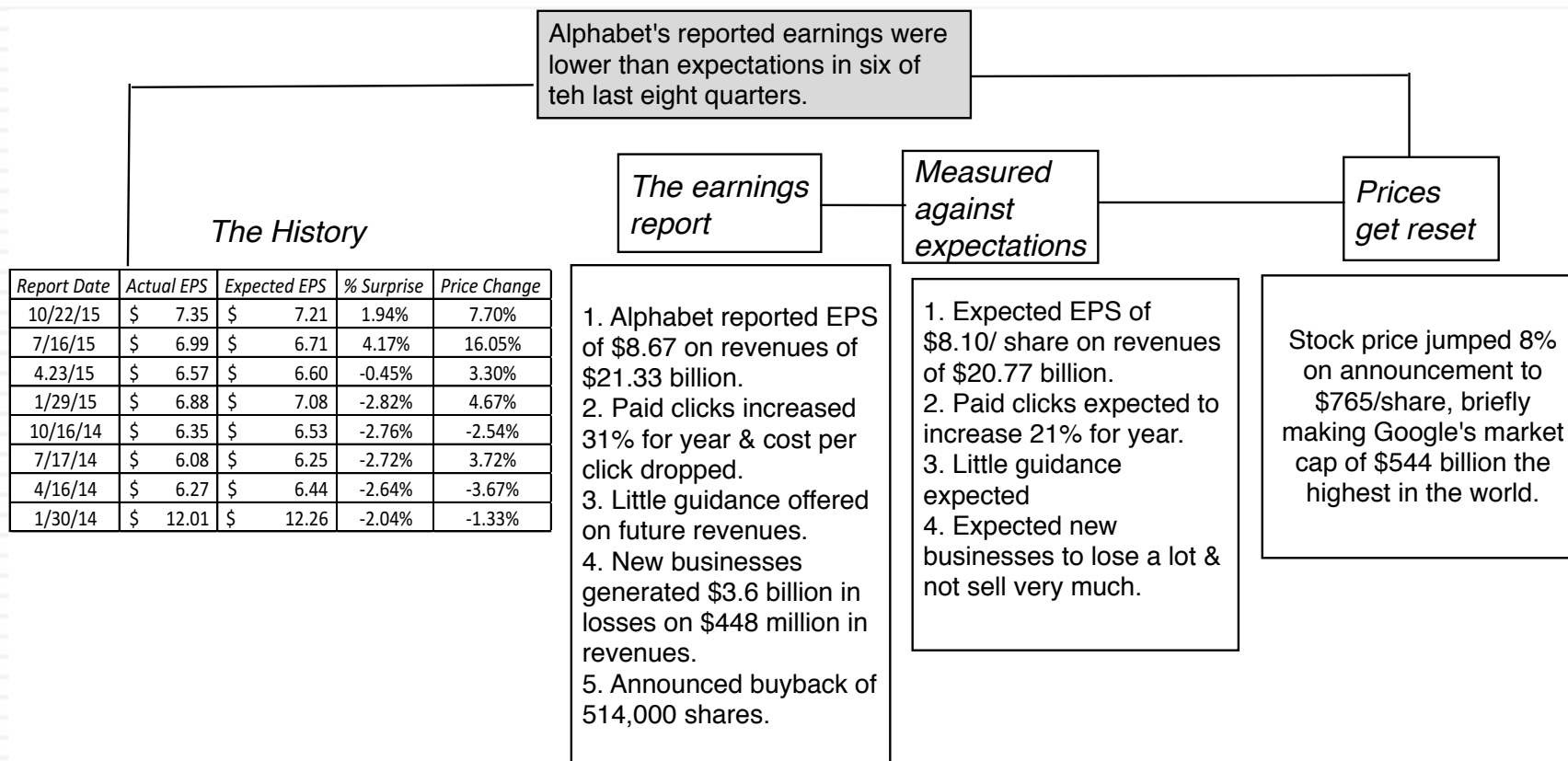
Apple: The Post-Earnings Valuation

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Alphabet's Earnings Report (2/16): The Pricing Effect

6



Alphabet's Earnings Report (2/16): The Story Effect

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Pre-report Narrative

Alphabet is an online-advertising growth machine, growing both the total market and its share, while maintaining sky-high operating margins. Expected revenue growth of 12% in the near term, with margins expected to stay at 30%.

Alphabet's Earnings Report on January 26, 2016

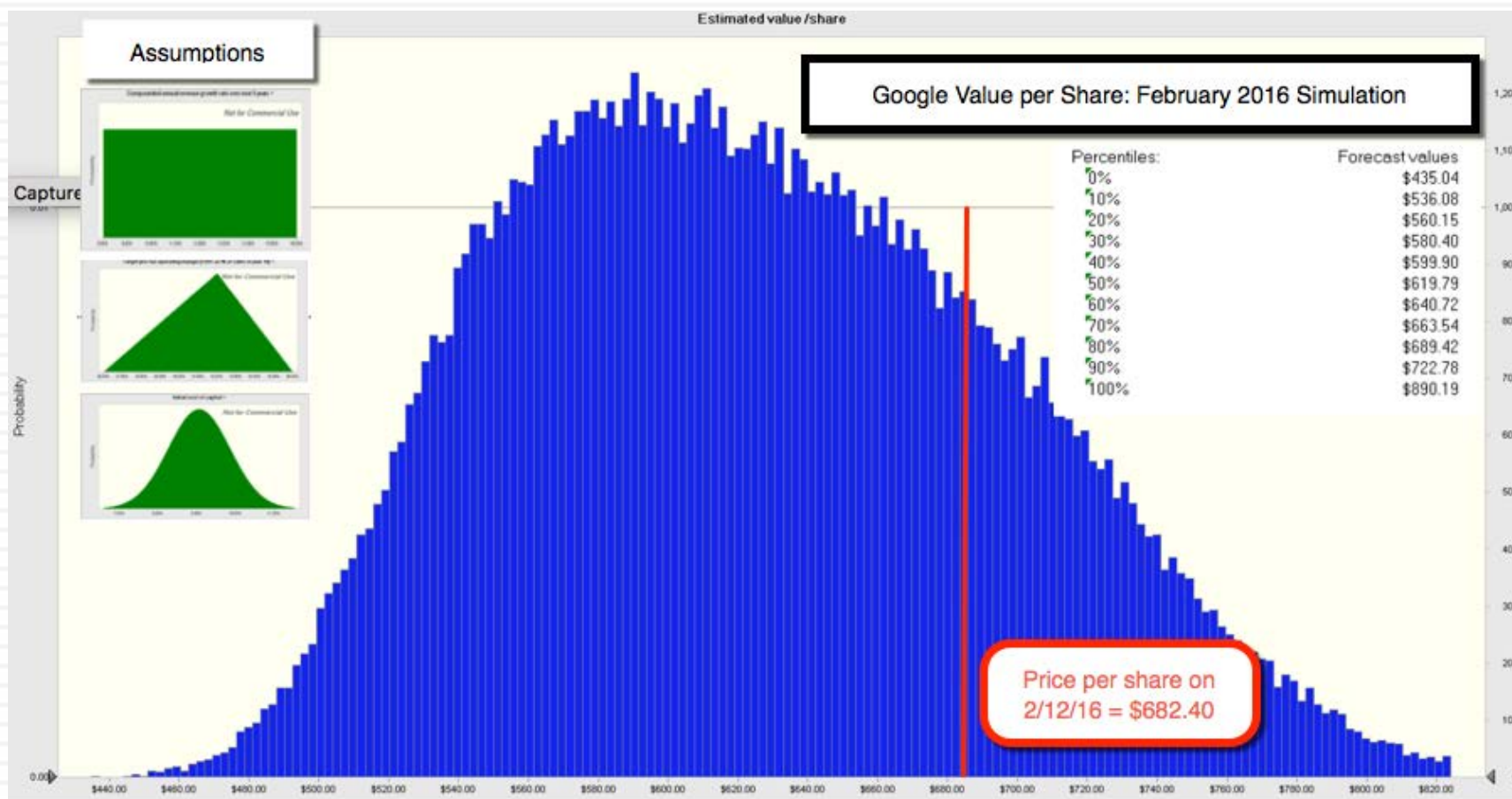
1. Revenue growth for most recent twelve months was 13.62%, with more clicks driving growth.
2. The pre-tax operating margin was 32% for the most recent 12 months, down from 31% in November 2015, reflecting lower cost per click.
3. New businesses increased spending, post restructuring, but there are few signs that revenues are coming from these businesses any time soon.

Post-report Narrative

Alphabet will continue to be an online-advertising growth machine, with revenue growth of 12% a year and perhaps slightly higher margins, even as competition picks up, generated by keeping costs controlled.

Alphabet: The Post-Earnings Valuation

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Alphabet's Transparency: Less than meets the eye

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	Twelve Months Ended December 31, 2014	Twelve Months Ended December 31, 2015
Google segment revenues	\$65,674	\$74,541

Google operating income	\$19,011	\$23,425
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This is Google's EBITDA, not its operating income. Actual operating income in 2015 was \$19,360 million.

Other Bets revenues	\$327	\$448
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The rest of Google (other than advertising) sells little, spends huge amounts of money and has lots of "potential". Anyone surprised?

Other Bets operating loss	(\$1,942)	(\$3,567)
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Apple vs Alphabet: As Businesses

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□ What they share

- ▣ A cash cow that keeps on giving.
- ▣ Attention to detail and customer focus.
- ▣ Brilliant and loyal workforce.

□ Where they are different

- ▣ Alphabet's advantage: Cash cow needs less feed, care and maintenance.
- ▣ Apple's advantage: Has gone through near death experience and reinvented itself.

Better Business: Alphabet

Apple vs Alphabet: As Investments

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1. Break even: You need far more to go right at Alphabet, for you to break even on your investment in the stock, than you do at Apple.
2. Corporate governance: Agree or disagree with Tim Cook, Apple is a corporate democracy (with all its limitations). As a stockholder in Apple, I can look to other investors to make a case for change at the company. Alphabet, with its three classes of stock, is a corporate dictatorship, a benevolent one at the moment, but what if things change?

Better Investment: Apple

Apple vs Alphabet: As Trades

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- The Big “Mo”: The momentum is with Alphabet, notwithstanding the drop in the stock price since the last earnings report.
- The News skew: One of the features of pricing is that markets seem to see the sunny side of even the most negative story, when you are in the favored pricing group and the bad news in even the best news report.

Better Trade: Alphabet (at the moment)