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# Valuing Google not easy, but it has earnings!

It is never easy to predict the future price of a stock, especially when brokers, promoters and corporate executives are asking you to buy into the initial public offering. No other stock demonstrates this uncertainty in the post-2000 period as **Google Inc.** (GOOG-NASDAQ, \$308.70, 650-623-4000, [www.google.com](http://www.google.com)) has in the last year that it has been trading as a public company.

Google provides web search and online advertising services on the Internet. It offers advertising solutions and global Internet search solutions through its website and Intranet solutions via an enterprise-search appliance. The company's products and services include Google.com, Google AdWords, Google AdSense and Google Search Appliance.

Its Google AdWords program is used by advertisers to promote their products and services on the web with targeted advertising. The company's Google AdSense program is used by the third party websites to deliver ads relevant to the content on their sites. It also provides enterprise search tools to search corporate systems through the Google



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Search Appliance.

In addition, the company provides e-mail services through Gmail, which offers a gigabyte of free storage for each user along with e-mail search capabilities and relevant advertising. Google was co-founded by Larry

Page and Sergey Brin in 1998, and is headquartered in Mountain View, Calif. It now has over 3,000 employees.

The big question to investors today is whether the horse has already left the barn, as Google more than tripled in price since the IPO. In fact, it is easier to predict whether a stock holds any appeal a few quarters after the IPO than at the time of issue. Today, you can get a fairly wide set of reports and lot more information on the company and its prospects than a year ago. And that information ranges from an evangelical recommendation by a TV personality to two analysts who find the stock overvalued compared to others, like Yahoo, in this sector.

But no matter what, this is a much better time to consider this stock than when it was issued. Even though it has tripled in price, the risk of error is much

lower today. Sure, you could have picked up the stock back then but the chances of a real disaster were almost equal, i.e., it was a wiser decision not to buy it then (or so I tell myself).

There is a lot of similarity between Google and many of the Internet stocks of the hype years. For one, you can't escape this company if you are on the Internet, surfing, learning or just enquiring. Millions of followers make this a stock almost as popular as McDonalds, IBM or Microsoft.

Second, the founders were in their 20s and even now are some of the youngest billionaires on the planet (there is still hope for all those bright minds toiling in their labs and basements). By the way, officially the two founders were paid a salary of under \$100,000 each, last year, another throw back from the old days of benevolent CEOs like Apple's Steve Jobs and Microsoft's Bill Gates.

## Cheaper than Yahoo

One way Google is very different from the old Internet types is that it actually has earnings. Most analysts feel it will make over \$7 per share in 2006. That makes it cheaper than its biggest competition, Yahoo, believe it or not.

And it is growing faster than Yahoo (nearly twice as fast at 90 per cent a year) and has a higher operating margin and PEG ratio. Google has no debt and returns nearly 40 per cent on its equity, making this not a typical start up Internet company but a very profitable large mega-enterprise, which is growing faster than most its size.

Our General Valuation Model or for that matter any pricing model is fraught with error for such hyper-growth companies, as a slight change in a growth factor, a very likely scenario, throws the number way off. None the less, the company should trade in the range of \$300 to \$350, with a lot of volatility on any news that threatens Google's prospects of nearly doubling its sales growth or them making acquisitions.

The latest buzz is that they want to buy the AOL book of business, which has cost the company a few points on the stock market. Yet the competition for AOL is coming from all corners now, including Microsoft and Yahoo. The pressure is mounting for Google, the leader, to play and pay. These are tricky manoeuvres for the young tycoons and us, the investors.

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